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DOMINATION, AUTOPOIESIS AND REGULATORY FAILURE: THE ACCOUNTANCY CONNECTION

A thesis submitted in fulfilment of the requirements for the award of the degree DOCTOR OF PHILOSOPHY from UNIVERSITY OF WOLLONGONG

by

KATHLEEN A COOPER, BCom

Department of Accountancy
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I, Kathleen A Cooper, certify that this thesis has not been submitted previously as part of the requirements of another degree and that it is the product of my own independent research.

Signed: __________________________

Kathleen A Cooper
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Abstract

Early professional accountancy associations justified their applications for incorporation by Royal Charter or under relevant legislation on the premise that the public interest would be served if work of an accounting nature was restricted to those with the requisite knowledge and skill. A claim to specialised knowledge and skill was used by the profession to achieve hegemonic domination of not only accounting practice but also the determination of appropriate accounting practices or accounting standards. The success of the Australian accountancy profession in achieving its objective is evident in its domination of the promulgation of approved accounting standards that have the force of law.

However, an examination of unexpected corporate failures or the reporting of losses on activities previously disclosed as profitable, suggest the profession's domination of accounting has not necessarily served the public interest. Accounting standards and practices have been shown to be deficient in that the flexibility in their application has been used by corporate management, in some instances, to create an impression through the financial statements that companies were well-managed and profitable. The reality, often revealed by investigators in the wake of corporate collapse, is that some of these companies have consistently reported profits when, in fact, they have been unprofitable for a number of years prior to collapse.

This study offers an explanation of the profession's propensity to promote indetermination in accounting practice through the promulgation of flexible and vague accounting standards. In particular, this study maintains that flexible accounting standards and practices are a result of the profession's need to ensure its autonomy not only in the practice of accountancy but also domination of the determination of appropriate accounting practice. This requires maintaining alliances and structural coupling between the profession and business interests.

The theoretical framework adopted for purposes of analysing the manner in which the profession originally attained and has since maintained hegemonic domination of accountancy is based on a translation model of power incorporating the concept of autopoiesis. The study provides an overview of the professionalisation of accountancy, in particular, the development of its knowledge base that was then used to justify its claim to domination in the public interest. Some notable unexpected Australian corporate failures are used to demonstrate that the public interest may not have been served because flexibility in accounting practice have been utilised to mislead users of financial statements. The development of the standard dealing with accounting for foreign currency transactions and translations is used to demonstrate that standard setting is as much political as technical. The study maintains that the indetermination that characterises accounting standards and practices are a defence mechanism aimed at ensuring the survival of accounting as an autopoietic system.
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VOLUME ONE
ACCOUNTANCY AND THE PUBLIC INTEREST

Serving the public interest has been the catch cry of the accountancy profession since the formation of the first professional accountancy associations last century. Just what this meant was never spelled out in the Royal Charters of incorporation or documents detailing the objectives of these associations. This altruistic motive appears to have been premised on the need to instil in the public the perception that accounting was a task requiring specialised skill and training. If this was the case, then only those who qualified for membership of the professional associations should undertake this work.

What is the Public Interest

Over time, the public interest objective of accountancy has been given more substance even if only in indirect ways. For example, Thomas Brentnall, a foundation member of the accountancy profession in Australia, implied a link between accounting and the public interest. This link was the relationship between Australia’s need as a young country to borrow on favourable terms from overseas interests and the provision of reliable accounts to absentee lenders. Such accounts could be provided by appropriately trained and educated public accountants (Australasian Corporation of Public Accountants (ACPA), 1910a, p134). In more recent times, the profession in Australia has issued a series of statements of accounting concepts (SACs). These statements maintain that general purpose financial statements provide a means by
which management is accountable for the resources entrusted to them. This is consistent with historical stewardship concepts and the role of record keeping. However, this narrow stewardship focus is extended to an accountability to the general public. It is claimed that when general purpose financial statements provide relevant and reliable information, resource providers will use this information to facilitate an economic allocation of resources (SAC 2 Objectives of General Purpose Financial Reporting paragraphs 26, 27; SAC 3 Qualitative Characteristics of Financial Information paragraphs 5). An economic allocation of resources will benefit the general public because resources will only be directed to those entities that will use them efficiently and effectively and in compliance with any rules laid down for their use (SAC 2, paragraphs 12, 13). This is consistent with the religious basis of stewardship that all things were created by God to be used for the common good of human kind (Chen, 1975). This is the interpretation of public interest adopted for purposes of this study.

Public Interest - Fact or Fiction?

History, unfortunately, suggests that accounting has not necessarily achieved this. In fact, there is evidence to suggest that accounting has been used quite consistently to manipulate the information presented in financial statements often to present an impression of a profitable and well-managed organisation. In some instances, subsequent investigation has revealed that the companies were not profitable and quite often, were not well-managed. For example, a prominent feature of the Australian corporate landscape in the late 1980's early 1990's has been the number of spectacular and often unexpected corporate collapses. These collapses were unexpected because, in many cases the companies concerned had been publishing audited financial statements depicting them as profitable and well managed. In one notable case to be discussed at length in Chapter 4, the company issued a press release boasting record profits just two weeks before being placed in receivership. Another
factor has been the announcement by companies of huge losses on activities that were
previously reported as profitable. An example that will be discussed extensively in
Chapter 6 is foreign currency transactions.

There is also substantial evidence to suggest that this has been a persistent problem for more than a century. In a book dealing with the Australian land boom and
subsequent crash in the 1890's, Michael Cannon has stated:

The falsifying of balance sheets, the payment of dividends from non-existent profits and the publication of misleadingly optimistic forecasts were among the shocking features of the crash (1972, p28).

It could quite rightly be argued that at this particular point in time, the accountancy profession was in its infancy. There were no accounting standards and no method of enforcing them even if they had existed. However, in more recent times, claims similar to those made by Michael Cannon have been made and excuses of this type are no longer valid.

Sykes undertook a study of the major corporate collapses to occur in Australia since the formation of the first Australian company (1988, Introduction, px). The evidence collected by Sykes led to the conclusion that poor accounting systems and practices were among the main dangers facing top management because these could mean that management was given misleading information as to the profitability of the company (p.549-550).

In 1990, Sykes reaffirmed this view but in the context of investors rather than management:
As receivers and investigators gradually strip bare the recent corporate scandals in Australia, one factor becoming apparent is that the accounts of the companies concerned have been unsatisfactory, to say the least (1990, p.43).

To the extent that resource providers were misled by the information in the financial statements, it is probable that there was not an efficient allocation of resources. Therefore, the public interest has not been served. It is accepted that financial reports are highly condensed representations of a company's activities and financial position. In addition, the information that is publicly disclosed is further limited by the types of financial statement required. For example, for the first half of this century, companies were only required to publish an audited balance sheet. The requirement to publish a profit and loss account was a later development. A further refinement to disclosure requirements was provided by the professional associations and the stock exchange with the introduction of a requirement to publish a funds statement. In the aftermath of the corporate collapses of the late 1980's, the requirement to produce a funds statement was replaced with a cash flow statement requirement in apparent recognition that companies could be profitable but be insolvent. This was not readily apparent from a balance sheet or funds statement.

However, where subsequent investigation demonstrates that where duly audited financial statements were misleading, and that flexible accounting practices have facilitated the deception of users of financial statements, the argument that accounting has not served the public interest would have merit.

INACTION DISGUISED AS ACTION?

As indicated, above corporate failures have been part of the Australian business landscape since last century. In the aftermath of these failures questions are invariably raised about the ethics of corporate management and claims that the regulatory system is not adequate. McQueen, for example, suggests that the spate of corporate
failures in the late 1980's has created a "moral panic" over the ethics of business and the inability of the regulatory system to contain corporate wrongdoing (1991, p22). Furthermore, this is not new. McQueen refers to recurrent instances of both corporate failure and regulatory failure in Australia from as early as the 1870's (pp22-23). Similarly, Justice Rogers of the New South Wales Supreme Court considers the Australian economy is characterised by a recurring cycle of booms and collapses. Inevitably, the collapses are followed by calls for more effective regulatory measures. New measures are often introduced or existing regulations are strengthened but, as Justice Rogers notes, the next round of collapses reveal that the measures taken have not prevented a recurrence of the problems (1991, p1).

In an accounting context, Clarke and Dean consider the solutions proposed by the General Council of the Australian Society of Accountants in the wake of the corporate failures of the 1960's have done nothing to prevent the same abuses of the corporate form being repeated in the 1980's and 1990's (1992). In the 1960's, there were neither accounting standards nor a conceptual framework of accounting (p182). In the 1980's, substantial progress had been made in both areas but with little apparent impact on preventing companies from producing misleading financial statements. In fact, Clarke and Dean claim that compliance with accounting standards has been as much responsible for manipulation of financial information as non-compliance (p186).

Similarly, Chambers maintains:

The practices that companies have adopted have generally been permissible under the statutes, regulations and technical rules of accounting. . . The trouble has been that the laws, regulations and rules have been vague, toothless and often self-contradictory (1973, Preface, Securities and Obscurities [no pagination]).
One of the explanations for management's penchant for manipulating financial information is linked to competition for resources. If the purpose of financial statements, as set out in SAC 2 and SAC 3 and outlined above, is to facilitate decisions about the allocation of resources, then management has an incentive to present an image that will induce the entrusting of resources to them. On the basis that resource providers will prefer the image of a well managed company, as evidenced by profitability, to a less well managed company, as evidenced by smaller profits or even losses, management will desire to portray an image of a well managed and profitable organisation. Accounting practices are likely to be interpreted and applied in such a manner as to present companies in the most favourable light so as to encourage investment and the extension of credit facilities. Rennie (1988) and Shanahan (1990) support this view. Evidence from investigators' reports into three of Australia's notable corporate collapses will be presented in Chapter 4 to support this contention.

The ongoing cycle of regulatory failure-regulatory reform suggested above indicates layers of failure. Where accounting methods have been used specifically to present a misleading picture of a company, these failures can be seen to be connected. For example, management has responsibility under the law for the preparation of financial statements and, therefore, technically, is responsible for the selection of accounting methods. However, if accounting standards did not allow for a choice of methods or the application of particular accounting standards on the grounds of materiality, then management would not be able to select the method most suited to their purpose. Therefore, the company accountant advising management on the appropriate accounting method to use and those responsible for developing and promulgating accounting standards are implicated in the failure of regulation to achieve an efficient allocation of resources. Under the corporations law, financial statements of most public companies must be examined by an independent external auditor. The role of the independent auditor includes ensuring that the information reported in financial
statements represents what it purports to represent, is verifiable and unbiased. Unless there has been some undetectable and deliberate attempt by management to conceal fraud or illegal acts, misleading financial statements receiving an unqualified audit opinion suggest a further layer of failure. There is evidence of further failure in the enforcement layers of the regulatory system when prosecutions arising out of investigations of corporate collapses where financial statements have been shown to be misleading either fail to produce a conviction or where legal action, either civil or criminal is not instigated. Evidence of failure at all these levels will be provided in the course of this study.

STATEMENT OF PURPOSE

The overall purpose of this study is to provide an explanation for the role played by the accountancy profession in the ongoing cycle of regulatory failure-regulatory reform. In particular, attention will centre on the profession’s claim to serve the public interest by facilitating an economic allocation of resources through the information provided in external financial reports. This claim to serve the public interest was the platform on which the profession aspired to and achieved a dominant position in the determination of appropriate accounting practices and standards. It will be argued that accounting standards are flexible by design. This flexibility extends not only to allowing a selection of accounting methods but also ambiguity.

Flexibility and ambiguity create indetermination in the application of accounting practices. Indetermination serves at least two purposes. Firstly, it justifies the existence of a profession because without indetermination, accounting practice could be reduced to a set of mechanical processes. Anyone who can learn the processes can be an accountant. The need for professional judgment calls for specialised knowledge and skill and a professional organisation is a means of ensuring that those who espouse to the possession of this knowledge and skill have undertaken specified
education and training. Second, indetermination is a means by which the profession maintains its domination because it reduces dissidence and resistance to its rules of practice. This is particularly important where a company's right to incorporation, limited liability and even its continued existence is contingent upon it complying with the accounting and audit provisions of the corporations law. Flexibility in accounting practices and standards allows companies to comply with the letter of the law if not the spirit. Evidence suggests that the management of some companies have used this flexibility to produce financial statements that present the corporate image most useful for management purposes.

The focus of this study will be the Australian accountancy profession and regulatory system. While emphasis will be on the accountancy profession it is contended that the regulatory system comprises a number of sub-systems including the accountancy professional associations, accounting standard setters, corporate regulators such as the Australian Securities Commission (ASC), State and Federal Governments and companies. The activities of the accountancy profession cannot be examined in isolation from the other participants particularly as this study maintains that these other systems play a vital role in influencing the outcome of the profession's activities. Also, while recognising the risks of generalisation, where considered appropriate, reference will be made to the activities of accountancy professional associations and regulatory systems in other countries. This is because there is an increasing trend towards harmonisation of accounting practices throughout the world. In addition, the profession in Australia has traditionally been influenced by the activities of the professions in the UK and the USA (evidence will be used to support this assertion in subsequent chapters).
THEORETICAL FRAMEWORK

The theoretical framework adopted for purposes of this study is based on a translation model of power and autopoiesis. In a translation model of power, power is not something that can be possessed and it is not used to achieve a particular outcome. Instead, resources, including knowledge and skill, are used to create an environment wherein some groups or organisations are able to dominate a given area or field by forming alliances and agency relationships with other interest groups. The group wishing to act as the agent for the others tries to prove, or create the impression, that it is the appropriate representative of all those who have an interest in a given field. Alliances and agency relationships are then used as resources to enable one group to achieve hegemonic domination of a particular area.

Domination is the means by which power is exercised because it allows the dominant group to determine the rules of practice including membership of the dominant group. In a translation model, domination and agency are seen in terms of a chain where it is essential that each link in the chain must inject its own energy or domination and agency will not be maintained. Furthermore, domination and agency are subject to challenge by both endogenous and exogenous factors. This means that domination and agency are not fixed. Forces of dissidence and resistance can effect changes because such forces may necessitate a renegotiation of alliances and the foundation upon which they are built.

The specific translation model adopted for purposes of this study is based on the works of Callon (1986), Latour (1986) and Clegg (1989). The translation of resources to achieve domination involve five interrelated stages: problematisation, interessement, enrolment, mobilisation and dissidence and resistance. The translation process takes place at two levels of a power circuit, the levels of social and systems
integration. Once domination and agency have been achieved, power is exercised at
the third level of the circuit, the level of episodic agency power.

This study argues that the accountancy profession used its claim to specialised
knowledge and skill to achieve hegemonic domination of accounting. It used this
claim to specialised knowledge and skill to form an agency relationship between itself
and the general public. The basis of this agency relationship was that accounting was
a means by which management would be accountable for the resources entrusted to it.
Only those with the requisite knowledge and skill, as recognised by the professional
associations, could ensure that financial statements duly audited fulfilled this function.
However, a claim to be serving the public interest was not sufficient. There had to be
a means of demonstrating this and also conveying this to appropriate parties such as
legislators and those most likely to make use of accounting services. This required
the formation of alliances. As will be discussed in Chapters 2 and 3, the profession
has consistently forged alliances with governments, business interests and the press.
It will be argued in this study that the maintenance of alliances has been an integral
goal in the development of flexible accounting standards.

The concept of autopoiesis will be used to help explain the development of the basis
of the accountancy profession's claim to a specialised body of knowledge and skill. It
will also be used to help explain the regulatory failure-regulatory reform cycle. The
concept of autopoiesis was derived from the study of biology by Maturana and Varela
to explain living beings that are self-producing (Maturana and Varela, 1988, pp42-
43). Robb has adapted the concept of autopoiesis for application to the social
system that is accountancy (1989a, b; 1991). An autopoietic system is a unity created
by an act of distinction whereby the organisation defines itself and facilitates its own
existence (p40) separate and distinct from its environment (p46). In other words, an
autopoietic system has a boundary that distinguishes the components created by the
system itself and it is also autonomous because it creates its own reality and rules
Autopoietic systems also determine the structure of the components within its boundary (Luhmann, 1986, p174). Through the process of autopoiesis, the system recursively reproduces itself.

The autopoietic system is organisationally or operationally closed but cognitively open. It reacts to stimuli in its environment and uses energy and information from the environment to restructure the components of the systems and create new ones. Hence, an autopoietic system can alter components and the structure of the system. However, such changes are not determined by the environment. The direction and nature of the changes is determined by the system itself. Also, any changes in the autopoietic system are always directed towards self preservation. Similarly, because an autopoietic system is cognitively open, it can trigger changes in the environment but cannot determine the nature of those changes.

In Chapter 2, it will be argued that double entry bookkeeping exhibits the characteristics of an autopoietic system and also that it has facilitated the separation of a company not only from its owners but also the abstraction of its activities into classifications designated by the system and recorded in the books of account as debits and credits.

Just as dissidence and resistance pose a threat to domination in a translation model of power, a lack of structural coupling or congruence between the structures of the autopoietic system and between the autopoietic system and its environment can threaten the survival of the autopoietic system. If compatibility is not maintained, the interactions between the autopoietic system and its environment may become destructive and ultimately could lead to the destruction of the autopoietic system rather than conservation of its autopoiesis.
It will be argued in this study that the accountancy profession translated its claim to specialised knowledge and skill to create conditions conducive to achieving hegemonic domination of external financial reporting, including auditing, as a means of regulating the activities of corporate management. It will further be argued that accounting is, by its nature, an autopoietic social system. Autopoiesis will be used to help explain the regulatory failure-regulatory reform cycle. Specifically, it will be argued that dissidence and resistance which are part of the translation model of power, are also necessary to the maintenance of autopoiesis and hegemonic domination. This is because the means by which an autopoietic system maintains its structures and extends its boundary are conversation and communication. The meaning of these terms in the autopoietic context will be explained in Chapter 2. Maintenance of autopoiesis requires a continual process of conversation and communication. Dissidence and resistance trigger conversation and communication within the system. Indetermination in accounting practices and standards also ensure continued conversation and communication within the autopoietic system and between it and its environment.

FORMAT OF THE STUDY

The study will take the following format:

Chapter 2 will further explicate the circuits of power framework and the concept of autopoiesis and specifically link them to accounting as a system within the environment of corporate regulation. This foundation will then be used to explain the emergence of professional accountancy associations in the UK and, in particular, the development of the knowledge base upon which the emerging accountancy profession based its claim of service to the public interest.
The professionalisation activities of Australian accountants will be examined in Chapter 3. The study will cover the formation of the first professional accountancy associations through to the achievement of statutory backing for approved accounting standards. This chapter will include an examination of the alliances forged between the various professional associations in Australia and between those in Australia and the UK and alliances between the Australian professional bodies and the government, business interests and the press. It will be demonstrated that these alliances were essential to the acquisition of a Royal Charter by Australian public accountants. Post-professionalisation activities will also be examined including the establishment of profession-sponsored research and standard setting organisations.

The first part of Chapter 4 will provide an interpretation of how financial reporting serves the public interest. This interpretation will be developed within the context of economic and social arguments for the regulation of external financial reporting by corporations. It will then be demonstrated that, despite the rhetoric, corporate regulation has failed to achieve the results it was supposed to. Furthermore, it will be shown that accounting and auditing practices as well as accountants have contributed to this failure. The investigators’ reports into some of Australia’s notable corporate collapses will be analysed to support this claim.

In Chapter 5, some of the underlying weaknesses contributing to regulatory failure will be identified and explained. It will be argued, however, that these weaknesses are the result of dissidence and resistance to the existing institutional order, including accountancy. It will be argued that accountancy’s contribution to regulatory failure is a result of the profession’s desire to maintain its dominant position and recursively perpetuate its own existence.

Chapter 6 will use the development of the foreign currency translation standard to demonstrate the forces at work that result in flexible, vague and ambiguous
accounting standards but, at the same time, allow the profession to maintain its dominant position. The analysis will predominantly be in the Australian context but because of the increasing harmonisation of accounting standards around the world, the philosophy underlying the development of foreign currency accounting standards in other countries will also be examined where considered relevant. The experiences of the Financial Accounting Standards Board with its first foreign currency standard, FASB 8, will be the subject of specific study because Australian standard setters were clearly influenced by the attitude towards foreign currency accounting in the USA.

The final chapter will provide a summary and overview of the dominant argument of the study within the circuits of power framework and autopoiesis. The purpose of Chapter 7 is to specifically identify the links between Chapters 2 to 6 and develop an overall explanation for the failure of accountancy as a regulatory measure and a conclusion as to the likelihood of change in the efficacy of corporate regulation.

EDITORIAL NOTE

Before continuing, some apparent anomalies and inconsistency in terminology and spelling will be addressed.

This study covers the emergence of the first professional associations through to the present time. In that time, one of the major Australian accountancy associations has changed its name from the Australian Society of Accountants (ASA) to the Australian Society of Practising Accountants (ASCPA). Hence reference to the ASCPA in the latter history of the profession does not indicate a new organisation only that an already existent organisation now has a new title. In general, the acronyms ASA and ASCPA will be used interchangeably.
Similarly, in 1984, the Accounting Standards Review Board (ASRB) was established by a memorandum of the Ministerial Council. In 1991, the ASC established the Australian Accounting Standards Board (AASB). Apart from re-organisation and the change in name, the AASB and the ASRB are synonymous. The change in name also has implications for the identifying prefixes used for approved accounting standards. Prior to the name change, approved accounting standards were prefixed “ASRB”. Since 1991, the identifying prefix is “AASB”. The two will be used interchangeably.

Finally, there are a number of what appear to be spelling anomalies in this study. These have arisen because spelling conventions in the source material used for this study have varied from country to country and overtime. The most notable of these anomalies are the spelling of words such as problematisation, organisation, and mobilisation. The alternative, for example, problematization, will only be used in direct citations of source material. A similar anomaly arises with the spelling of enquiry and its derivatives. In some instances, this word is spelled inquiry. Once again, the second version will only be adopted where this is necessary to maintain consistency with the source of the information.
CHAPTER 2

THEORETICAL FRAMEWORK

CIRCUITS OF POWER AND AUTOPOIESIS

This study will be undertaken within the framework of a translation model of power incorporating the concept of autopoietic systems. The purpose of this chapter is initially to give a brief account of everyday conceptions of power and outline four models based on the diffusion model of power and demonstrate the limitations of these models as explanations of regulatory failure. A translation model of power based on Clegg's circuits of power framework will then be developed. The concept of autopoiesis will be used to elaborate on the power framework in the context of apparent systems closure. The emergence of accounting will be used to demonstrate systems closure through the development of double entry bookkeeping and the relationships between accounting, business practice and the law.

POWER AS A CAUSE

A review of the literature on power reveals that capacities viewed as power have been seen as coercive, persuasive, restrictive, facilitative, prohibitive, productive, enabling and disabling. It has been seen as having one, two and three dimensions or faces. Individuals have been said to possess power because of the position they hold in society, for example, a monarch, president, prime minister, premier or even a dictator, or due to their wealth or control over sources of production. Power can also be seen as a physical attribute such as size or the horse power of an engine. Power has also
been seen in a spiritual or intangible sense such as an evangelist or religious leader with a large following or the power of the press.

It is not difficult to find definitions of power. Barnes has described power in terms of its capacity to achieve a particular outcome (1986, pp181-182; 1988, p2).

> Power should be taken in the first instance as a theoretical term referring to distributions of capacities, potentials or capabilities (1988, p2).

Ball offers a similar description "... 'power' refers, at a minimum, to one agent or agency's ability to affect... attitudes and/or actions" (1988, p80).

Connolly has looked at the different forms power has been said to take (1983, p93). These include persuasion, manipulation, coercion, deterrence, anticipatory surrender and force.

While the above indicates there is some agreement that power carries connotations of capacities, these definitions say nothing about how these capacities are attained and maintained. The nature of power in this respect is problematic. The inference is that people or things seen to possess power in this sense can achieve a particular outcome which includes causing something not to happen. Power, therefore, is seen as an effect or cause. It can be possessed and hoarded.

Models based on this view of power have been termed by Latour as diffusion models (1986, p267). In a diffusion model, power is seen as a cause. In other words, power is possessed and used to achieve a particular outcome. The diffusion model is also characterised by friction or resistance such that the outcome achieved may or may not be completely what the possessor of power intended. It could be said, therefore, that in a diffusion model, power is a matter of degree depending on the amount of
opposition or indifference or, conversely, acceptance, enthusiasm or even fear there is
towards the possessor of power by those who are subject to it. Latour likens power
in a diffusion model to the inertia principle in physics (p266). This means there is
some inner force which will trigger and keep an order, claim or artefact moving in one
direction until an obstacle such as the action or reaction of others changes the
direction or speed of this movement. A diffusion model seeks to explain the initial
force and/or the force which diminishes the power through resistances and friction
(p267). The diffusion model is characterised by its simplicity. All that is necessary to
explain events is to identify those who have power.

Many of the political economy models of regulation which could be used to explain
the repetitive pattern of regulatory failure-regulatory reform identified in Chapter 1
are based on a diffusion model of power. For purposes of illustration, four such
models will be briefly outlined: public interest, private interest, cost/benefit and
pluralist.

(i) Public Interest Model

The public interest theories of regulation are based on the premise that regulation is
instituted to further the public interest in some way. This may be to protect the public
from abuses of the corporate form including fraud and misrepresentation, anti-
competitive activities of monopolies, pollution and similar anti-social behaviour of
companies, other groups and individuals. Public interest theories can be classified as
economic and/or social theories and, as such would be consistent with the views
expressed in SAC 2 *Objective of General Purpose Financial Reporting* (hereafter
referred to as SAC 2) and SAC 3 *Qualitative Characteristics of Financial
Information* (hereafter referred to as SAC 3) regarding the relevance and reliability of
information contained in general purpose financial statements. SAC 3 defines
relevance and reliability as
"relevance" means that quality of financial information which exists when that information influences decisions by users about the allocation of scarce resources by:

(a) helping them form predictions about the outcomes of past, present or future events; and/or

(b) confirming or correcting their past evaluations;
and which enables users to assess the rendering of accountability by preparers;

"reliability" means that quality of financial information which exists when that information can be depended upon to represent faithfully, and without bias or undue error, the transactions or events that either it purports to represent or could reasonably be expected to represent (paragraph 5)

The introduction to SAC 3 specifically links these qualitative characteristics to the objectives of general purpose financial reporting as identified in SAC 2 paragraphs 26 and 27:

... the objective of general purpose financial reporting is to provide information to users that is useful for making and evaluating decisions about the allocation of scarce resources (paragraph 26)

When general purpose financial reports meet this objective they will also be the means by which managements and governing bodies discharge their accountability to the users of the reports . . . . the rendering of accountability by reporting entities through general purpose financial reporting is encompassed by the broader objective of providing information useful for making and evaluating decisions about the allocation of scarce resources, since users will ultimately require the information for resource allocation decisions (paragraph 27).

SAC 3 paragraph 4 further states that these qualitative characteristics will assist preparers of financial information, auditors, participants in the standard setting process, regulators and others to select appropriate reporting policies and indicate to
users the qualities that users can expect of financial information made available to them.

SAC 2 paragraphs 12 and 13 make it clear that financial information has both economic and social consequences and that the community interest will be best served when there is an efficient allocation and use of scarce resources. For example, investors, creditors, governments and parliaments will use financial information to make investment, credit and policy decisions. If these decisions are based on relevant and reliable financial information, resources will be allocated to those entities which will use them in the most efficient and effective manner. This in turn, will increase productivity, employment opportunities and living standards.

This implies that regulation of company financial reporting is necessary to ensure an adequate or economic distribution of resources. The report of the Senate Select Committee on Securities and Exchange (the Rae Committee), for example, concluded that government regulation had two goals. The first of these could be termed a public interest objective:

... to maintain, facilitate and improve the performance of the capital market in the interests of economic development, efficiency and stability (Australia, 1974, 16:15).

This is similar to Posner's view of the "public interest" theory that "... regulation is supplied in response to the demand of the public for the correction of inefficient or inequitable market practices" (1974, p335).

(ii) Private Interest Model

In contrast, the basis of the private interest theory is essentially that one interest or pressure group is able to "capture" regulation or the regulatory body established to administer the regulation of a particular industry or industry in general. In Stigler's
view, "capture" means that the impetus for a given regulatory measure came from a particular industry. Furthermore, the design and operation of the regulation is directed towards the benefit of that industry (Stigler, 1971, p3).

Alternatively, regulation may be introduced which is not of benefit to a particular industry or industry in general but over time, industry is able to dominate or control the regulatory agency established to administer the regulation (Posner, 1974, p341). According to Walker, the relationship between the accounting professional bodies and the Australian Accounting Standards Board (AASB) is a classic case of this form of regulatory capture (1987). This matter will be discussed in more detail in later chapters of the study.

A number of reasons have been advanced for the success of industry in achieving this preferential treatment. Most are based on the view that power is a function of status in a community. A long standing view is based on the notion that the institutions of society, including regulation, are controlled by the capitalists as being the controllers of productive resources, or, using perhaps more modern terminology, big business (Posner, 1974, p341). This approach is based largely on the works of Marx. Essentially, the private interest model is based on the premise that the ruling class, for example, business interests, are able to enlist the support of the State, including the regulatory system, by virtue of the pressures they are able to bring to bear in pursuit of their own objectives. Because these pressures are greater than those exerted by other groups, the State serves business interests to the exclusion of others. Furthermore, the system is set up in such a way to ensure that the ruling class maintains its dominant position (Miliband, 1969, p146; Quinney, 1975, pp192-193). An accounting example of this would be where a business group or groups successfully lobbied for the repeal of a particular standard on the basis of the economic consequences flowing from application of its provisions.
A variation on this theme is the power-elite model which adopts the perspective that dominant groups in society, for example, business or industry, are able to achieve political ends at the expense of other less powerful groups (Tomasic, 1980, p28; Hart, 1980, p239).

Higley, Deacon and Smart see elites as including leading businessmen, incumbent and retired politicians, trade union leaders, wealthy graziers, voluntary associations and even leaders of minority, reform or protest organisations (1979, p4). These authors define elites as "... persons with power to affect organisational outcomes individually, regularly and seriously" (p3). In an accounting context, it has been argued that standard setting bodies have been unduly influenced by the audit section of the profession for the benefit of clients. In other words, business interests had de facto control of the accounting standards through company auditors (Burns, 1974).

(iii) Cost/Benefit Model

Under the cost/benefit model, the explanation of the success or failure of regulation is concerned with an analysis of the impact of regulation or policy on individuals and groups. According to Wilson, individuals and groups tend to react more to decreases in net benefits than increases (1974, p138). Hence if the impact of a regulatory measure on an individual or group is negligible, they are less likely to take an interest in it than if the impact, in terms of either costs or benefits, is great.

Research by Morris (1986), Gavens, Carnegie and Gibson (1989) and Coombes and Stokes (1985) suggests there is a bias in the standard setting process towards the interests of large business. This did not occur because of their position in society per se but because they were more likely to respond to exposure drafts than smaller business interests. This could be seen as indirect support for the cost/benefit model because larger companies could be seen as having more resources at their disposal to
keep up to date with proposed changes in accounting methods. Morris offered a number of reasons, which could be seen as consistent with the cost/benefit model, for why some who could be considered to have an interest in standards did not take advantage of the due process procedures and voice their views in submissions. For example, Morris argued that some potential lobbyists may not participate in due process procedures because they considered their view would not be taken into consideration. Others may not lobby because of the "free riding" problem whereby the benefits of lobbying by one group may flow through to competitors even though they have not incurred the expense of lobbying (1986, p46). These considerations would suggest the cost of lobbying would not be justified.

To the extent that some groups lobby and others do not, the cost/benefit model is a variation of the private interest model.

(iv) Pluralist Model

Supporters of the pluralist model do not believe that power is consistently vested in the hands of a select interest group. They consider power to be widely dispersed and open to competitive bargaining. For example, Clegg sees the pluralist conception of power as

... most likely to be dispersed among many rather than fewer people; to be visible in instances of concrete decision-making rather than through reputation; to be competitively bargained for rather than structurally pervasive; to be best viewed through relatively formal instances of voting and to be more widely dispersed than narrowly concentrated in communities (1989, p8).

In a similar vein, Matthews' discussion of Australian pressure groups, puts the pluralist viewpoint in the following terms
... no group has a monopoly or even a new monopoly of political resources. Resources may be spread unequally; but they are not spread cumulatively. Even the unorganised or weakly organised sections of the population ... at least have the power to vote (1980, p468).

In Cranston's view, the pluralist model is based on the premise that there are a number of conflicting interest groups including the state which may act independently for its own interests or as a surrogate for other interests (1982, p4). To achieve business regulation or the implementation of policies generally, it is necessary to mobilise support. To gain this support, it may be necessary to counter opposition by making compromises, for example, watering down or weakening the effects of a proposal, rather than see the proposed policies defeated. The overall effect is that there is no clear-cut winner or loser because no one group has achieved their ideal situation.

LIMITATIONS OF POLITICAL ECONOMY MODELS

There are two major defects in these models. The first relates directly to the concept of power. Being perceived as having power is one thing, exercising power is another. Hence, an elite such as a monarch or politician may be seen to have power but may not be able to exercise power in any concrete manner. For example, the Queen of England is ruler of the United Kingdom in name only. She is a figurehead. The laws of England are formulated by Parliament and are administered and enforced by a network of public offices, law enforcement agencies and the judiciary. The Queen may give the royal assent to laws but this is on the advice of the Prime Minister who in turn is acting on behalf of Parliament, which, in turn, is supposed to represent the interests of the United Kingdom as a whole.

In Australia, the power of the Prime Minister is constrained by the membership of the relevant political party. Hence the Prime Minister may propose nominations for particular portfolios in the government but will be guided in this selection by party
views. Party policies are also determined in this way. The laws created by the Federal and State Parliaments are, in Australia, constrained by the Constitution and are subject to interpretation and possibly rejection by the judges of the High Court.

A dictator usually has power only as long as an army or a police force enforces it. The population may only follow orders emanating from a dictator out of fear of reprisals either on this earth or, in the case of a religiously based dictatorship, in the hereafter.

In Australia, the AASB has power under the Corporations Law to review and develop accounting standards (Australian Securities Act, section 226). Where these standards are subsequently approved, section 298 of the Corporations Law imposes on company directors an obligation to comply with these standards.

In all such cases, a diffusion model would maintain that the force which prompted a particular law or activity was the power of an individual or group. Furthermore, this power would be all that was necessary to sustain achievement of the status quo until such time as friction or resistance such as opposition from other interest groups or indifference diminished the force of the power. These theories concentrate on power as an outcome but they do not explain how those who are perceived as being in power achieved this position or the mechanisms whereby they might lose it. As Latour argues

If the notion of 'power' may be used as a convenient way to summarise the consequences of collective action, it cannot also explain what holds the collective action in place (italics in original) (1986, p265).

In other words, monarchs hold their position by virtue of their ancestry. At some time in history, however, there has to be some explanation as to why a particular
family line holds this position and what stops or has stopped some other family lineage from claiming this privileged position. A dictator usually attains this status through force but by what mechanism does a dictator gain and maintain the support of an army of followers in the first instance? The AASB has a statutory mandate but subsequent chapters of this study will demonstrate that this mandate is necessary but not sufficient to enable the AASB to exercise its standard setting power. In other words, the AASB cannot simply issue accounting standards without considering the impact of proposed accounting standards on those who will be bound by them. If it did, it is likely the statutory mandate would be withdrawn in response to pressure from interest groups such as business and, possibly, the government itself if standards issued by the AASB were perceived as having adverse consequences on the economy as a whole.

Related to this is the notion of interests. All four political economy models outlined above are based on interests of some description. This raises the question of how these interests are determined. For example, what exactly is the public interest? This issue will be discussed in more detail in subsequent chapters (in particular, Chapter 4). For present purposes, a brief overview will be provided following Ippolito and Walker who describe the public interest in the following terms:

... a collective good, the achievement of which will not selectively and materially benefit the membership or activists of the [public interest] organisation

... in the best interests of all the ... people

... policies beneficial to all citizens or beneficial to large portions of the population generally (1980, p302).

However, as Higley, Deacon and Smart assert:
Societies rest on various social and cultural understandings, but . . . there is never a single, overriding point of view to which all, or even most, members of a society adhere. Consequently, in the broader areas of social action common interest is always fairly minimal (1979, p2).

Clearly, the nature of the public interest is problematic and defies definition in anyway other than perceptions of what individuals or groups may perceive to be the public interest. This is a political decision and, as such, requires explanation within a power framework because questions of public interest are really nothing more than an extension of a private interest model. The same comment is valid for the cost/benefit model.

Private interests, are arguably, more easily identified than public interests because they are attributed to particular groups such as business, political activists, trade unions, the wealthy and so forth. Ippolito and Walker define an interest group as:

... an organised collection of individuals who are bound together by shared attitudes or concerns and who make demands on political institutions in order to realise goals which they are unable to achieve on their own (1980, p271).

Private interest theories thus suggest that particular groups within society are able to influence regulation because of their position in society (as outlined above) and/or the ability to effectively organise activities aimed at achieving particular outcomes. However, the issue which is not addressed is how the "interests" of a given group are determined. The nature of the group will usually indicate its philosophical underpinnings, for example, aboriginal land rights, but how these are developed and shaped and finally presented as an issue is another matter.

Issues develop overtime and tend to change in response to the views of supporters and even opponents. In other words, there are likely to be trade-offs between those
with an interest in a particular issue in a bid to gain consensus within the support
group and present a united front. Opponents may make similar compromises for the
same reason. Overcoming opposition may also result in compromise in order to have
general agreement on an issue. The bid for a Royal Charter by some groups within
the Australian accountancy profession will be used to demonstrate this point in
Chapter 3. The charter bid extended from 1905 to 1928. Bringing it to fruition
required gaining acceptance for the conferral of the charter from other groups within
the profession both in Australia and the UK and also from government sources who
considered Australia did not need such forms of recognition from the UK. To
overcome this opposition, a number of compromises were made including the
widening of admittance criteria to the organisation to be formed by the Royal Charter.

The accounting standard setting process is a further example of such activities. As
will be discussed in Chapter 5, the due process procedures of standard setting
organisations which include the calling for submissions on the content of proposed
accounting standards are political activities undertaken to overcome resistance to an
accounting standard on the part of those who will be required to comply with it.
Often, however, it is also necessary for the accountancy profession to overcome
dissidence within its own ranks over appropriate accounting practices. Chapter 5 will
provide evidence of both resistance to accounting standards by business and
government interests and dissidence within the profession by reference to issues such
as the inflation accounting debate. Chapter 6 will use the accounting standard dealing
with foreign currency translation as a specific and detailed example of dissidence
within the profession and resistance from business interests to a particular accounting
issue.

The point is that issues or interests may not be readily identified or articulated. As
Hindess has observed "... the specification of interests is always open to dispute:
interests are not given properties of individuals or groups" (1986, p117). A further
implication of this line of argument is that if interests are developed over time, then members of a group may not have identical interests. Hence "... every identifiable group contains winners and losers, and even where all the winners are in one group they end up short-changed" (Peltzman, 1976, p240). Again, accounting standards can be seen as evidence of this. For example, in the case of the foreign currency standard, business preferred flexibility in the translation of foreign currency financial statements and the accounting for translation gains and losses while the profession was committed to uniformity. As Chapter 6 will demonstrate, the compromise was a reduction in translation methods from four to two. The ability to defer and amortise foreign exchange gains and losses on overseas borrowings was removed except in specified circumstances. Both sides lost to a certain extent.

A further and related point is why some interests are supported while others are not even within one group. This line of argument also applies to the pluralist model. Lukes, for example, has argued

... the pluralists assume that interests are to be understood as policy preferences - so that a conflict of interests is equivalent to a conflict of preferences. They are opposed to any suggestion that interests might be unarticulated or unobservable, and above all, to the idea that people might actually be mistaken about, or unaware of, their own interests (1978, p14).

In addition, the pluralist model

... emphasises the importance of initiating, deciding, and vetoing... takes no account of the fact that power may be, and often is, exercised by confining the scope of decision-making to relatively "safe" issues (p18).

Again, the accountancy profession provides evidence of this which makes it clear that even within the profession itself, there is not a consensus on appropriate accounting practices in all cases particularly controversial issues. The foreign currency issue was
extremely contentious as evidenced by a gestation period for the Australian standard of some 12 years. An exposure draft was issued in 1973. No further action appears to have been taken until 1979. One explanation for this was that the issue of the 1973 exposure draft was prompted by the volatility of the exchange market in the early 1970's. When this volatility declined in the mid-1970's, there was no longer a need to pursue the issue (Corsi, 1987, p8). Alternatively, it could have been that the issue was too controversial and achieving agreement was considered to be too hard (Pierpont, 1977, p88). Similarly, Moonitz has stated that, in its final years, the APB avoided controversial issues because of adverse reactions to its attempts at dealing with difficult issues from members of the accountancy profession, business and the government (1974, p28).

Furthermore, it has already been pointed out that larger business concerns are more likely to make submissions on proposed accounting standards than smaller companies (Coombes & Stokes, 1985; Morris, 1986; Gavens, Carnegie and Gibson, 1989). The reasons for this suggested by Morris and referred to previously support the criticisms of the pluralist model put forward by Lukes. For example, unless business keeps up to date with proposed accounting standards, it cannot know the likely impact of such proposals much less articulate their interests. Not taking action because of the free rider problem can itself be seen as a form of power because it denies the potential benefits of lobbying to competitors that may well face similar impacts from accounting standards.

A diffusion model of power cannot adequately explain regulatory failure. The major reason for this is that it sees power as being something that is possessed and hoarded rather than as power relationships. In a diffusion model possession of power is often deemed to be a function of the possessors position in society. However, there is a difference between being perceived as having power to order or proscribe a particular activity and the ability to enforce that edict. Possession of power, if this is indeed
possible, and the exercise of power are not the same. Furthermore, the political economy models of regulation offered as examples of diffusion models are based on the concept of interests. If interests cannot be clearly identified and articulated, they cannot adequately explain action in general and regulatory activities in particular. In addition, diffusion models imply that all interested parties are equal in terms of knowledge of strategy, agenda setting and access and the ability to organise and form alliances with others with similar interests.

Regulation is complex. Mitnick sees regulation as a special case of the general policy-making process which has three aspects: access (issue creation, issue expansion, agenda entrance); decision, implementation, administration, impacts (and their evaluation); termination (1980, p79).

The second aspect could be further divided into enactment, for example, company legislation and accounting standards, and enforcement phases.

In Mitnick's view, the behaviours at each stage of the policy making process must be accounted for and explained in order to understand regulation and its effects:

A full theory of regulation must ... explain how regulation is proposed, formally considered and approved, put into effect, administered, has impact, is evaluated and, is altered (1980, p80).

Mitnick's views are as applicable to the setting of accounting standards as they are to regulation in general. For this reason, it is argued that a diffusion model of power will not adequately provide an explanation of why accounting standards are flexible, vague and ambiguous. Therefore, a translation model of power will be used for purposes of this study.
CIRCUITS OF POWER FRAMEWORK

In a translation model, power may be an effect but it is not a cause and it cannot be possessed. Outcomes are shaped and usually changed or modified, that is transformed, by all those who have an interest in them and are prepared to act on that interest. The end result is that the final outcome probably bears little resemblance to what was originally intended (Latour, 1986, p268). Clegg defines the translation process as follows:

By attending to politically engaged agents seeking to constitute agencies, to constitute interests, to constitute structures, the method seeks to map how agents actually do 'translate' phenomena into resources, and resources into organisation networks of control, of alliance, of coalition of antagonism, of interest and of structure (1989, p204).

The process of translation is complex and comprises four moments or stages of translation, problematisation, interessement, enrolment and mobilisation. There is a further moment of translation, dissidence, which can be seen as the antithesis of power. However, it will be argued in this study that dissidence is as necessary to the maintenance of power relationships as the other moments of translation (these concepts will be explained briefly later in the chapter). Despite the complexity of the translation process, its essence can be explained in fairly simple terms. For example, Callon states:

To translate is to displace . . . allies . . . to express in one's own language what others say and want, why they act in the way they do and how they associate with each other: it is to establish oneself as a spokesman. At the end of the process, if it is successful, only voices speaking in unison will be heard (1986, p223).
A translation model either specifically identifies or implies the necessity for efficient organisation and agency. With regard to organisation, Latour states that since power cannot be possessed or hoarded

You no longer have stored-up energy to explain why a President is obeyed and a multinational grows since these effects are a consequence of the actions of multitudes. You are thus faced with multitudes that wonder how to act as one (1986, p269).

Related to this is the idea of agency or the identification of who or what will act as the representative or agent of the multitudes:

If power is not something you can hoard and possess, it is something that has to be made. Who will make it? Others . . . These others, the only ones who are really powerful (in actu), therefore have to attribute their action to one amongst them who becomes powerful in potentia (1986, p274, italics in original).

Clegg's circuits of power framework is based on a translation model. It explicitly uses the concepts of agency and effective organisation. In addition, the circuits of power framework uses the concept of hegemonic domination. Power is not something that can be possessed and used to achieve a particular outcome. Instead, resources, including knowledge, are used to create an environment wherein some groups, associations or organisations are able to dominate a given field by forming an agency relationship with other interest groups. The group wishing to act as the agent for the others tries to prove or create the impression that it is the appropriate representative of all those who have an interest in a given field. The professionalisation of accountancy can be seen as an example of a translation model whereby accountants have sought to gain hegemonic domination of not only work of an accounting nature but also the determination of appropriate accounting standards and practices. Selander, for example describes professionalisation as
... the aspiration that an occupational group cherishes to reach exclusive societal advantages and preference of interpretation within their special field of knowledge and praxis (1990, p139).

Domination and agency, however, are not necessarily fixed over time. Both are subject to challenge, resistance and opposition such that it may be necessary to renegotiate and modify the environment if domination and agency are to be maintained. The overall result is that outcomes are often compromise or second best solutions in order to maintain dominance and agency. It will be argued in this study that flexible, vague and ambiguous accounting standards are the result of such negotiations and explainable in terms of Clegg's power framework and its application to the professionalisation process.

The Moments of Translation

(i) Problematisation

The process of problematisation involves attempts by one group or organisation to convince another group or organisation that the latter has a problem and that the solution to that problem can be provided only by the former group or organisation. In Callon's terms, problematisation involves a group or organisation making itself indispensable in the network of relationships it is seeking to create (1986, p204). The purpose of this process is facilitation of a strategic agency relationship. To achieve this, the would-be agent must establish and control a "necessary nodal point" (Callon, 1986, p205) or "obligatory passage point" (Clegg, 1989, p199) between itself and the other group. Clegg refers to a "necessary nodal point" as "... a channel through which traffic between them occurs on terms which privilege the putative strategic agent" (1989, p199).

Callon further elaborates on the meaning of problematisation which "... describes a system of alliances, or associations, between entities, thereby defining the identity and what they 'want'" (1986, p206).
As will be discussed in detail in the next chapter, professions use their claim to expert knowledge and skill as a strategy to establish themselves as an obligatory passage point between professionals and their clients. Lubell, drawing on the works of Montagna, Barber and Greenwood, describes the process as follows:

Because professional services are built upon esoteric knowledge, the public tends to regard members of a profession with a certain degree of mystique. It is felt that the professional practitioner is better prepared than the client . . . to determine the client's needs and the nature of services appropriate for a given situation. The client does not tell the professional what services are required. Rather, the professional tells the client what services are necessary (1978, pp62-63).

This view can be extended to the relationship between the profession, regulatory authorities, government, investors and creditors and the general public in the development of accounting standards. The accountancy profession seeks to not only establish its members as obligatory passage points for clients but also between itself and the public interest in the promulgation of accounting standards. The accounting standards promulgated by the profession are held out as providing relevant and reliable information for the purposes of making decisions leading to an economic allocation of resources (SAC 2 and 3).

(ii) Interessement

In the next stage in the process of translation, interessement, a group or organisation seeks to cement its position in the power framework by "interesting", "enrolling" or "attracting" another group or organisation to its own by coming between that group or organisation and another (Clegg, 1989, p205). Callon explains interessement as "[t]o be interested is to be in between (inter-esse), to be interposed" (1986, p208).
The purpose of interessement is to establish membership and meaning of certain categorisation devices (Clegg, 1989, p205). For purposes of this study, categorisation devices are taken to include professionalisation processes such as the formation of professional associations with entry requirements including specified training and education. In this way, the profession determines its membership and establishes a distinction between non-professional accountants and professional accountants, public accountants as opposed to those working in industry. Chapters 3 will show that the emerging accountancy profession sought to make this distinction on the basis that the public interest would be best served by members of specified professional associations. The reason for this being that specialised skill, knowledge and training were required in, for example, the conduct of an audit and only those who qualified for membership of certain professional associations had such attributes. In other words, the first phase of the translation process is aimed at achieving a dominant position in a particular field. The second phase is a consolidation process whereby the organisation seeking to attain the dominant position attempts to strengthen its hold or claim by forming an agency relationship with other parties who could also be expected to have an interest in the particular field. Callon describes interessement as "how the allies are locked into place" (1986, p206). This is necessary because, as Callon states the entities and relationships identified during the problematisation process must be tested to determine the strength of problematisation:

Each entity enlisted by the problematization can submit to being integrated into the initial plan, or inversely, refuse the transaction by defining its identity, its goals, projects, orientations, motivations, or interests in another manner (p207).

The process of interessement can take many forms depending on the nature of the problem identified and those to be enrolled and what they want (p211). Interessement is aimed at achieving a balance of power favourable to the enrolling agency by
reducing competition within a particular field, for example excluding the unqualified from the practice of accountancy, and by creating alliances with those to be enrolled (p211).

(iii) Enrolment

The third phase in the translation process is enrolment (Clegg, 1989, p205) or definition and co-ordination of roles (Callon, 1986, p211). In this phase of the process, agencies attempt to form "alliances and coalitions between memberships and meaning which they have sought to fix" (Clegg, 1989, p205). This phase appears similar to the second. However, there is a difference. Alliances and coalitions are not the same as an agency relationship and could be seen as a means of avoiding resistance from other groups that may wish to encroach on another's hold over a particular field of endeavour. Interessement attempts to form alliances but may not necessarily be successful. Enrolment is the achievement of alliances (Callon, 1986, p211). Callon describes enrolment as "... the group of multilateral negotiations, trials of strength and tricks that accompany the interessements and enable them to succeed" (p211).

(iv) Mobilisation

The final phase of the translation process, mobilisation, is the means by which the enrolling agent ensures that it is not betrayed by the enrolled agencies, that is, the representations of interest remain fixed (Clegg, 1989, p205). This final phase can be seen as the most critical in the process as it effectively is the culmination of the previous phases. Will the enrolling agency be accepted as the representative of the enrolled and will the enrolled follow their representative? In other words, what the enrolling agency is seeking is a transition from enrolment to active support (Callon, 1986, p218).
(v) Dissidence

Even if the process of translation is successful, it does not mean a dominant position will be maintained. There is a further stage in the translation process, dissidence, whereby translation may become treason. Callon explains this stage as follows:

Dissidence ... brings into question some of the gains of the previous stages. The displacements and the spokesmen are challenged or refused. ... New displacements take the place of the previous ones but these divert the actors from the obligatory passage points that had been imposed upon them. New spokesmen are heard that deny the representivity of the previous ones. Translation continues but the equilibrium has been modified (pp218-219).

Power and dissidence or resistance are inextricably linked (refer for example, Clegg, 1989; Barbalet, 1985) and while power may be limited by dissidence or resistance, Clegg argues that it will be rare for existing obligatory passage points to be destroyed (1989, p209-210). The idea of this relationship between power, dissidence and resistance will be linked later with the notion of autopoiesis and systems closure which, it will be argued, have allowed the accountancy profession to maintain and even expand its dominance of financial reporting.

Clegg's Circuits of Power Model

There are three circuits of power in Clegg's model: episodic, dispositional and facilitative. The circuits are interrelated with relationships at the dispositional and facilitative levels either reproducing or transforming power relationships at the episodic level. The facilitative level is the most dynamic of the circuits. As its name implies, it is the level that empowers or disempowers the rules of meaning and membership which fix or re-fix the obligatory passage points at the dispositional level which in turn set the scene for domination and facilitate the episodic power relations at the agency level. Each level and the type of power associated with that level will
be discussed in turn with brief examples drawn from the regulation of company accounting used where appropriate to explain the level in more detail.

(i) Episodic Agency Circuit

Episodic agency power is the circuit through which outcomes are secured. Therefore, it is the most visible of the circuits (p211). In this sense, it closely resembles the traditional conception of power whereby an A, because of a superior bargaining position or standing conditions which allow A to utilise resources, can cause a B to follow a particular course of action. This can be either some action B would prefer not to take or preventing B from taking some particular action (p217). Power at the episodic agency level is the closest power comes to being reified, that is, "... thinglike ... solid, real and material ..." (p207). The episodic agency view of power is based on the concept of sovereign power (p187) which Clegg sees as being "... tied irrevocably to the formal apparatus of the state ..." (p155).

In terms of the moments of translation, the episodic circuit represents the outcome of the translation process. Those who exercise power at this level have achieved both an agency position and a position of domination in a given field and thereby are able to cause others to undertake some activity they might not otherwise have done. In other words, they have used the resources available to them and translated them into power.

It is important to note that agency in the circuits model is not restricted to humans but extends to collective forms of decision-making, including organisation (p187). Achievement of organisational agency is potentially more significant than individual agency because, as Clegg points out

... it involves the stabilisation of power relations across an organisational field of action, and thus between many subjectivities, rather than simply within one embodied locus of subjectivities (p188).
This view of agency as organisational is essential to the application of autopoiesis to the accountancy profession.

The setting of accounting standards that are binding on members of the two accounting professional associations and, in the case of approved accounting standards, binding on preparers of statutorily mandated external financial statements is an example of power at the episodic agency level. The fact that the profession effectively dominates this process could be seen as the ability of A (the profession) to make B (preparers of financial statements) do something B would not otherwise have done (comply with accounting standards).

This level is characterised by resistance which may take one of two forms (p207). First, resistance may take the form of attempts to create entirely new power relationships by establishing new obligatory passage points. As will be discussed in more detail in Chapter 4, the establishment of the Accounting Standards Review Board (ASRB) was viewed by the Australian accountancy professional associations as a move by the Federal Government to remove the standard setting process from their control.

The second and more likely form of resistance leaves existing power relationships intact but resists the exercise of power (p207). An example of this type of resistance may be evidenced by a failure on the part of professional association members to comply with accounting standards. On the other hand, resistance may be proactive in that business groups may lobby the government to over-rule an accounting standard as has happened twice in the USA and also in Australia with regard to SAC 4 Definition and Recognition of the Elements of Financial Statements (details will be provided in Chapter 5). In Australia, activities of this nature are more likely to be undertaken in the case of approved accounting standards which have the force of law.
under the Corporations Law. Resistance may also be evidenced in formal submissions on proposed accounting standards and/or media coverage of the impact of a particular accounting standard.

It will be argued that this potential for conflict helps explain why accounting standards are flexible, vague and ambiguous. The long debate over the foreign currency translation standard will be used to demonstrate this point in Chapter 6.

It should be clear that episodic agency power is not necessarily absolute or permanent or immutable. Maintenance of power at the episodic agency level requires reproducing the rules of membership and of meaning, rules of practice and obligatory passage points through the dispositional and facilitative circuits of the framework. Even if resistance does not create new obligatory passage points, it can cause a change in the way power is exercised at the episodic agency level. This is consistent with what Jamous and Peloille term "transformations of a profession" which "... are not made by a self-regulating system but by sudden jolts when the principles of the dominant legitimacy are shaken" (1970, p142).

Influences and relationships within the other two levels of the power framework will determine the degree of change in the balance of power at the episodic agency level.

(ii) Dispositional Circuit

Dispositional power at the level of social integration is based on Lockwood's (1964, p245) concept of social integration as orderly and conflictful relations between the actors in a system (Clegg, 1989, p18). These relationships are concerned with specifying rules of meaning and of membership (p224). These relations of meaning and of membership construct an "actor-network", "organisational field" or "field of force" which is made up of the allies and those successfully enrolled into an agency relationship by the translation process (p225). DiMaggio and Powell define an
organisational field as "... those organisations that, in the aggregate, constitute a recognised area of institutional life..." (1983, p148).

In the context of the present study, the relevant organisational field or field of force is corporate regulation. The major organisations making up this field include the accountancy profession as a whole, the legal profession, State and Federal Parliaments as representatives of the public interest, regulatory authorities such as corporate affairs commissions and the National Companies and Securities Commission (both now replaced by the Australian Securities Commission), the stock exchange and corporations. It is recognised that other organisations such as those representing industry and those who use external financial statements are also likely to have a place in the organisational field comprising corporate regulation. However, it is likely that these groups would play a less significant role in the organisational field than the major groups.

This power circuit encompasses rules of practice or modes of rationality which can be seen as solutions to the problems organisations face. This is part of the process of problematisation. The key to this power circuit is for a would-be agent to first convince an organisation or organisations that they have a problem and then persuade them that the would-be agent can offer the optimal solution. In this way, the enrolling group or organisation endeavours to establish itself as the "obligatory passage point" through which environmental resources such as knowledge and information must pass. Maintaining power at the episodic level requires control of the "obligatory passage points" at the dispositional and facilitative levels which means fixing and refixing the rules of practice which, in turn, provide the context determining what the rules of membership and of meaning are interpreted as being. This fixing and refixing is aimed at stabilising the organisational field and is achieved through a process of institutional isomorphism, which means that organisations within the field become increasingly alike. This acts as an in-built defence mechanism which guards against
radical change in the future. Chapter 3 will argue that the professionalisation of accountancy was directed towards achievement of this position.

As indicated above, this circuit is characterised by interessement and enrolment which are necessary to the formation of an agency relationship. One way of achieving an agency position or forming alliances is by demonstrating a commitment to representing the interests of the principal, for example, by lobbying the government to attain a particular outcome beneficial to the principal. An early example of interessement on the part of the accountancy profession in the United Kingdom was the support of business by the Institute of Chartered Accountants in England and Wales (ICAEW) against government proposals to require disclosure of profit and loss information. After almost forty years, the ICAEW eventually supported greater disclosure in the interests of shareholders and creditors (Aranya, 1974, pp7-8). An Australian example is provided by submissions to the government or regulatory authorities by the Institute of Chartered Accountants in Australia (ICAA) on various matters including allowance for depreciation on income-producing buildings, double taxation of dividends and taxing of closely related companies as groups (ICAA, Annual Report, 1982, p7).

Achievement of an agency relationship also requires effective organisation. The relevant moment of translation here is enrolment. One way in which the accountancy profession could be seen to do this is by attempts to unify the profession. In other words, to join a number of professional associations into one, or, where this has proved infeasible, to at least work together to give the appearance of a united front. The standard setting mechanism established jointly by Australia's two major accountancy professional associations is an example.

Finally, mobilisation is also part of this circuit as it includes rules of practice which are the basis of the establishment of obligatory passage points. The purpose of
mobilisation is to avoid betrayal by enrolled agencies so that relations of meaning and membership remain fixed. In the context of the present study, rules of practice will be taken to include accounting and auditing standards, ethical pronouncements, rules of entry to membership of the accountancy profession, membership of accounting standard setting and review boards and due process procedures.

By successful translation of resources through the dispositional level, domination is institutionalised (Clegg, 1989, p213). "Institutionalised" in this context is based on Meyer and Rowan's view of institutionalisation as "... the processes by which social processes, obligations, or actualities come to take on a rulelike status in social thought and action" (1977, p341).

In the context of the present study, therefore, it is argued that the accountancy profession has used its claim to unique knowledge and skill to create the view in society that only those with that knowledge and skill and recognised by the accounting professional associations should undertake work of an accounting nature and also determine appropriate accounting practices. By the process of formation of professional accounting associations with entrance requirements specifying a high standard of education and training and ethical codes and continuing professionalisation activities such as the development of practice guidelines, accounting standards and conceptual framework projects, the profession has effectively institutionalised its domination of the accounting aspects of corporate regulation. As will be discussed in Chapter 3, the Australian accountancy profession does not have any statutory authority to establish accounting standards enforceable by law. However, through control of the Australian Accounting Research Foundation (AARF) which provides technical support in the development of approved accounting standards, the two major accountancy bodies in Australia, the Institute of Chartered Accountants in Australia (ICAA) and the Australian Society of Certified Practising Accountants (ASCPA) effectively dominate the standard setting process.
If the translation process at this level is successful, then agency will have been achieved and, as Callon puts it "... only voices speaking in unison will be heard" (1986, p223). The profession appears to have attained this position with regard to the setting of accounting standards. However, it should be noted here that while agency and organisation facilitate domination, domination will be weakened because of agency (Clegg, 1989, p193). In other words, domination will, to a certain extent, be dependent upon the continued support of enrolled agencies and allies or in refixing the rules of practice and rules of meaning and of membership. The forces at work at both this level and at the facilitative level of the framework will determine the extent of this support and its maintenance or changes therein.

Changes in the rules of practice, membership and meaning at the level of social integration arise from either endogenous or exogenous forces arising from innovation in techniques of discipline and production (p224). However, as already indicated, radical change in an established organisation in the face of innovation is rare (p226). One reason for this is what Clegg terms "organisational outflanking". Organisational outflanking refers to the ability of organisations in an established network to outmanoeuvre subordinate or new organisations that lack the resources to launch effective collective action to effect change in the existing order (pp218-240). While there is a trend towards the status quo, resistance or dissidence within the ranks of the dominated can weaken the relationships within and between the dominant groups within an organisational field.

More importantly, however, is the view based on the work of DiMaggio and Powell (1983) and Meyer and Rowan (1977) that organisations in a particular field structure the environment in which they exist in such a way as to make radical change difficult. The organisational field effectively institutionalises responses or rules of practice which guide innovation (Clegg, 1989, p266). The process by which this is achieved is

(a) Coercive Isomorphism

Coercive isomorphism occurs where one organisation in a given field has the ability to exert pressure on another organisation within the same field. For example, companies wishing to offer their shares for sale to the public are required to undertake activities prescribed by the Corporations Law. These activities include the issue of a prospectus and, once incorporated, the annual publication of audited financial statements. They are dependent on the government for the ability to raise finance from the public and also the benefits of limited liability. Corporations are also dependent on the stock exchange in order to have shares publicly listed and, therefore, must follow the requirements of the stock exchange, which include the lodging of interim financial reports, or face losing their listing. As a consequence of the Corporations Law and stock exchange requirements, corporations are dependent on the accountancy profession in order to prepare financial statements which will be attested to by the external auditor as showing a true and fair view which in Australia extends to the application of Australian accounting standards. Corporations, therefore, are subject to coercive isomorphism which guarantees similarities in the manner in which companies are incorporated and report to their shareholders and others who use annual financial statements.

(b) Mimetic Isomorphism

Mimetic isomorphism, as the name implies, occurs when organisations imitate the features of other organisations. Conditions of uncertainty or ambiguity arising from innovation in techniques of discipline or production lead organisations to mimic the features of similar organisations which are perceived by the imitating organisation as
being more legitimate or successful (DiMaggio and Powell, 1983, p152). Collins refers to this as "status" emulation. Would-be professions model themselves on established professions which have successfully protected their members from market competition (1990, p25).

The formation of the ICAA could be seen as an example of mimetic isomorphism in that the founders of the ICAA sought to imitate its UK counterpart, the ICAEW, by gaining a royal charter. The Scottish precursors of national professional accountancy associations were themselves styled after the legal profession (Carr-Saunders and Wilson, 1933, p209). The affinity of the ICAA with the ICAEW is evidenced by its application for a charter which was virtually identical to that of the ICAEW. The ICAEW was granted its charter on May 11, 1880 (Howitt, 1966, pxi) and by the turn of the century had established itself as a source of some authority and influence in the development of corporate and related legislation. Examples of this include the inclusion of a member of the ICAEW on the Board of Trade's departmental committee to review the Companies Acts of 1862-1890 appointed in 1894 (The Accountant, 1895a, p411). A past president of the ICAEW gave evidence before the Board of Trade's departmental committee on behalf of the London Chamber of Commerce (The Accountant, 1895b, p750).

A further example of mimetic isomorphism is the decision to develop an Australian conceptual framework for accounting, an idea obviously derived from attempts by the Financial Accounting Standards Board (FASB) to develop such a conceptual framework. However, the idea of a conceptual framework or theoretical core was not novel. The FASB itself appears to have imitated other professions or groups in its decision to develop a conceptual framework.
Perhaps because accounting in general and financial statements in particular exude an aura of precision and exactitude, many persons are astonished to learn that a conceptual framework for financial accounting and reporting has not been articulated authoritatively (FASB 1976, p2).

This perception of the need for a conceptual framework appears to have origins in the notion of what constitutes a profession. Goldstein considers that the key to controlling a field of knowledge is an intellectual core that raises those who possess that particular core "... above mercantile concerns ... to become a kind of secular analogue of the clergy" (1984, p175).

Both the Australian and USA conceptual frameworks appear to be based on a desire to increase the efficiency of the standard setting process. The FASB defined a conceptual framework and its purpose as

... a constitution, a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and financial statements (1976, p2).

Similarly, Release 200 stated that the Ministerial Council had directed the newly created ASRB to sponsor and encourage the development of a conceptual framework for accounting in Australia

... since without such a framework the Board would not be able to ensure that approved accounting standards were logically well developed and consistent with each other (ASRB, 1985a, paragraph 3.2)

Moonitz (1974) and Miller and Redding (1988) support the view that a conceptual framework is directed towards improving the standard setting process. According to Moonitz, the lack of a conceptual framework would result in pronouncements issued by the FASB being inconsistent, incomplete or vague which, in turn, would allow
special interest groups to exploit loopholes in standards (1974, p84). The basis of Miller and Redding's argument is that a conceptual framework provides a "global view" of accounting as well as defining basic terms. This means that accounting issues do not need to be handled on an ad hoc basis as the need arises. An ad hoc approach, particularly when a controversial issue is involved, results in inconsistencies and contradictions in standards as compromises may be made in order to accommodate the needs of particular interest groups or because, as the composition of the standard setting board changes overtime, different viewpoints will be encompassed in accounting standards (1988, p24).

The extracts from the FASB and from Release 200 also suggest that conceptual framework projects are seen as a means of legitimising not only accounting standards but also the profession's domination of the standard setting process. When viewed in context of events occurring in corporate regulation at the time conceptual framework projects were considered in both Australia and the USA, it is difficult to avoid the conclusion that these projects were defence mechanisms aimed at maintaining accountancy's position within the regulatory framework.

The FASB's predecessor, the Accounting Principles Board (APB), was disbanded, in part, because of its inability to formulate the basic postulates and principles of accounting. Moonitz argues that the lack of such a conceptual framework frustrated the work of the APB (1974, pp83-84). Some of the difficulties the APB encountered in its standard setting activities will be discussed in Chapter 5. Similarly, the Australian profession, through its research arm, the Australian Accounting Research Foundation (AARF), initiated a conceptual framework project around the time of the establishment of the ASRB. As will be discussed in subsequent chapters, this move on the part of the Federal Government, had the potential to remove from the profession control of the standard setting process.
Research by Hines supports this view (1989). On the basis of an examination of studies of conceptual framework projects undertaken by authors such as Peasnell (1982), Hopwood (1988) and Agrawal (1988), Hines concluded that conceptual framework projects in the UK, USA, Canada and Australia were strategic manoeuvres aimed at not only legitimising accounting standards but also the status and self-regulation of the accountancy profession (1989, pp85-89). Even if the projects were technical failures, undertaking them created the impression that the profession had "... a coherent differentiated knowledge base for accounting standards" (p85).

A further example of mimetic isomorphism relates to the adoption of accounting practices incorporated into formal accounting standards. There is an increasing trend for harmonisation of accounting practices throughout the world and Australia is part of this process. Australian accounting standards include a statement regarding the compatibility of the particular standard with international accounting standards. In addition, it is not unusual for Australian accounting standards to closely follow standards issued in other countries, in particular, the USA. While the growth in multinational corporations suggests that harmonisation is desirable, adopting practices already elevated to standard status in other major countries can be seen as a bid for legitimisation. In addition, it should not be forgotten that corporations are also part of the regulatory organisation field and while corporations may be dependent on accountancy, corporations can also be a potent source of dissidence and resistance. The result is that mimetic isomorphism can readily be seen between corporations and accountancy. The fact that particular practices are widely used by corporations in the absence of an accounting standard is often used as a reason for the adoption of those practices in subsequent accounting standards. The chapter dealing with the development of the foreign currency standard will show that the Australian exposure drafts and the eventual accounting standard dealing with this issue were explicitly based on standards developed in the USA and Canada which in turn reflected
accounting practices in common usage by corporations in those countries and, coincidentally, in Australia.

(c) **Normative Isomorphism**

Normative isomorphism is usually associated with professionalisation, in particular, the emphasis on formal education and training and the claims to a body of esoteric knowledge which cannot be completely codified (Clegg, 1989, p229; DiMaggio and Powell, 1983, p152).

Professional associations often play a significant role in the determination of the content of specific educational programmes. In Australia, the ICAA and the ASCPA impose minimum requirements on subject content for accountancy programmes in Universities. Universities failing to satisfy these requirements are not accredited by the professional bodies. In a world where student numbers are essential to funding, accreditation is often necessary to survival of accountancy departments because students wishing to qualify for admission to either of the peak professional associations must complete specified accredited subjects. In this way, the professional associations are in a position to instil in students specific ideas which become recognised norms or, in other words, are institutionalised. Accounting graduates take these views with them into the organisations that employ them and the process continues.

Ongoing professional training re-enforces this tendency. Graduates wishing to progress through the ranks of the professional associations are required to undertake additional study prescribed and, in general, offered by the professional associations or delegates. Progression through the level of the professional associations also requires specific work experience for specified minimum time periods. Through mechanisms
such as these, there is a propensity for accounting and related activities across organisations to become similar and remain so.

This process of formal education and training also helps re-enforce the myth that accounting professionals, duly educated and trained, are the obvious choice to undertake work of an accounting nature including the development of accounting standards. However, formal education and training does not mean that accounting can be completely codified. There must always be room for the exercise of professional judgment. In accounting, the argument goes, that no two corporations are the same and even within corporations, similar transactions should not necessarily be accounted for in the same way. One of the ways in which the professional associations have institutionalised this view is the concept of materiality which according to Australian Accounting Standard 5 - *Materiality in Financial Statements* (AAS 5) is

... an overriding concept which governs not only preparation and presentation of "financial statements", but also the applicability of Statements of Accounting Standards. Unless explicitly specified otherwise, a Statement of Accounting Standards (or any of its individual provisions) needs only to be applied where it will have material consequence (paragraph 2).

Approved accounting standards each have a materiality clause which provides that an item is material if

... its omission, non-disclosure or mis-statement is likely to affect economic decisions or other evaluations made by users entitled to rely on the accounts or group accounts (eg. AASB 1012 paragraph .05).

Professional judgment is required in determining whether an item is material in a given situation. Many standards provide for alternative accounting treatments of similar transactions under specified circumstances. For instance, under AAS 20 - *Foreign
Currency Translation and its approved counterpart AASB 1012: Foreign Currency Translation, the financial statements of foreign subsidiaries are translated using either the current rate method or the temporal method depending on whether the subsidiary is independent of the holding company (self-sustaining) or is nothing more than an extension of the operations of the holding company (integrated). The standards provide guidelines but these are usually qualitative rather than quantitative so that professional judgment is essentially subjective.

The Corporations Law recognises that accounting standards are not applicable to all companies at all points in time. Section 284(2) states

Accounting standards may be of general or specially limited application and may differ according to differences in time, locality, place or circumstance.

This approach is not uncommon and is part of a strategy aimed at creating an aura of mystique or indetermination around a profession. If knowledge can be reduced to a set of mechanical processes to be applied in all circumstances, it loses its sense of esoteric knowledge. Any person who has the ability to learn these steps can undertake the work and the area is no longer one where exclusive practice can be claimed. As Larson has observed

... the "best" cognitive basis for a monopoly of competence is one which reveals, or activates, or maximises the favourable characteristic of a professional. It must be specific enough to impart distinctiveness to the professional "commodity"; it must be formalised or codified enough to allow standardisation of the "product" - which means, ultimately, standardisation of the producers. And yet it must not be so clearly codified that it does not allow a principle of exclusion to operate: where everyone can claim to be an expert, there is no expertise (1977, p31).
This study will argue that flexible, vague and ambiguous standards are a result of the accountancy profession's determination to maintain domination of the standard setting process and ensure the employment prospects of members of the professional associations in areas of the preparation and audit of external financial reports. This approach is adopted at the expense of relevant and reliable financial reports. Similarly, formal education and training programmes instituted and mandated by the professional associations are geared towards engendering certain attitudes in future members of the profession and, thereby, future employers and guaranteeing the reproduction of these views over time. In this way, accounting has become what Jamous and Peliolle term a self-perpetuating system (1970, p116).

(iii) Facilitative Circuit

Facilitative power at the level of system integration can be seen in terms of domination. This is the level at which innovation in techniques of discipline and production introduce possibilities for the empowerment or disempowerment of organisations or agents. Innovation may arise from institutional isomorphism or competitive ecological pressures (Clegg, 1989, p232) that have the potential to alter existing power relationships (p234). For example, by gaining charters, the ICAEW and ICAA sought to improve their competitive position in the struggle for domination of work of an accounting nature. Two related strategies were used to achieve this. First, the claim to a body of esoteric knowledge, as evidenced by a high standard of education and training, and, second, imitating established professions such as law and medicine by the formation of a professional association.

Discipline in this framework is not used in the Foucauldian sense as "hierarchical observations, normalising judgements and examinations" (p232). Instead, discipline is viewed more in terms of "rationalised obedience" and is inseparable from the concept of production in that power produces power (p232). Using the ICAEW and ICAA as
examples once again, gaining a charter gave members a certain status in society whereby they were recognised as qualified accountants by the initials they were able to place after their names. Status gave the profession a vehicle for market closure or at least partial market closure and market closure re-enforced the status of the ICAEW and the ICAA and its members. However, achievement of this status meant certain educational and ethical requirements had to be met and maintained. Education, status and market closure may thus be seen as interrelated power mechanisms.

In Australia, approved accounting standards have the force of law. The two major professional associations dominate the standard setting process. Hence, the professional associations dominate the methods used to produce statutory external financial statements as well as non-statutory financial statements prepared by members of the professional associations.

This level provides the greatest potential of all the circuits to introduce uncertainty and instability into the model because it introduces opportunities to disrupt and/or replace existing standing conditions in the episodic agency circuit and also provide conditions for the refixing of the obligatory passage points in the dispositional power circuit. On the other hand, this level of power can be used to reproduce existing power relations in the other circuits.

Lockwood sees system integration in terms of orderly and conflictful relationships between the parts of a social system (1964, p245). Conflictful relationships or competitive ecological or institutionally isomorphic pressures have the potential to change existing standing conditions and obligatory passage points and may arise from what Lockwood terms a "lack of fit" of the existing institutional order with its material base (p252). In the context of the present study, institutional order may be seen as the rules of practice, membership and meaning that permit the accountancy profession to dominate both work of an accounting nature and the standard setting
process. The material base could be seen as the public interest which accounting is supposed to protect through the regulation of external financial reporting, or more specifically, the objectives of general purpose financial statements as set out in SAC 2.

The conflictual relationships or "tensions" may arise from either endogenous or exogenous sources and may trigger defensive activities or "compensating measures" within both the level of system integration and social integration (Lockwood, 1964, p252). If the defence mechanisms are successful, existing obligatory passage points and the relationships of meaning and of membership which they determine, will remain intact. This does not necessarily mean that the features of the organisational field will be unchanged. In order to maintain the existing institutional order, it may be necessary to create new organisational forms but the processes of institutional isomorphism will tend towards the creation of organisations similar to those already in existence, that is, with the same or similar rules of practice, of membership and of meaning (Clegg, 1989, p233). Hence, change in the organisational field through, for example, the creation of new organisations, may be acceptable to the existing organisational field because the status quo will appear to be changed when, in fact, it has been maintained.

It is possible to identify all of the moments of translation at this level of the power circuits as groups respond to change and challenges to their dominance in a particular area. Problematisation is evident at this level and will be demonstrated later in this chapter by showing that accounting evolved and developed in response to environmental and economic changes (competitive ecological pressures) over time even before the formal establishment of professional accounting associations (institutional isomorphism). These changes meant that with the increasing complexity of commercial life, the importance of accountants also increased. This provided the vehicle by which accountants, using strategies of problematisation, interessement, enrolment and mobilisation, were empowered to determine appropriate accounting
practices and apply them. It also provided the grounds for the application for a charter by the first national professional accountancy association in England.

The formation of national accountancy professional associations, as opposed to the evolution of accounting referred to above, could itself be attributed to forces at the facilitative level of power which may be due to both institutionally isomorphic and competitive ecological pressures. The formation of national or peak accountancy professional associations is also evidence that tensions or conflictful relationships do not have necessarily negative effects. The tensions created in the nineteenth century by the increasing complexity of commercial life gave rise to the "problem" identified by the founding members of the ICAEW that accounting work could and was undertaken by unqualified people. The 1879 charter application clearly suggests that the public interest would be served by such work being undertaken only by those with the necessary qualifications "... to secure for the community the existence of a class of person well qualified to be employed in the responsible and difficult duties often devolving on Public Accountants" (cited by Howitt, 1966, p21).

A not so altruistic reason for the formation of the ICAEW, and the ICAA and ASCPA, for that matter, is that achievement of an agency relationship requires effective organisation. The drawing together of a number of smaller professional associations into one large organisation could well enhance the success with which alliances and agency relationships are achieved. Strategic activities such as these could be seen as mobilisation. The recent One Voice unification campaign of the ICAA and the ASCPA was based on a similar premise that one unified professional association would generate more respect from the government and thus be more effective than two separate associations. As will be discussed in Chapter 3, lack of unity within the profession was a major factor in the long delay in the achieving of a Royal Charter for the public accountants of Australia.
Accounting has continued to respond to changes not only for the benefit of the recipients of the output of accounting but to maintain its role in society. This has often meant the creation of even more organisations within the accounting network. The formation of research groups and standard setting boards are examples. The creation of some of these organisations, for example, the AARF and the ASRB, will be discussed in detail in subsequent chapters. In keeping with the underlying premises of the facilitative level of the framework, this process led to the creation of new organisations, that is, bifurcation.

This study maintains that the purpose in establishing these various committees and boards was in response to criticism of the profession which may have ultimately led to a vesting of the determination of accounting standards in an organisation other than one appointed by the profession. The failure of the profession to enforce its own accounting standards led to the establishment of the ASRB in 1984. The ASRB initially was seen as an independent standard setting body and in this sense, the rules of practice or obligatory passage points of the standard setting process were altered with a corresponding change in the standing conditions in the episodic power level. However, the process of institutional isomorphism saw a near end to this when the ASRB was merged with the Accounting Standards Board of the AARF in 1988. The profession was, once again and now formally, an obligatory passage point in the determination of accounting standards. In fact, its position was strengthened because standards promulgated by the ASRB have statutory backing and must be complied with.

As the foregoing indicates, the circuits of power framework has three distinct but related levels, episodic agency, dispositional and facilitative. Each level is characterised by agency and organisation. Power can be seen to be exercised at the episodic agency level but achievement and maintenance of this position requires a stabilisation of standing conditions at this level. This in turn depends on stabilisation
of control of obligatory passage points or rules of practice that provide the context for interpretation of rules of membership and of meaning which both the dispositional and facilitative circuits must pass through. Achievement of power at the episodic agency level by establishment of obligatory passage points is the result of a translation process of problematisation, interessement, enrolment and mobilisation at the dispositional and facilitative levels.

The fifth stage of the translation process, dissidence or resistance, is introduced by exogenous and/or endogenous factors arising from innovation in techniques of discipline and production at the facilitative level. These factors have the potential to disrupt power relationships at both the dispositional and facilitative level and through these, the obligatory passage points which enable the exercise of power at the episodic agency level. However, once established, it is unlikely that dissidence or resistance will result in radical change in an organisational field. New organisations may be introduced to the organisational field but these will tend to have similar rules of practice, of meaning and of membership so that obligatory passage points and standing conditions at the episodic agency level will remain essentially unchanged.

This study argues that the accountancy profession has used this approach to achieve and maintain hegemonic domination of accountancy work and the development of appropriate accounting practices including accounting standards.

The following section will outline the concept of autopoiesis as an explanation of the ability of the profession to achieve system closure and effectively self-perpetuate its existence.
AUTOPOIESIS

The term autopoiesis was derived by Maturana and Varela to explain living systems which recursively reproduce themselves (1988). The original theory was established in the discipline of biology where the living systems under analysis consisted of cells and organisms. These cells and organisms were said to be operationally or organisationally closed in that they produced their own boundaries, processes, structures and all other elements needed for existence (Maturana & Varela, 1988, p46; Bednarz, 1988, p59). Autopoiesis occurs where the elements produced recursively reproduce the system itself.

While autopoietic systems are organisationally closed, they are, at the same time, cognitively open (Maturana & Varela, 1988, p95). In other words, the autopoietic system does not exist in a vacuum "... it ... is born in a particular place, in a medium that constitutes the ambience in which it emerges and in which it interacts" (p95).

In order to survive, the cells and organisms have to be compatible with their environment. Compatibility is determined by what Maturana and Varela term structural congruence or coupling in that there must be congruence or compatibility between the structures of the autopoietic system and the structures of its environment (p95). If this compatibility ceases to exist, the autopoietic system also ceases to exist. This is not to say, however, that the environment actually has any input to the autopoietic system or vice versa (Luhmann, 1986). The system is autonomous and, as such, specifies its own rules, laws and its very existence (Maturana & Varela, 1988, p48; Luhmann, 1988a, p15). The environment can trigger changes in the autopoietic system but the system itself will determine what changes actually occur within its structure (Maturana & Varela, 1988, p95). Any changes which do occur are aimed solely at maintaining autopoiesis (p99).
There have been a number of attempts to extend the concept of autopoiesis to social systems in general (e.g. Luhmann, 1986; Bednarz, 1988; Mingers, 1989) and particular social systems such as law (e.g. Teubner, 1988a, b; Luhmann, 1988a, b) and accountancy (Robb, 1991). The attempt to extend the notion of autopoiesis is fraught with difficulty and has led writers such as Robb (1991), Lempert (1988), Kennealy (1988) and Mingers (1991) to suggest the need to speak of "virtual autopoietic systems" (Robb, p218) or apply the concept in terms of metaphor (Mingers, 1991; Lempert, 1988; Kennealy, 1988). A way out of this dilemma has been proposed by Luhmann (1986, p172-173) who has developed a multi-level approach whereby the upper level consists of a general theory of self-referential autopoietic systems while the lower levels comprise psychic systems, living systems and social systems. This approach overcomes one of the major difficulties of applying autopoiesis in a biological sense by divorcing human actions from the concept of autopoiesis in social systems. The difficulty lies in characterising an autopoietic system as autonomous. If a social system is autopoietic, it is by definition, autonomous in that it creates its own boundary, components, reality and rules. Creation of humans lies in the biological system and thereby, humans cannot be a component of a social system.

To overcome this difficulty, concepts of cognition, conversation, meaning and communication have been adapted to explain the interaction between components of a social system and also between a social system and its environment. Maturana and Varela refer to cognition as "bringing forth of a world" or as an "effective action" that will facilitate the continued existence of a living being within the environment in which it has established itself (1988, pp28-30). Cognition, used in this sense, can be seen as thought processes and is linked with knowledge or ways of knowing how to survive or conserve structural coupling (p174).

Communication is the means by which social systems achieve and conserve their autopoiesis. It is the coordination of behaviours (Maturana and Varela, 1988, p193).
However, this is not to say that this coordination is in any way conscious or that it consists in the transmission of information as is commonly understood to be the process of communication. Communication is the basic element of social systems (Luhmann, 1986, p174). It is created by the system, exists only within the system and is self-referential (Luhmann, p175). Robb terms communication as "the use of meanings in linguistic interactions" (1991, p219).

Interaction within a social system is via communication (Teubner, 1988a, p3) or communicative acts (Robb, 1991; Luhmann, 1988a, b; Bednarz, 1988) rather than through physical forms of interaction. Communication is thus the basic element of an autopoietic social system (Teubner, 1988a; Luhmann, 1988a, b; Robb, 1991).

Robb (1990) has extended the idea of communication in social systems to include conversation. Communication still has all the properties listed above but, in line with Pask's (1980, p.144) view of communication, is further seen as the "... sending of signals between participants ..." (Robb, 1991, p219). The signals sent between participants are the result of conversation which is defined as "... the medium of social integration" (1990, p23) and "... the mechanism of conflict resolution" (p15). Robb uses conversation in terms of the creation of shared meanings within the cognitive domain (1991, p219). Conversation is, therefore, contextual. Meanings are also contextual with the result that the creation of new meanings depends on the existence within the cognitive domain of already shared meanings such as terms, definitions, assumptions, intuitions and rules (p219). As indicated, the view adopted by Robb is based on the interpretation placed on the term "conversation" by Pask. For Pask, shared meanings or concept sharing implies agreement or consensus (1980, p147) which Pask maintains is arrived at through "commanding and obeying or questioning and answering" (p144). In this sense, conversation is a process of conflict resolution (p151). The means by which concepts are shared include requests, commands and persuasion (p147). Concepts can also be seen as skills such as...
knowing how to perform specified tasks or understanding rules such as geometry (p147).

Communication is essential to conservation of autopoiesis because it calls forth further conversation which, in turn, founds new meanings to be communicated. This process of conversation, meanings and communication within the cognitive domain of the autopoietic system may cause boundary, structural and component changes within the system, it may even extend the boundaries of the system but these will only be contextual changes designed to maintain autopoiesis.

This interpretation of conversation and communication is the key to the application of autopoiesis to social systems. For example, Luhmann describes autopoietic social systems as meaning-using systems to distinguish them from living autopoietic systems (1986, p173). This is similar to the approach adopted by Robb who argues that social systems are not "assemblies of human individuals" but are systems of shared meanings (1991, p219).

**Autopoiesis and the Accountancy Profession**

As indicated above, a major difficulty in applying the concept of autopoiesis to social systems such as accountancy is that autopoietic systems only produce themselves and use elements created by the system to reproduce the system. Humans do not recursively produce and reproduce themselves and, therefore, cannot be part of an autopoietic system. They can, however, be part of the environment within which the autopoietic system exists. Systems created by humans also cannot be part of an autopoietic system because they have not created themselves. Mingers refers to systems designed by humans as heteropoietic (1989a, p164). Allopoietic systems produce something other than themselves (Robb, 1991, p216; Mingers, 1989a, p164).
Heteropoietic and allopoietic systems can also be part of the environment in which autopoietic systems exist.

Robb states, however, that autopoietic systems can also be allopoietic systems (p216). Autopoietic systems are organisationally closed but cognitively open so that they import energy, information and material. These imports may be transformed by the autopoietic system to create something other than the components and structures which make up the system. In this way, the autopoietic system exports energy, information and material (p216). In this sense, professional accounting associations, research and standard setting boards, conceptual framework projects and accounting and auditing standards can be seen as the output of accountancy as an autopoietic system.

On the other hand, accountancy may be viewed as an autopoietic system by using autopoiesis as a metaphor or to abstract from the allopoietic and heteropoietic systems and view accounting and auditing standards, conceptual framework projects and even professional associations as forms of communication and organisation. In Robb's view

An autopoietic social system is one in which meanings arise from conversations and are acted upon through communication and in which that communication gives rise to conversation to form new meanings (italics in original) (1991, p220).

This is not inconsistent with the circuits of power framework in which Clegg makes it clear that achievement of power depends on effective agency and organisation but that this need not necessarily be human "... agency is not a generic term for people; it may well often refer to collective forms of decision-making, such as organisations" (1989, p187).
Collective forms of decision-making arising from agency relationships and alliances, problematisation, interessement, enrolment and dissidence and resistance occurring within the circuits of power will be interpreted as communication or communicative acts for the purposes of this study. This, of course, does not overcome all of the difficulties in applying autopoiesis to accountancy. Other difficulties will be addressed in discussion dealing with determination of the boundary of the accountancy system and its interactions with other systems within its environment including society which will be viewed as the overall system within which accountancy exists.

One point which should be made clear at this point is what autopoietic system is being considered. It was pointed out earlier, in terms of the circuits of power framework, that the focus of this study is corporate regulation. In the context of autopoiesis, this is also the relevant environment in which accountancy as an autopoietic system exists. In keeping with the previous discussion as to the other participants in the field of corporate regulation, the elements sharing the regulatory environment with accountancy include the legal profession, State and Federal Parliaments as representatives of the public interest, regulatory authorities and corporations.

Because accountancy derives its statutory power to develop and approve accounting standards from the government, it could be argued that it is a part of the legal system constituted by acts of parliament. However, it is contended here that accountancy imports only its powers from acts of parliament. Its output or conversation and communication in the form of accounting standards are developed within the autopoietic system. As an autopoietic system, it is cognitively open and is responsive to triggers from other elements in the system including the law and corporations, if such responses are necessary to its survival. In this sense, it may also import information such as reactions to proposed standards or perceived needs for standards on particular topics.
The Boundary of Accountancy

If an autopoietic system creates itself as well as all the elements which make up the system and relationships between them, the questions must be answered as to how, where and when a particular autopoietic system emerged. Teubner (1988b, p223), Luhmann (1988a, p26) and Maturana and Varela (1988, p40) shed some light on how these questions may be answered. Teubner, for example, maintains that the products of a system and even the processes which produce the products can exist initially in the absence of a completely autopoietic system. The recursive reproduction of the system by its own productive processes is one indication of the emergence of an autopoietic system.

Maturana and Varela identify an autopoietic system as a unity created by an act of distinction. In other words, the system takes on an identity separate and distinct from its environment. It, therefore, has a boundary created by the system within which it produces the other components of the system. Maturana and Varela describe a boundary as a membrane which "... not only limits the extension of the transformation network that produced its own components but it participates in this network" (1988, p46).

The unity thus created can be said to be self-determined. To be autopoietic, the system must also be self-reproducing or self-referential, that is, it refers to itself in the reproduction of its elements (Luhmann, 1988a, p26). The act of distinction implies the system and the function it performs is unique or, in Luhmann's terms, the system has "exclusive orientation to a function" (p26). System unity extends beyond the determination of the system to the final elements and processes which the operations of the system combine (p14).
Accountancy appears to meet these criteria to a certain extent. Some of the products of accountancy, for example, double entry bookkeeping, which Baecker (1992) argues is a self-referential system, audited financial statements, bankruptcy and liquidation work and cost accounting, existed before accountants attempted to achieve exclusive practise of these functions. Indeed, prior to the mid-nineteenth century, accounting in Scotland, which has been designated the place of origin of the accountancy profession, was seen as a sub-set of the law (Carr-Saunders and Wilson, 1933, p209).

By forming professional associations, accountants endeavoured to not only separate the practice of accountancy from the law but also to ensure that only those with the requisite training undertook work of an accounting nature. However, there are a number of professional accountancy associations representing different branches of accountancy or types of accounting practice. Membership of a professional association is not necessary to undertake many aspects of work of an accounting nature. In the absence of one definitive professional accountancy association or statutory recognition, of what constitutes a "professional" or "qualified" accountant, for example, an accountant's registration board, it is difficult to see the boundary of accountancy. The extension of accountancy into activities such as management consultancy services and information systems compounds this difficulty.

This difficulty is not insurmountable. Robb suggests looking at systems where it is difficult to distinguish a boundary as "virtual" autopoietic systems or thinking of them "as if" they are autopoietic systems (1991, p218). The distinguishing element will be the presence of mutual causal feedback loops which must exist and be organisationally closed so as to sustain autopoiesis. Similarly, Luhmann talks of partial systems where there is not a complete differentiation between the system in question and its environment.
Indeterminacy in that which belongs to a system always means incomplete differentiation, or in other words dependence on an overall social basis of operation which is not ordered as the difference between partial system and environment (1988a, p26).

Accountancy, and in particular, the regulation of corporate financial reporting, does not operate in isolation from the rest of the regulatory framework. In Australia, the provisions of the Corporations Law requiring the audit of financial statements and the true and fair view prescription which now extends to compliance with the provisions of the Act and Australian accounting standards, means the accountancy profession is, in part, dependent on the law for its existence and legitimacy. The law itself must operate within the confines of society as a whole as must accountancy.

Nonetheless, the accountancy profession through the AARF and the AASB does perform a unique function in that it dominates the determination of accounting practices. Mutual feedback loops between the system and its environment are evident in the events which trigger the decision to develop a standard dealing with a particular accounting practice and also in the mechanisms whereby the standard is developed, modified and ultimately issued and becomes operative.

The process does not cease once the standard is formally issued and operative. The impact of the standard is monitored and, if necessary, the process of development and modification are re-instituted. Even if the standard is not subject to question or modification, the feedback loops are still operative because the scope for interpretation which is built into accounting standards allows for the exercise of professional judgment on the part of the accountant advising management on the application of the standard to a particular transaction. In addition, the auditor is required to determine whether the interpretation and application of the standard is appropriate to the particular circumstances of transactions.
This interaction may extend to the legal system and regulatory authorities in the event of a dispute between the appropriateness of a particular application of a standard which impinges on the truth and fairness of the resulting financial statements. The result of all these interactions may be a referral back to the accountancy system regarding the efficacy of a particular accounting standard. Hence, there are mutual causal feedback loops between accountancy, accounting practitioners who are not part of the autopoietic accountancy system but components of its environment, the legal system, the corporate system, regulatory authorities and society in general.

**Autonomy of Accountancy**

Another element which may help distinguish the boundary of an autopoietic system from its environment and identify it as an autopoietic system is autonomy. Autonomy, in this context, means that the system is self-determined in that it produces and reproduces itself by organising itself in such a way that it alone determines what is part of the system and the relationships between its elements or components (Maturana and Varela, 1988; Bednarz, 1988; Teubner, 1988b; Luhmann, 1988b). In this, the notion of autonomy extends beyond being able to determine its own operations or self-regulation. Luhmann uses the concept of operational autonomy to describe the autonomy of autopoietic systems. Operational autonomy means that the autopoietic system makes use of its own operations to produce its own operations, that is "... they can reach forwards and backwards to operations of their own in order to produce operations of their own" (1988b, p345).

Autonomy is, therefore, essential to an autopoietic system since without it, the system would not be self-determined and self-perpetuated. This is the key difference between an autopoietic system and one which is not autopoietic (Mingers, 1989a, p166; Bednarz, 1988, p58; Maturana and Varela, 1988, p48). Luhmann describes
autopoietic systems as "sovereign" in that "[t]hey do not create a material world of their own. They presuppose other levels of reality" (1986, p174).

Achieving this requires the appropriate organisation of the components or elements of the system. Organisation establishes the relationships between the components or elements of the system. It is the organisation of the components or elements and the relationships between them which place the system in a particular classification. Mingers uses the analogy of the organisation of components and their relationships and properties which characterise or define a car (1989a, p163). Maturana and Varela use a chair to make the same point (1988, pp42-43).

A profession can be defined in a similar fashion. The attributes or identifying elements or components of a profession are often said to include a body of esoteric knowledge, a code of ethics, self-regulation and exclusive practice of a particular function. These attributes require the establishment of support mechanisms such as at least one professional association, or better still, statutory recognition such as a registration board, to identify the qualified and thereby exclude the unqualified; researchers to discover and extend the body of esoteric knowledge; academics (who may also be researchers) to impart knowledge to the would-be qualified; and practitioners to provide training facilities for aspiring professionals and also supply the professional service to the public. It is important to note here that professional associations, researchers, academics and practitioners are being used in an abstract sense not as human individuals. From the perspective of autopoiesis, these "components" or "elements" have to be viewed in terms of "meaning" or, following Robb "shared meanings":

Social systems are assemblies of shared meanings, rather than assemblies of human individuals or even the acting out of social roles as they are often defined (1991, p219).
This notion of shared meanings will be elaborated in the following discussion of the structure of the accountancy system. For present purposes, the importance of "meaning" is provided by the interpretation of Luhmann by Bednarz.

Meaning is . . . the basis upon which, or rather the vehicle by which, certain kinds of systems are organised - it is the counterpart of life in the physical domain . . . it is the basis upon which system unity is established . . . meaning is essentially a relation (italics in original, 1988, p62).

Structure of the System of Accountancy

Organisation is necessary to the autonomy of the autopoietic system because it provides the mode of operations which establish and maintain the system's autopoiesis. However, organisation is not sufficient to maintain autopoiesis. Organisation provides the characteristics of a broad classification. Structure provides the specifics which identify or specify particular characteristics of the system. Mingers, for example, extends the car analogy to specifics that make the distinction between a car as opposed to a "rusty blue mini" (1989a, p163). Hence, structure can be used to specify a particular profession such as accountancy. The distinction between organisation and structure is important. As Bednarz notes:

While organisation is necessary to establish system unity . . . structure is necessary because different domains place different demands upon system components (1988, p59).

Structure thus confers meaning on the components or elements of a system and the specific relations between them. In an autopoietic social system, structure is not a physical attribute but a process of conversation and communication (Robb, 1991, p220).
By the processes of conversation and communication, the system creates its own reality in that it does not import concepts as such from outside its own boundary (Teubner, 1988a, p9; Luhmann, 1986, p174). Instead, it takes information, material and energy from the environment. The system itself determines how these will be used. For example, accountancy has effectively created its own reality by the use of everyday terms such as assets, liabilities, income, expenses, profits and so forth and giving them specific accounting meanings determined within the system itself.

The system of accountancy takes the conceptualisation of double entry bookkeeping and the meanings developed for terms within the double entry system further by developing rules for when and how an asset, liability, expense or revenue will be recognised by the system. It determines what transactions will be recorded and which will not. In external financial reporting the purpose of these processes is classification and measurement in the balance sheet and determination of accounting profit. Some of these items are tangible, others are intangible but nonetheless given a "thinglike" quality that accounting purports to "measure". Profit, goodwill, depreciation and provisions for doubtful debts all fit into this classification. The creation of its own reality lies in part in that what accountancy sees as an asset, for example, may not be seen as such by those outside the accountancy system. The non-accountant may have difficulty in seeing how part of income tax to be paid for the current period can constitute an asset called Future Income Tax Benefit or how an anticipated foreign exchange loss can also be an asset in the same way as an item of plant, a building, inventory or a vehicle is an asset.

The structure of accountancy determines the meaning allocated to these accounting terms. The professional associations or the research groups appointed or created by them play a major part in determining the meaning attached to accounting concepts. In Robb's terminology these meanings are the result of "conversations" (1991, p220). The outcome of these conversations, meanings, are communicated to other
components of the system and also to relevant systems in the autopoietic system's environment. Responses from both within the autopoietic system and from its environment trigger further communication between the system, its components and the environment. Further conversation takes place giving rise to new meanings and the process of conversation, communication, conversation continues.

The development of an accounting standard follows this pattern and it is this pattern of conversation, communication, conversation which both identifies and maintains accounting as an autopoietic system. This pattern also explains the failure of the accountancy profession to find an agreed conceptual framework of accounting or generally accepted accounting practices as well as flexible, vague and ambiguous accounting standards. If a definitive solution could be found in the form of a conceptual framework or in explicit accounting standards dealing with particular issues, communication would stop and accounting would cease to be an autopoietic system. It would no longer have exclusive orientation to accounting work because anyone who had the ability to apply given criteria would be able to undertake work of this nature. Uncertainty in what constitutes an asset or liability in a given situation creates the necessity for professional judgment on the part of the accountant preparing the financial statements as well as on the part of the auditor. The removal of uncertainty removes the need for a professional and all the related structures which give rise to a profession. This uncertainty also provides the mechanisms for change within the structures of accountancy without altering its autopoietic organisation.

Structural Change, Communication and Autopoiesis

Autopoietic systems are organisationally or operationally closed but they are cognitively open in that they must be compatible with their environment if they are to survive (Maturana and Varela, 1988, p95). If a social system is a system of "shared meanings" (Robb, 1991, p219) and "communication" is the sending of signals to
system participants who share meanings, there must be acceptance of meanings
between participants of individual systems and relevant systems in the environment.
When meanings are not shared or accepted by all parties, even those within the system
under consideration, further communication and conversation take place to establish
new meanings. In this way the structures of an autopoietic system may change.
When one component of a system changes, there will be correlative changes
throughout the system (Maturana and Varela, 1988, p116).

Luhmann provides further refinement of the role of communication in an autopoietic
system (1988a, pp16-18). Communication is not simply the act of sending signals but
is the synthesis of information, communication and comprehension (p17). In order to
establish the boundary of an autopoietic system and maintain its autopoiesis, it is
essential to control or at least partially control the communication process as well as
determination of meanings communicated or in Robb's terminology, conversation
(Luhmann, 1988a, p18; Teubner, 1988b, p222). If reproduction of the conversation
and communication processes is to continue, the information or meanings must be
understood or comprehended (Luhmann, 1988a, p16). This is essential if further
elements are to be produced and identified within the system.

Maturana and Varela use the term ontogeny to describe the history of structural
changes within an autopoietic organisation (1988, p74-75). These changes occur as a
result of interactions between the components of the system or between the system
and its environment. This notion of change is similar to the concepts of dissidence or
resistance in the circuits of power framework which may arise from either endogenous
or exogenous sources. If the autopoietic system is to survive, it must be compatible
with its environment in much the same way as an organisation attempting to maintain
its agency relationships and hegemonic domination in the circuits of power
framework. Just as the circuits of dispositional and facilitative power at the levels of
social and system integration respectively can be both integrative and disintegrative
(Clegg, 1989, p224) as a result of dissidence and resistance, interactions between the autopoietic system, its components and environment are also double edged. Perturbations within the system and between the system and its environment have the potential to destroy autopoiesis if compatibility is not maintained. At the same time, however, these perturbations provide impetus for conversations which give rise to new meanings and may open up new avenues of communication.

Structural coupling is used to describe the recurrent interactions between the system and its environment (Maturana and Varela, 1988, p75). The changes which take place in the system as a result of these interactions are not determined by the environment but by the structures of the autopoietic system (p95). This is a two-way process in that the autopoietic system can trigger changes in the environment but cannot determine what those changes will be (p95). Furthermore, when one aspect of the system changes, there will be corresponding changes in other aspects of the system as well as in the environment (p116). There is a further rider to this concept of change. Since the operations of the system are aimed at reproducing the elements of the system and maintaining autopoiesis, change is limited. The structure may change but the autopoietic organisation remains unchanged. This is almost axiomatic because the system is organisationally or operationally closed. However, this does not mean the system cannot extend beyond its own boundaries and import concepts from other systems or its environment. It can do both through "shared meanings". For example, double entry bookkeeping made a distinction between assets and liabilities, debits and credits. As double entry bookkeeping was progressively adopted by business concerns, the meanings given to assets and liabilities or the distinction between them, became part of the language of business. As will be discussed shortly, as the nature of business changed, and with the progressive separation of ownership and management, double entry bookkeeping became accounting (Baecker, 1992). This change was facilitated in part by the law. Accounting shared its meanings with other members of the environment. It took energy from its environment and new
concepts or distinctions emerged such as permanent capital and the going concern. By these means, double entry bookkeeping extended its boundaries and progressively made the transition to accountancy. This is similar to Clegg's view of new organisations emerging at the facilitative level of the power circuit. These new organisations exhibit similar characteristics to existing organisations because of the process of institutional isomorphism.

Maturana and Varela refer to changes in the autopoietic system and the environment as a structural (1988, p102) or natural drift (p117) which is the result of adaptation and conservation of autopoiesis. This is an evolutionary process which Teubner sees as occurring through three evolutionary and necessarily communication mechanisms: variation, selection and retention (1988b). Clegg also uses these mechanisms to explain change in the configuration of episodic power capacities occurring as a result of innovation of techniques of discipline and production at the level of system integration (1989).

Teubner (following Luhmann) considers these three functions can be related to social systems as follows

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\ldots \text{normative structures take over variation, institutional structures (especially procedures) take over selection, and doctrinal structures take over retention (1988b, p228).}
\]

For Clegg variation is explained in terms of sources of difference in innovations of the techniques of production and discipline (1989, p233). In the circuits of power framework, these sources may be strategically innovated within an agency or arise independently in the environment. The major source of innovation is competitive pressure for resources (p234). Whether these sources of change result in empowerment or disempowerment depends on the position an agency has created for itself within the existing configuration of power relationships at the episodic agency.
level of the circuit. There are similarities here with Teubner's view that the change that takes place depends on whether or not the system has reached the stage of autopoiesis. If the system is autopoietic, change may be triggered from the environment but will be determined by the system itself. Similarly, Clegg maintains that where an agent controls the obligatory passage points, change will tend to result from institutional isomorphism and, thereby, will be empowering rather than disempowering (p233).

There is also similarity between Clegg's use of selection and retention and that used by Teubner. However, again, Teubner is referring to systems which have reached autopoiesis while Clegg's interpretation relies on control of obligatory passage points. Selection for Clegg lies in the selection of sources of change, arising for example, through market competition and agency and environment characteristics. Selection is at the discretion of the agency which has greatest control over available resources (pp234-236). In an autopoietic system, selection is determined by the norms, meanings, conversations institutionalised by the system itself. Retention in the circuits is the "reproduction of the selective variation" (Clegg, 1989, p235). Teubner calls it a stabilising function which guarantees system-internal mechanisms (1988b, p234). In other words, the system is self-referential in that it "remembers" past interactions and, in particular, what was successful and what was not (p234). In this way, the system learns how to survive which is essential to the maintenance of autopoiesis. It is also essential to the maintenance of hegemonic domination and control of obligatory passage points in the circuits of power framework.

**IMPLICATIONS OF CIRCUITS OF POWER AND AUTOPOIESIS**

While it is clear that an autopoietic system must be operationally closed, the system is, nonetheless, subject to change as a result of interactions within the system itself and with its environment. However, it is important to remember that the environment
does not determine what change takes place within the autopoietic system. The environment can only trigger responses which are determined by the system itself. Similarly, the autopoietic system only triggers responses from the environment.

Responses within the system and with the environment are given meaning through a process of conversation which is then transmitted by a process of communication. Maintenance of autopoiesis is contingent upon control of the processes of conversation and communication. These processes of conversation and communication must be continuous or the system will disintegrate.

The circuits of power framework explains how an organisation or agent is empowered to exercise power at the episodic agency level of the circuits framework. It also explains how this power is maintained and the likely form that change arising from dissidence and resistance in response to innovations in techniques of discipline and production. The extension of this framework to incorporate the theory of autopoietic systems demonstrates how domination and agency are perpetuated in the context of systems closure.

It is contended in this study that accountancy has used methods of translation to achieve and maintain hegemonic domination of work of an accountancy nature including the determination of accounting practices and standards. Over time, accountancy has also developed to the stage of at least a virtual or partial autopoietic system in that it determines its own boundaries, elements, components and relationships between them. It also uses its own processes to recursively reproduce itself. This is evidenced by the continual recycling of accounting issues and the continual pattern of regulatory failure-regulatory reform which has characterised the corporate scene since its inception more than 100 years ago.
Indetermination arising from flexible, vague and ambiguous accounting standards are part of this process and are essential to the maintenance of autopoiesis of the system of accountancy. This argument also extends to the lack of an agreed conceptual framework of accounting. An agreed conceptual framework would remove the necessity for accounting standards because the elements of accounting would have definitive meaning and interpretation in particular circumstances would no longer be required. In the absence of an agreed conceptual framework or the in-built uncertainty of accounting standards, conversation and communication within the system and between the system and its environment would cease. The system would also cease to have exclusive practice of the function of accountancy. Without this exclusive orientation and conversation and communication, the system would no longer be autopoietic and would disintegrate. In terms of the circuits of power framework, there would be no need for an accountancy profession to act as agents or allies for the public, corporations, regulatory bodies, users of financial statements and so forth. The whole system of professional associations, researchers, academics and practitioners would become redundant. Hence, despite the rhetoric, uncertainty in accountancy is undoubtedly here to stay - for the foreseeable future at least.

The balance of this chapter will be devoted to an overview of the origins of accounting knowledge and the manner in which it became progressively more abstract thereby laying the foundation for the accountancy profession's claim to a specialised body of knowledge and skill.

ABSTRACTION, ESOTERIC KNOWLEDGE AND DOMINATION

The first part of this section will briefly outline the origins of the occupation of accountancy and the nature of professions in general. The purpose of this historical excursion is to show how accounting evolved over many centuries and also that this evolutionary process laid the foundation for the claims to a special body of knowledge
made in the mid-nineteenth century by the emerging profession and its bid for hegemonic domination of accounting. In particular, the increasing abstraction of accounting provided the need for accountants with specific accounting training. It is also intended to show that abstraction is not a recent phenomenon. Schmandt-Besserat has undertaken extensive studies of clay tokens, envelopes and tablets dated from 8000BC (1981; 1983; 1984; 1986a, b). These archaeological artefacts are considered to represent not only an ancient recording or accounting system but also the precursors of writing and numeracy and suggest the art of abstraction clearly emerged at an early stage of human development or, to quote Schmandt-Besserat

This story, in essence, a study in the stages whereby human culture slowly, and then ever more quickly, mastered the art of abstraction, which stands as one of the peculiar marks of distinctive human consciousness (1986 b, p39).

Following this historical discussion, the attributes of a profession will be briefly outlined. The attributes identified and discussed are drawn from literature dealing ostensibly with the sociology of the professions. The purpose of undertaking this side-track is to link the process of professionalisation with the frameworks of power and autopoiesis. In other words, the introduction of a discussion of professional attributes is not meant to suggest a functionalist or trait approach to the analysis of accountancy’s bid to effect control of the occupation. This control was not premised on the value of the attributes reflected in services to society but on the basis that they demonstrated the profession’s ability to regulate the activities of members (Johnson, 1972, p45).

This part of the study will form the basis of an analysis, to be undertaken in Chapter 3, of the professionalisation processes adopted by accountants in a bid to achieve and maintain hegemonic domination of work of an accounting nature.
The Genesis of Accounting

(i) Record Keeping in Ancient Civilisations

Schmandt-Besserat provides evidence that shows the existence of the keeping of some form of accounting records from possibly as early as 8000BC (1981; 1984; 1983; 1986a, b). An extensive examination of archaeological artefacts has led Schmandt-Besserat to conclude that clay tokens and envelopes were used by ancient Middle East civilisations for accounting purposes from a time pre-dating both writing and counting (1981; 1984; 1986a, b). In fact, the transition from the use of tokens as a means of record keeping to the imprinting of tokens on clay tablets, is seen by Schmandt-Besserat as the "invention of writing" (1981, p341; 1986b, p237).

Initially, plain tokens in the shape of ovoids, spheres, disks, cones, tetrahedrons and cylinders were used from about 8000BC probably to account for agricultural commodities (1986a, p35; 1986b, p32). At this point in time, it appears the association between tokens and what they represented was readily understood by all members of the community (1984, p876). As life became more civilised around 3300BC, as evidenced by the appearance of "monumental architecture" indicative of the emergence of formal government and coercive taxation, more complex tokens were developed by the use of new shapes such as parabolas and bent coils and incised and punch markings, appliqué coils and embossing tokens with pellets (1983, p117; 1986a, p36; 1986b, p32). The more complex nature of the tokens of this time period suggest a more complex or abstract usage such as quantities of goods and measurement of land and services (1984, p875), manufactured and luxury goods (1986b, p36), types of fibres and cloth, tools, weapons and furniture (1986b, p37). The more abstract nature of the tokens meant an understanding of what they represented was limited to the "initiated" (1986 a, p36).
The practice of enclosing tokens in clay envelopes for storage purposes developed between 3300 and 3250 BC (1986a, p36-37). However, once enclosed and the envelope sealed, it was impossible to determine the content of the envelope. According to Schmandt-Besserat, "accountants" of the time overcame this problem by making an imprint of the tokens on the surface of the envelopes (1986a, p37). In time, the use of tokens enclosed in envelopes gave way to the imprinting of symbols on clay tablets (1986a, p37). Mattessich has suggested that the duality of the ancient recording system and its one-to-one correspondence between the item being recorded and the symbol representing it was in fact identical in its logical structure to the modern double entry system (1987, p80).

With the advent of counting and writing around 3200BC (Mattessich, 1987, p86) an even more abstract reality was created. As these skills were limited to the select few, usually referred to as scribes, with the necessary education or training, accounting, or more accurately at this point, record keeping, was already exhibiting operational closure (Lee, 1990, pp219-220). Keister's research confirms this (1963, p372). By reference to archaeological texts and journals, Keister found that archaeologists had recovered evidence of the keeping of commercial records in Mesopotamia (1963, p371). These records, in the form of clay tablets up to 4000 years old, record diverse commercial activities including receipts, disbursements and partnership agreements. By this time, the law required the recording of all commercial activities in Mesopotamia (including marriage). Public scribes were called upon and paid for completing this task (Keister, 1963, p372). The dependence of accounting on other systems, primarily, the law, was also clearly emerging at this time.

It appears that commercial trade between Mesopotamia and its contemporaries, saw the spread of record keeping practices to Egypt, Babylon and beyond (Keister, 1970). Accounting or record keeping continued to be used as a representation of economic
reality. The closure of accounting by the use of abstractions in the form of writing and numerals continued (Lee, 1990, p299).

(ii) The Emergence of Double Entry Bookkeeping

By the ninth century, this closure was becoming more complete with the term "accountant" coming into vogue at that time to describe those who kept records of commercial activities (Abs et al, 1978). The term had a more literal sense than what it has today, however. As Lee points out, the accountant was the object of accounting or, more precisely, the accountant's honesty, integrity, stewardship or accountability in the conduct and recording of commercial activities (1990, p300). The emergence of double entry bookkeeping provided a further abstraction of economic reality and at the same time, provided the vehicle for the separation of the accountant as a recorder of commercial activities from the person who actually undertook those activities. The records so produced were a further abstraction in that commercial activities recorded were classified as debits and credits.

In spite of the developments outlined above, and Mattessich's suggestion that the system of plain and complex tokens and clay envelopes represented evidence of an early double entry system (1987, p81), there does not appear to be any concrete evidence of how or when double entry bookkeeping emerged. However, there is some consensus that double entry bookkeeping was a product of the increase of commercial trade in mediaeval Italy (de Roover, 1978; Irish, 1968; Littleton, 1968).

Littleton identified a number of antecedents of double entry bookkeeping which, in addition to numeracy and literacy, included private property, money, credit, commerce and capital (1968, p21). According to Littleton, these elements were essential to the formation of double entry bookkeeping because they provided the material in the form of the exchange of goods for profit and credit transactions and a language in the form of money, writing and arithmetic by which to give expression to
private property, capital, commerce and credit (p22). Littleton argued that these elements were all in evidence in ancient civilisations yet did not give rise to bookkeeping (p24). The catalyst which Littleton identified for the eventual emergence of double entry bookkeeping was the crusades (p25) which saw a transition from an agricultural society to one based on trade (p26).

In the two hundred year battle for Jerusalem, there was a steady stream of armies to and from the crusades. The Italian cities, Venice, Florence and Genoa, had by this time well-established trading posts and a large fleet to conduct trade with the East and, thereby, were in a position to provide, and profit from, transport and supplies for the travellers to and from the crusades. In addition, a demand for goods from the East created the need to produce European goods for purposes of exchange with the East (pp25-26). Many of the traders of the time took advantage of this boom in commercial activity by buying goods and ships to carry them. Partnerships were also formed, not only to provide the necessary funds to finance ventures but also to allow the less adventurous to invest without the necessity of undertaking lengthy and dangerous sea voyages (Irish, 1968, p55). Finally, Littleton suggests the adoption of Arabic numerals and methods of calculation facilitated the systematisation of record keeping necessitated by bills of exchange (p28). In Littleton's opinion, double entry bookkeeping was a direct development of this process (p29). At this time, however, there was no distinction between capital and profit and little distinction between business and private affairs (Irish, 1968, p58). It should also be noted that while records may have been kept, their use was restricted to calculation of profit at the end of each venture. There is no indication that records were kept for purposes of evaluating performance. Performance evaluation appears to have been an innovation of the late nineteenth and twentieth centuries.

Chatfield (1979) and Irish (1968) maintain that changes in avenues of trade and form of business association in England also resulted in new accounting practices. Foreign
trade, in particular, saw a growth in the formation by Royal Charter of corporations such as the Russia Company, the East India Company and the Hudson's Bay Company (Irish, 1968, p59). These ventures were initially of limited duration. At the conclusion of each venture, the company was liquidated and profits and assets divided amongst the participants (p60; Chatfield, 1977, pp79-80). In time, concepts of going concern and permanent capital as opposed to revenue eliminated the need to liquidate ventures at the end of each voyage. Maintaining a permanent capital meant that accounting methods had to be adapted to distinguish between income and capital rather than simply distributing all funds on the termination of each venture. While methods of distinguishing between capital and income were required, they did not clearly emerge at this time. Ultimately, the rules for such distinctions were determined over time by business practice and by the courts (Irish, 1968, p63). Nonetheless, record keeping was thus becoming more complex and, at the same time, an increased need for accounting records was occasioned by the growing separation of management and ownership. As yet, however, financial statements, separate from the accounting records, were not prepared (pp60-61).

The Industrial Revolution further contributed to the evolution of accounting practices and the role of the accountant in society. This time in history saw the birth of factory-based industries with concomitant developments in management accounting, in particular, accounting for materials, wages and overhead costs (Lee, 1990, vol 2, pp1-2). The Industrial Revolution and the accumulation of capital from a number of sources to take advantage of the developments in technology occurring at this time made freedom of incorporation a necessity (Irish, 1968, pp61-62). However, incorporation to this time was a privilege granted by Royal Charter.

In 1844 the Joint Stock Companies Registration and Regulation Act provided for general incorporation but this right was granted on the basis that accounts be kept, balanced and annually audited and published. The intent of this legislation was, inter
alia, to provide a means by which directors and management would be made accountable for their actions and also to provide to investors and creditors information on the state of affairs of the company (Select Committee on Joint Stock Companies, First Report, pp v, vi, 5). The 1856 Joint Stock Companies Act extended the 1844 Act by granting limited liability to corporations even though the 1855 Act had made the account and audit provisions optional. By the turn of the century, however, the account and audit provisions again became a part of the mandatory provisions of the UK legislation and along with it, opened the way for an emerging profession to lay claim to the domination of the account and audit provisions. However, even before this time, bankruptcy legislation had laid the foundation for the need for accountants to become formally organised.

The development of double entry bookkeeping can be seen as integral in the evolution of the modern limited liability corporation. This, of course, is not to say that the modern corporation would not have evolved without double entry bookkeeping. Rather, it would probably be more appropriate to say that the two were complementary developments. The importance of the emergence of double entry bookkeeping is that it provided a means of recording the activities of business entities and determining the consequences of those activities.

Baecker sees double entry bookkeeping as a self-referential system (1992, pp164-165). It makes a distinction between assets and liabilities, debit and credit (p163). The rules of the system require that for every debit there must be a credit. This provides for a check on the accuracy of the recording process but also a means of viewing assets as liabilities and vice versa (p163). The system is self-referential because the system determines what transactions will be recorded (p160) and corresponding debits and credits are not determined by anything outside the recording system (p164).
Double entry bookkeeping, by making a distinction between debits and credits, facilitates the separation of the business entity from ownership interests. This arises because the duality of the system provides a way of making a distinction between cash or wealth that the entity can use for trade or other purposes and capital or wealth as a liability to the ownership of the business entity (p169). It is at this stage that double entry bookkeeping becomes accounting by the further abstraction of the system to financial statements representing the consequences of the activities of the business (pp161, 169). In this sense, accounting is a means of structural coupling between business and ownership.

As indicated above, the development of double entry bookkeeping and the evolution of the business entity, separate and distinct from ownership interests, appear to have occurred in tandem. This process appears to have been facilitated by the emergence of shared meanings in that overtime, the principles of double entry bookkeeping became part of business language and practice (p165). In other words, there was a process of conversation and communication. Meanings developed by the double entry system were shared with business. Mutual feedback loops developed between double entry bookkeeping and business and further concepts, such as going concern and permanent capital, emerged. Triggers in one system gave rise to responses in the other and vice versa.

(iii) The Emergence of the Accountancy Profession

Dependency on accountants and operational closure of accounting through the construction of reality in its own unique terms continued with not only the spread of trade and double entry bookkeeping but also with the dissemination of knowledge of the double entry system through publication of bookkeeping texts. The first known book dealing with double entry bookkeeping was published by Pacioli in Italy in 1494. In 1683, a treatise on double entry bookkeeping was authored and published in Scotland (Parker, 1974, p358). While the invention of the printing press made
possible ready access to bookkeeping texts and thus reversed the closure of
accounting by its increasing abstraction, reading and writing were still largely skills
held only by an educated elite (Lee, 1990, p301-302).

However, literacy, numeracy and record keeping were not skills confined to
accountants. Similarly, diligence and honesty, accuracy and orderliness, foreign
exchange calculating, negotiation and arbitration and agency which by the eighteenth
century were seen as skills or traits of accountants, were also considered to be
applicable to other occupations (Hines, 1989, pp75-76). Hence, even though an
accountancy reality had been created and, thereby, a client and societal dependency
upon accountancy skills, the practice of these skills was being undertaken by any
person who could read and write and wished to designate themselves an accountant.
In other words, there was competition over work of an accountancy nature.
Accountancy did not control the obligatory passage points at this time. It lacked
organisation and even though, by implication, it considered itself to be in an agency-
type relationship with those in need of the expert knowledge and skill of accountants,
this relationship was not formally recognised.

Walker (undated) presents evidence to support this. For example, evidence reported
by Walker shows that accountants represented the majority of professional trustees in
Scotland in the mid-eighteenth century and that 75 per cent of bankrupt estates were
managed by professional trustees (p20). Minority participants in this area included
lawyers, bankers and merchants. When legislation was proposed in 1853 which
would have placed the management of bankrupt estates in the hands of the courts
(p16), these minority groups were occupationally organised through professional
associations to protect their interests (p21). The accountants, on the other hand,
lacked such organisation. In Walker's view, it was the threat of the removal of the
administration of bankrupt estates which mobilised the accountants of Edinburgh and
Glasgow to become formally organised (pp21, 26, 35). Having formed professional
associations incorporated by Royal Charter, the accountants launched what could be termed an associative strategy to form alliances with the legal profession and merchants of Scotland to defeat this legislation on the basis that it was proposed by a committee from London and was, thereby, a reproach to Scottish nationalism (p28-34). This combination ultimately saw the defeat of the legislation (pp34-35).

The formal establishment of professional accountancy associations can be seen as taking place within the facilitative circuit at the level of systems integration. In forming professional associations incorporated by Royal Charter the Scottish accountants of the time were using mimetic institutional isomorphism by organising themselves along the lines of the legal profession (Carr-Saunders and Wilson, 1933, p209). The English associations appear to have followed the lead of their Scottish counterparts and in 1886, the Incorporated Institute of Accountants of Victoria was formed in Australia. One of the foundation members, Thomas Brentnall, stated specifically that the decision to form a professional association and thereby raise the status of practising accountants was influenced by the achievements in this regard of the ICAEW, the Society of Accountants and Auditors and the three Scottish Institutes (Brentnall, 1938, p64). The decision to apply for a Royal Charter was similarly motivated (Editorial, 1905, p4). As Collins notes, emulation of older professions in acquiring privileges and status is not an uncommon strategy (1990a, p25). It appears the accountants in Scotland perceived the benefits of organisation accruing to the legal profession and merchants in protecting their interests in the face of legislation damaging to their livelihood and took appropriate action to allow them to initiate a counter attack. Hence, emulation of the legal profession and merchants was not only appropriate but advisable. However, as Walker points out, formation of professional associations, even by charter, was not sufficient to achieve domination of accounting (undated, p27). It was a starting point but complementary activities were necessary if the emerging accountancy profession was to attain control of the obligatory passage points in its field.
The formation of Australian professional associations by Royal Charter and incorporation and complementary activities will be the subject of Chapter 3. The following section of this chapter will provide a discussion of the attributes of professions and the relationships between these attributes, frameworks of power and autopoiesis.

THE NATURE OF PROFESSIONS

Problem of Definition

The view adopted for purposes of this study is that professionalisation is part of the process of achieving hegemonic domination of a particular area of knowledge. Accountancy has employed this strategy, amongst others, to delineate a boundary between itself and other disciplines and acquire hegemonic domination, if not autonomy and monopoly, of work of an accounting nature. It has also used its claim to professional attributes to establish itself as a profession as opposed to a purely technical occupation.

One approach to identifying particular professional groups is to make a distinction between professions in trade or commerce or what may be called technical professions, for example, a plumber or electrician, and the "learned professions" which, for purposes of this study, will be taken to include accountancy. While the distinction between technical and learned professions is a starting point, the problem of definition remains. However, it is possible to identify a number of attributes which learned professions are considered to exhibit. Larson, for example, maintains that the unequivocal answer of social scientists is that
... professions are occupations with special power and prestige. Society grants these rewards because professions have special competence in esoteric bodies of knowledge linked to central needs and values of social systems, and because professions are devoted to the service of the public, and above and beyond material incentives (1977, px).

To be more specific, professional attributes are said to include at least the following:

1. a body of unique knowledge
2. high level of education and training
3. a code of ethics
4. a public interest in the practice of professional activities
5. professional associations
6. autonomy to determine and enforce the nature and level of education and training, codes of ethics and standards of practice and, thereby, control of admission to the profession
7. monopoly over the body of knowledge and its practice
8. public recognition and acceptance of autonomy and monopoly
9. social status and prestige
10. client dependency (Summarised from Carr-Saunders and Wilson, 1933; Stewart, 1975; Larson, 1977; Hines, 1989; Lee, 1990)

As suggested previously, it is not merely the perception that a group possesses these attributes that identifies it as a profession. Rather, the demonstration of these attributes justifies autonomy (Johnson, 1972, p45).

Walker provides evidence of this in the battles of the three chartered accountancy associations before the Privy Council and Court of Session over rights to exclusive use of the title, chartered accountant, and the designation, C.A.
... the most persuasive arguments employed by the chartered societies for the maintenance of their monopoly rested on the functionalist concept that their privileges had been sanctioned by the community as the fair reward for the provision of essential accountancy services by competent practitioners (1991, p260).

This study maintains that the attainment of autonomy, monopoly and the social status and prestige associated with public recognition and acceptance and client dependency are contingent, to a large extent, on the first five elements listed above. These five elements are interrelated and while some, such as Goldstein, argue that the possession of esoteric knowledge is a pre-requisite of professionalisation, it is really a chicken and egg-type debate because the acquisition of knowledge is an on-going process as is the professionalisation process and one re-enforces the other over time (1984, p175). This is similar to Foucault's concept of power-knowledge

... it is not the activity of the subject of knowledge that produces a corpus of knowledge, useful or resistant to power, but power-knowledge, the processes and struggles that traverse it and of which it is made up, that determines the forms and possible domains of knowledge (1979, p28).

Just as professionalisation and knowledge are not sequential, the other attributes are not sequential and are subject to change over time in response to environmental changes and changes in other attributes. Having acknowledged the lack of a simple cause and effect relationship between the attributes, this particular analysis will centre on the concept of esoteric knowledge and how it is used in the process of achieving hegemonic domination and the support of the state by facilitating the demonstration of the other attributes.
Esoteric Knowledge

The *Chambers Family Dictionary* defines esoteric as "taught to a select few: secret, mysterious: initiated" (Kirkpatrick, 1990, p257). Karpik states that "knowledge" can be seen as not only referring to

... the symbolic reality transmitted by the university, but to that combination of abstract knowledge and practical application that appears in the form of books, legal codes and procedures, in the practices of organisations and institutions, in oral transmission and tradition, all of which are used daily (1990, p186).

Larson refers to theoretical knowledge as "... esoteric, granted to specialists by specialists and fully meaningful only in their circles" (1977, p45). According to Goldstein, the possession of "a body of esoteric knowledge" is essential to the designation of a profession. In Goldstein's view:

... the sociological conception of a profession posits a previously given *intellectual* core and a subsequent, multifaceted *social* process which takes place around that core: the application of the body of knowledge to social needs; the social strategies by which a certain group comes to monopolise that application; the prestigious social niche which that group carves for itself, in part a function of that contact with the world of learning which serves as the basis of its claim to have been elevated above mercantile concerns and to have become a kind of secular analogue of the clergy (italics and emphasis in original) (1984, p175).

These excerpts suggest that professional knowledge goes beyond technical skills to something more abstract and mystical. This intellectual core, body of esoteric or unique knowledge, or the claim to it, is the first step towards the demarcation of a boundary which distinguishes an identifiable profession from other professions and occupations. Creation of this boundary provides an incentive to form professional associations because a body of esoteric knowledge requires a high level of education and training. There must be some group to determine the form and content of this education and training as well as provide it. There must also be some mechanism,
such as a code of ethics, to monitor the work of those undertaking work of a professional nature and ensure that their skill and knowledge is being used in the public interest.

A professional association can fulfil these functions and, at the same time, re-enforce the demarcation of the boundary by making a public demonstration of the distinction between those possessing a given body of knowledge from those who do not, in other words, a distinction between the qualified and the unqualified. This process of exclusion requires evidence of acquisition of unique knowledge and skills and, thereby, gives rise to the need, not only for specific education and training but evidence, such as examinations, that the necessary knowledge and skills have been acquired. The emphasis on knowledge and skill directs attention to the status and prestige of the members of the profession rather than on the nature of the work they do (Collins, 1990a, p26).

(a) Uncertainty, Indetermination & Discourse

The claim to a body of knowledge and the legitimacy to that claim as evidenced by the existence of a professional association where admission is restricted to those with the requisite knowledge, training and skills provides the basis for autonomy, monopoly and client dependence. Johnson elaborates on this by reference to the exclusionary effects of a community language or jargon. The possession of such a language or jargon not only facilitates autonomy but also maintains internal homogeneity (1972, p56). The evolution of accounting from ancient civilisations through to the emergence of professional accountancy associations was detailed earlier as one of increasing abstraction with the ultimate abstraction being double entry bookkeeping. Littleton saw double entry bookkeeping as a language for reworking material such as private property, capital, commerce and credit and expressing it in terms of permanent records and arithmetical calculations including values, prices and profits (1968, p22). The further development of accounting through the centuries brought further
abstractions such as the concept of going concern and the need to allocate items such as revenue and expense to arbitrary time periods and the distinction between capital and revenue.

However, autonomy, monopoly and client dependence would be impaired if the body of knowledge could be reduced to technical processes. For this reason, there must be a trade-off between the control over a body of knowledge that would arise from codifying it to the extent that it becomes a technical process open to all who have the ability to learn and apply it and the desire to restrict entry to the practice of the body of knowledge. This desire for operational or organisational closure gives rise to the introduction of an element of uncertainty, indetermination or mystique surrounding the body of knowledge. Johnson refers to this as social distance which "... creates a structure of uncertainty ..." (1972, p41) and gives rise to power relationships between practitioner and client which may give rise to a greater social distance between practitioner and client (p42). Social distance facilitates practitioner autonomy and control over practice (p43).

Thus uncertainty or indetermination is deliberately created as it is a source of power for the profession (p43). However, in creating this aura of uncertainty or indetermination, the profession has borrowed what it needed from other disciplines. Bakhtin expresses this view in the following manner

The word, directed toward its object, enters a dialogically agitated and tension-filled environment of alien words, value judgments and accents, weaves in and out of complex interrelationships, merges with some, recoils from others, intersects with yet a third group: and all this may crucially shape discourse, may leave a trace in all its semantic layers, may complicate its expression and influence its entire stylistic profile (1981, p276).

As noted earlier, the use of complex tokens representing intangibles such as services rendered followed in time with the advent of numeracy and literacy provided a special
niche in the community for those who understood the meaning of the complex tokens and, later, the scribes who could read and write. The scribes were ensured of work through the legal requirement to record all commercial transactions.

Indetermination is enhanced by the application of undefined quality labels such as materiality, relevance and reliability. These are matters of professional judgment and are guided by professionally-determined criteria and, thereby, are used to widen further the gap of understanding between the trained accountant and the lay person, the initiated and the uninitiated, the qualified and the unqualified.

This creation of an accounting specific reality can be viewed in terms of discursive processes and discursive formation which Goodrich

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\ldots \text{refers to loosely as both the processes that intervene and determine the relationship of a language to the formulation of utterances (discursive processes) and also} \ldots \text{more generally to the relation of bodies of knowledge to social practice and structure (discursive formation) (1987, p132).}
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The uncertainty and indetermination inherent in the body of professional knowledge can be explained in terms of discursive processes and formation. The meaning ascribed to terms, phrases and words evolve through common usage and also according to some intended purpose within a particular area of knowledge or as Volosinov has stated

\[
\text{Every sign} \ldots \text{is a construct between socially organized persons in the process of their interaction. Therefore, the forms of signs are conditioned above all by the social organization of the participants involved and also by the immediate conditions of their interaction (1973, p21).}
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Furthermore, as Goodrich, using the work of Volosinov and Bakhtin, observes, signs, terms, phrases and words can have a multiplicity of meanings or referentiality
depending on the ideological context in which they are used (1987, p142-143). Hence, simple and complex clay tokens might have appeared to some members of ancient civilisations as nothing more than odd shapes while the accountants of the time and others with a knowledge of their use would have seen them as a means, for example, of recording debts due and owing, or so much grain or cloth made of particular fibres. Similarly, modern day accountants use terms such as assets and liabilities which have an everyday meaning as well as an accounting meaning when used to classify intangibles such as goodwill, contingent liabilities and other potentially more obscure items including future income tax benefits. The use of abstractions such as profit and accounting income, depreciation and amortisation is an extension of this process and helps ensure the dominance of trained accountants in the regulation of financial reporting.

This indetermination and uncertainty is not confined to the content of accounting but also to what actually comprises work of an accounting nature. Carr-Saunders and Wilson refer to a Board of Trade committee appointed to consider the registration of accountants and the restriction of accountancy work to those whose name appeared on that register (1933, p208; p217). The committee was unable to come to a conclusion as to what constituted work of an accounting nature and made a recommendation against registration (p217). Carr-Saunders and Wilson suggest that this was in part due to the wording of the minute which established the committee (p217). However, they further state that all representatives of the chartered bodies appearing before the committee were opposed to any scheme which was suggested. Registration may have provided a monopoly over accountancy work to those who qualified for admission to the register but it could also have had an adverse impact on the autonomy of the profession in determining the nature of accounting work and the qualifications necessary for registration and, thereby, entrance to the relevant professional associations (pp217-219).
The power of the profession derived from the aura of uncertainty and indetermination is enhanced by the profession's ability to specify its own body of knowledge and perpetuate it through its control of the content and nature of professional education, training and practice. Not only are clients dependent on the professional practitioner but society is also dependent on the profession as a group to establish standards of education, training and practice because only the profession has the necessary knowledge and skills to determine what is appropriate. Uncertainty and indetermination are not only a source of power for a profession but they are also essential to the maintenance of autopoiesis which requires continuous conversation and communication.

(b) Conversation, Communication and Autopoiesis

(i) Reality Creation

Conversation and communication were defined earlier in this chapter as "the creation of shared meanings within the cognitive domain" and "the use of meanings in linguistic interactions" respectively (Robb, 1991, p219). Similarly, Pask refers to conversation as "concept sharing" and communication as "the transmission and transformation of signals" (1980, p144). While the two processes are linked in that in order to have conversation there must be some communication, they are distinct and one need not follow from the other. In other words, good conversation does not imply good communication or vice versa (p144). Communication is a basic element of a social system (Luhmann, 1986, 1988a, b; Bednarz, 1988; Kock, 1981). Communication determines the structure of the system, its adaptive capacities and ensures all components of the system perform the functions necessary to achieve autopoiesis and organisational closure (Robb, 1990, p20).

While conversation is the process of ascertaining meaning, this cannot be achieved unless there are sufficient shared meanings already within the system. In this sense,
conversation also has parallels with Bakhtin's view of discourse and how meaning is conferred on particular concepts:

But no living word relates to its object in a singular way: between the word and its object, between the word and the speaking subject, there exists an elastic environment of other, alien words about the same object, the same theme, and this is an environment that it is often difficult to penetrate. It is precisely in the process of living interaction with this specific environment that the word may be individualized and given stylistic shape (italics in original) (1981, p276).

Conversation also is similar to the rules of practice that provide the context in which rules of membership and meaning are determined. Rules of practice or pre-existing shared meanings, in this regard, can be seen as premises or assumptions such as the idea encompassed in the statements of accounting concepts issued by the AARF that users of financial statements will use general purpose financial statements for making decisions that will facilitate an economic allocation of scarce resources (SAC 1 paragraphs 7-9 and SAC 2 paragraphs 11-15).

Because conversation and communication are the means by which a system makes a distinction between itself and other systems and establishes and maintains its autonomy (Pask, 1980, p151), these are also the processes by which an autopoietic system creates its own reality. As Luhmann notes

Autopoietic systems . . . are sovereign with respect to the constitution of identities and differences. They do not create a material world of their own. They presuppose other levels of reality. . . . Whatever they use as identities and as differences is of their own making (1986, p174).

By creating their own reality, autopoietic systems are able to institutionalise indetermination and uncertainty, in other words, indetermination and uncertainty form the "material basis" of the system (Goodrich, 1987, 144). As will be discussed
shortly, indetermination and uncertainty ensure the continuation of conversation and
communication by introducing the potential for conflict and instability. Both these
elements are essential to the maintenance of autopoiesis because "[i]t is not the
function of communication to produce a consensus as to the favoured state of mind.
. . If the system were set up to produce consensus it soon would come to an end" (Luhmann, 1986, p176).

There are clear parallels between the process of interessement at the dispositional
level of the circuits of power and conversation and communication. As noted earlier,
interessement is the process of establishing rules of membership and meaning (Clegg,
1989, p205). Dispositional power is the level of social integration at which orderly
and conflictful relationships specify the rules of meaning and membership (p224). In
turn, the rules of membership and meaning establish an actor network, organisational
field or field of force (p224). As discussed previously, social systems, are structures
of shared meanings which determine the components of a system and the relations
between them. Structure, however, is not physical but rather a process of
conversation and communication (Robb, 1991; Mingers, 1989; Bednarz, 1988).
Laclau and Mouffe use the concepts of discourse, articulation, elements and moments
in much the same context (1985, p105). Articulation is

... any practice establishing a relation among elements such that
their identity is modified as a result of the articulatory practice.
The structure of a system resulting from articulatory practices is
"discourse". Moments are differential positions articulated within
a discourse. Elements are differences which have not been
"discursively articulated" (p105).

Conversation and communication are similar to rules of practice in the frameworks of
power. Control of the rules of practice through control of the obligatory passage
points is the basis of hegemonic domination and the exercise of power at the episodic
level. Similarly, an autopoietic system, is by definition, autonomous in that it is self-
perpetuating and determines the components of the system and the relationships between them (Maturana & Varela, 1988; Bednarz, 1988; Teubner, 1988b; Luhmann, 1988b). Thus, an autopoietic system must also control conversation and communication (Luhmann, 1988a, p17). Luhmann has defined communication as "... a synthesis of three selections: namely, information, utterance and understanding (misunderstanding) (1986, p174) and more recently as "... a synthesis of information, communication and comprehension" (1988a, p17).

Autopoiesis, autonomy and control of obligatory passage points are not static, if they were, the system would not develop further and would cease to exist. As Luhmann states "... the elements are produced in order to end immediately, the system continually disintegrates itself and the autopoiesis stops at every moment - unless continued" (1988b, p341).

In terms of accountancy, shared meanings or concepts can, therefore, be taken to include the rules of double entry bookkeeping as well as terms such as asset, liability, revenue, expense, equity and capital which have unique meanings in an accounting context as well as rules for their recognition and measurement. It also includes the specialised skills of a trained accountant which allow the accountant to determine the manner in which double entry principles are applied and the interpretation and application of these rules when judgment is required such as in revenue recognition, cost allocation and materiality. While the basic principles of, for example, what constitutes an asset or a liability, revenue or expense may be generally accepted, there are often differences of opinion as to when such items should be recognised or how they should be measured. Accounting standards provide guidelines as to how such differences of opinion may be solved.

However, as will be discussed in later chapters, it is these very disagreements which make standard setting a difficult task. Conversation, persuasion or conflict resolution
become political processes whereby consensus is often bought at the cost of compromise of ideal. For example, the foreign currency translation standard to be discussed in Chapter 6, allows a choice of translation methods based on the relationship between the parent company and its subsidiaries. It also allows flexibility in the treatment of gains and losses on foreign currency monetary items which can be reasonably attributed to qualifying assets. The standard also does not address accounting for speculative transactions in spite of a recognised need to do so. If accounting standards did not leave scope for flexibility or further refinement, accounting could be reduced to a technical process whereby anyone who could learn the application rules of a particular standard could undertake accounting work in that area. Flexibility and unresolved issues provide the means whereby accountancy can continue conversation and communication and, thereby, maintain its distinction from other disciplines and its autonomy.

(ii) The Processes of Change

Just because meaning is shared does not mean that it will not change over time. Any change, however, must be drawn from the knowledge base of the system itself because autopoietic systems are, by definition, self-referential and self-determining. In other words, only the system can decide what components comprise the system and what the relationships are between the components. Drawing once again on Luhmann and the application of autopoiesis to the law

The autopoiesis of the legal system is normatively closed in that only the legal system can bestow legally normative quality on its elements and thereby constitute them as elements.

The system reproduces its elements by its elements by transferring this quality of meaning from moment to moment and thereby always providing new elements with normative validity (1988a, p20).
The autopoiesis of the legal system in this regard is analogous to that of the accountancy profession and the emphasis it has placed on the development of a conceptual framework. The framework currently being developed by the AARF details the objectives of external financial reporting (SAC 2), and, in theory, proceeds to develop concepts dealing with the qualities accounting information should have to make it useful (SAC 3) and thereby fulfil the objectives specified in SAC 2. The AARF's most recent concepts statement deals with definitions of the elements of general purpose financial reporting, assets, liabilities, revenue and expense and the criteria to be used in determining when these elements should be recognised in general purpose financial statements (SAC 4 Definition and Recognition of the Elements of Financial Statements). Ultimately, the AARF intends to issue a concepts statement dealing with measurement of assets, liabilities, revenue and expense.

The development of a conceptual framework can be seen as a process of conversation and communication. Accountancy is creating its own reality in adopting a decision-usefulness approach to the specification of objectives of general purpose financial reporting. The argument being that users of financial statements who are unable to specify the accounting information they require, will use general purpose financial reports issued by reporting entities (paragraph 7). The objective of general purpose financial reports is to facilitate an economic allocation of resources (paragraph 13). This approach is logical, perhaps, given the altruistic motive of the profession. In other words, there must be a social need for accounting and that need is the provision of information which will facilitate an economic allocation of resources. However, accountancy can be seen to be creating its own reality because there is little empirical evidence to support its contention that shareholders, creditors and other resource providers actually use financial statements as the basis of their dealings with companies or that this will achieve an economic allocation of resources (SAC 2 paragraphs 21-25 and paragraphs 28-40). Research in the area of the users of financial information and how that information is used has been inconclusive (e.g. Lee
and Tweedie, 1976; Benjamin and Stanga, 1977; Libby and Lewis, 1977; Courtis, 1982). Nonetheless, the profession in Australia appears to have succeeded in convincing the state that a conceptual framework is not only desirable but necessary. The Australian Securities Commission Act section 226 includes as one of the functions of the AASB a duty to develop a conceptual framework that is to be used in evaluating proposed accounting standards. The state has thus sanctioned the profession's creation of its own reality. The profession is also in a position to maintain its autopoiesis through the conceptual framework because the reality created by the conceptual framework is the basis of further creations, such as what constitutes an asset or liability in a certain circumstance. This activity or reality creation is all premised on the notion of servicing the public interest by achieving an economic allocation of resources.

However, because the system creates and defines its own elements that create and define further elements, there is the potential problem that meaning will appear to change but really be static. The necessity for the system to co-exist with others within its environment adds to this problem. As Robb (again following Pask) notes, this is the danger in the "togetherness" or consensus created by conversation particularly in higher level organisations that have achieved autopoiesis (1990, p16, p20). Firstly, there may be so much "togetherness", that no information transfer takes place at all. Pseudo-conversation may occur in that conversation appears to take place but it is nothing more than repetition of previous conversation so that no new meanings are established. Pask specifies the limits of "togetherness" as

(a) complete saturation (organisational closure and no information transfer);

(b) the type of "supersaturation" that yields an indefinitely large number of replicas (imaging systems which, being replicas, do not need to converse for they have nothing to say) (1980, p155).
Alternatively, an organisation may have reached the stage where even pseudo-conversation does not occur unless the stability of the autopoietic processes is threatened. Stability may be threatened both from endogenous and exogenous forces. In the circuits of power framework, innovation in techniques of discipline and production precipitate changes in the rules of practice, membership and meaning. Whether the force for change is coming from within the organisation or from its environment, conversation will be instituted but only to the extent that is necessary to maintain autopoiesis.

Boreham has made a similar observation with regard to professions and paradigmatic shifts which may occur in the face of conflict

... changes will ensue only when those who dominate the upper levels of professional hierarchies have assimilated those elements of innovation which are applicable to the perpetuation of the dominance of the professional project (1983, p701).

This suggests that change within an autopoietic system is linked to conflict and instability. In fact, Luhmann maintains that instability is the basis of the stability of the autopoietic system because it ensures the recursive reproduction of the system by continuous conversation and communication (1986, p181). This implies a degree of almost planned instability and conflict which appears to be at odds with the circuits of power framework in that the continuation of the exercise of power at the episodic agency level depends on stability at that level as well as of control of the obligatory passage points. Change within the power framework is possible, however, in response to endogenous and exogenous forces due to innovations in techniques of production and discipline. When these forces cannot be dealt with by the dispositional level of the circuit, change or bifurcation, such as the creation of new organisations or components of the system, occur at the facilitative level of the framework. As will be discussed in Chapter 3, the formation of professional associations and continuing
professionalisation processes such as the establishment of research groups first within professional associations and eventually as separate entities provide an example of this process. The formation of research groups within the professional association is likely to be a mobilisation activity taking place within the dispositional level of the power circuit. Bifurcation in the form of a research organisation, the AARF, separate and distinct from the two major Australian professional associations, but financed and sponsored by them, followed criticism of the profession to fail to deal adequately with the development of accounting practices. This will be discussed in more detail in the next chapter.

In this sense, the responses in either of the situations identified by Robb (1990) can be seen to result, not only from autopoiesis but from organisational outflanking and institutional isomorphism which are both attempts to continuously fix and re-fix the rules of practice, membership and meaning. Organisational outflanking occurs where an established group controls the obligatory passage points and, thereby, also controls the rules of practice and the rules of practice set the context within which the rules of membership and meaning are determined. This established group usually has the resources to outmanoeuvre other organisations attempting to invade its territory, for example, formation of the AARF could be seen as a defence mechanism adopted by the profession to preempt any move by the government to take over the role of developing and prescribing accounting standards and practices. This also allows the profession to institutionalise indetermination and uncertainty in its body of esoteric knowledge and, thereby, maintain hegemonic domination of a particular field of endeavour.

Institutional isomorphism, be it coercive, mimetic or normative, will ensure, however, that radical change is unlikely to occur where the rules of practice, membership and meaning have become institutionalised (DiMaggio and Powell, 1983; Meyer and Rowan, 1977). This is facilitated by the processes of problematisation, interessement,
enrolment and mobilisation which, if successful, create alliances and agency relationships at the dispositional level. These relationships are complemented by institutional isomorphism which results in the components of an organisational field becoming increasingly alike. The danger in this is that a point of saturation may be reached so that bifurcation results in "... an indefinitely large number of replicas ... [having] nothing to say" (Pask, 1980, p155) or engaging in communication "... which may appear to be conversation, but is not in fact, conversational" (p154, emphasis in original). Nonetheless, as suggested above, conversation will be necessary if the autopoiesis of the organisation is to be maintained in the face of threats to its stability. Therefore, radical change can occur, even to the point of contradiction of previously accepted meanings or conversation, if this is necessary to the continued autopoiesis of the system.

However, while the possession or claim to a body of esoteric knowledge may be necessary to achievement of hegemonic domination of a particular area or field of endeavour, it is not sufficient. Recognition of the possession of this body of esoteric knowledge and a perception of its use in the public interest is also necessary.

**Public Recognition - The Role of the State**

Public recognition and acceptance of a profession and its unique knowledge depend on the state. Johnson refers to this as "state mediation" (1972, p46). State mediation can be seen to take place at the facilitative level of the power framework as part of the process of social integration. Social integration deals with the resolution of orderly and conflictful relationships or tensions within a social system (Lockwood, 1964, p245). In this sense, state mediation can facilitate a professional monopoly and at the same time limit autonomy. The granting of charters or incorporation of professional associations can be seen as facilitative. A monopoly is further enhanced by the state identifying a need in the community and legislating for its provision. For example,
legislation prescribing the preparation and audit of annual financial reports has provided a societal niche for accountants. On the other hand, specifying membership of boards or committees dealing with the practice of a profession, such as the promulgation of accounting standards, can be seen as limiting autonomy of the profession.

Without the support of the state, a would-be profession would have little hope of attaining the legitimacy conferred by incorporation, the granting of a charter, licensing or registration. Statutory licensing and registration would, to a certain extent, be more powerful tools than incorporation or granting of a charter because they provide legislative closure of a field of knowledge. In other words, only those who are licensed or admitted to a register under the legislation are able to undertake the activities of that profession. However, as noted previously, statutory licensing and registration would introduce an outside party, probably one without the requisite skill and knowledge of the professional, into the administration of the profession. The profession would be likely to lose some of its autonomy in that administration. In other words, the rules of membership would be altered and, as a consequence, the control of the obligatory passage points.

The accountancy profession in Australia provides an example of the loss of autonomy which may follow government intervention in the conduct of professional activities. The advent of statutory backing for approved accounting standards appeared to reduce the profession's autonomy in the standard setting process in that the AASB had the potential to become little more than a government department. This could have left the profession as "an occupational pressure group" trying to influence rather than control accounting practice (Johnson, 1972, p82). It will be shown in subsequent chapters that the Australian profession effectively controls the standard setting process in this country but the Federal Government has the right to veto standards approved by the AASB. The legislation establishing the AASB also prescribes
membership requirements including the bodies who may nominate prospective board members. To this extent, the profession's autonomy has been reduced. A similar situation could arise with regard to registration in that the legislators control the content of the registration act including prescribing the qualifications of those who may be registered.

Incorporation or granting of a charter does not necessarily lead to such a loss of autonomy. Rather it achieves the restriction of specified titles, such as chartered accountant or certified practising accountant, to members of a particular professional association. In some respects this has advantages over legislative closure in that registration or licensing forces the profession to admit an outside element, the government or a government appointed body, into the regulation of the profession. Exclusive right to a title may not guarantee exclusive practice in a given field but it does distinguish the qualified from the unqualified without necessarily losing any aspect of self-regulation or autonomy. The distinction between the qualified and unqualified highlights the boundary around the profession and also confers status and prestige on members of the professional association. This status and prestige facilitate the autonomy of the profession to determine levels of education and training and standards of practice. It also contributes to the autonomy of the practitioner in their day to day work activities because the professional practitioner is recognised as an expert in a given field. In other words, status and prestige underwrite the technological monopoly of the profession and its members.

In addition, the state, through legislation, can effectively provide a profession with a guaranteed clientele (Johnson, 1972, p78). Company legislation requiring the preparation and audit of annual financial statements is one such example. Refinements to this legislation such as the requirements to comply with approved accounting standards and procedures to be followed when a change of auditor is proposed by management have helped to consolidate state support of the accountancy profession.
Claim to a body of esoteric knowledge is not the sole pre-requisite to state support of a professional organisation. A distinctive trait of a profession, or in Lee's view, the most obvious trait is altruism or the use of a body of esoteric knowledge in the public interest (1990, p138). Hence the motives of the members of the profession in using their skills extend beyond material gains to benefiting society (Larson, 1977, px). However, to ensure that the public interest is served, it is considered that organisation of the profession is necessary to maintain high standards through education and compliance with ethical codes and that practices within the profession are based on an intellectual core.

It is apparent from the foregoing that the attributes of a profession are inter-related. There must be, or at least a claim to, a body of esoteric knowledge as evidenced by high levels of education and training. The expert skill and training which is derived from this body of knowledge must be used in the public interest as opposed to being used for mere personal gain. A public interest motive provides incentive for the state to lend its support to aspiring professions in the form of incorporation, charters, registration and licensing which provide public recognition of the expert knowledge and skills of members of professional associations. This, in turn, confers status and prestige on members of professional associations and operates as a means of operationally closing the practice in a given field to all but the qualified. The profession and its members use this status and prestige as a means to autonomy in the determination of appropriate skills, training and practice. To maintain public recognition, autonomy and a technological monopoly, the profession must continue to demonstrate its special body of knowledge and expertise.

Chapter 3 will use the circuits of power framework and theory of autopoiesis developed in the first part of this chapter and elaborated on in the second part to
demonstrate how the accountancy profession attained hegemonic domination of accounting including the promulgation of accounting standards.
CHAPTER 3

PROFESSIONALISATION AS A POWER STRATEGY

This section of the study will show that accountancy has used professionalisation processes to attain and maintain hegemonic domination of work of an accounting nature. The time frame of these activities will cover the formation of professional accountancy associations in the 1890's through to the merger of the ASRB and the Accounting Standards Board (AcSB) of the AARF in 1988. This particular time-frame has been selected because it provides evidence of the translation process that accountancy used to achieve hegemonic domination of accounting practices. The merger of the ASRB with the AcSB represents the culmination of the translation process in that it provided the profession with control of the obligatory passage points, in this case, the setting of accounting standards, and thereby, the means to exercise episodic agency power. This control was specifically endorsed by the State.

The processes used by the profession in achieving this dominant position have included formal incorporation of accountancy associations and, in some instances, acquisition of Royal Charters, and prescribed levels of education firstly provided by the profession itself and later through tertiary education facilities. Further professional training and development through employment and post-tertiary qualification courses of study and examination are also part of the professionalisation processes prescribed by the professional accountancy associations. In times when it
appeared the professional associations were unable to adequately regulate the activities of their members, that is through rules of membership and meaning, bifurcation occurred. In Australia, bifurcation saw the establishment of research and accounting standard setting bodies which were ostensibly separate from the professional associations that created them. Further bifurcation ultimately led to the establishment of the ASRB and statutory backing for approved accounting standards.

Early sections of this chapter will draw upon professionalisation activities of not only Australian accountants but also those of the UK. Details of the emergence of the profession in the UK are of interest because it is the recognised birth place of the accountancy profession (Walker, 1988; Carr-Saunders & Wilson, 1933; Hein, 1978; Stewart, 1975). Also, as will be demonstrated, some of the founders of the profession in Australia specifically stated an intention to emulate their UK counter-parts.

It is not intended to use archival material such as minutes of meetings in this study. This area has already been covered by Poullaos (1992; 1993). Instead, extensive use will be made in this chapter of *The Public Accountant* and other newspapers and journals to show the development of an accounting discourse over time. It is contended that the profession used these media to create a favourable public perception of the profession and certain of the accountancy professional associations. One of the ways in which this was achieved, was publication in *The Public Accountant* of dinner speeches given not only by members of the professional associations but by judges, members of Parliament, editors of journals and other public figures. These speeches invariably reflected a positive image of the profession and the work of both practitioners and the professional associations. Addresses to student societies and at annual general meetings of professional associations were also published. Once again, these addresses appear to have been designed to convey an image of a highly professional organisation dedicated to providing the public with well-trained and knowledgeable accountants. Editorials were also used extensively to
publicise the viewpoints of the profession on a number of matters including the long battle for a Royal Charter by accountants in public practice in Australia.

These activities can be seen as part of the professionalisation process aimed at delineating a boundary between qualified and so-called unqualified practitioners and achieving domination of accounting by members of professional associations by showing a commitment to the public interest by raising the standard of members of professional associations through prescribed levels of education and training. Others who were not favourably inclined towards the profession or the activities of some of the professional associations also used these mediums to counter these efforts.

It should be noted that this section of the study does not purport to be a comprehensive history of the accountancy profession in Australia or of the activities of Australian accountants in pursuit of a Royal Charter. Extensive histories of Australian professional associations, charter applications and the emergence of accounting standards and standard setting bodies have been undertaken by others (e.g. Zeff, 1973; Gibson, 1976; Graham, 1978; Marshall, 1978; ASA, undated; Poullaos, 1992; Rahman, 1992) and there is no intention to duplicate their work in this chapter. The intention of this chapter is to demonstrate that the professionalisation activities of some Australian accountancy associations were used as means of creating an accountancy discourse in their favour and attaining hegemonic domination of accountancy practices in Australia.

**PROFESSIONALISATION & FRAMEWORKS OF POWER**

The professionalisation of accountancy is explainable within the circuits of power framework. Initial professionalisation activities can be sited within the dispositional circuit at the level of social integration utilising the problematisation, interessement, enrolment and mobilisation moments of translation. The formal establishment of
professional associations was a strategic activity undertaken within the facilitative
circuit at the level of systems integration. These activities were aimed at achieving
hegemonic domination of accountancy in part by delineating a boundary between the
qualified and the unqualified. For example, one of the longest running debates within
accountancy itself has been the distinction between the accountant in public practice
and the accountant employed in commercial ventures. The desire for this distinction
led to the formation of The Australasian Corporation of Public Accountants (ACPA)
"[t]o support and protect the profession of Public Accountants in Australia"
(Editorial, 1908, p34) by drawing ". . . a distinct line . . . for all time between the
practising public accountant and the non-practising accountant" (Editorial, 1911a,
p199). Attempts to attain Royal Charters by public accountants in England, Scotland
and Australia were an extension of this process. Howitt clearly makes this point with
regard to the gaining of a charter by the Institute of Chartered Accounts in England
and Wales (ICAEW)

Among the great advantages of charters were the fact that the
tradition surrounding them dated back to the fourteenth century,
the prestige attaching to them and the characteristics of monopoly
they conferred (1966, p20.)

As noted in the previous chapter, Walker argues that formal organisation of the
accountancy profession in Scotland was prompted by the threat posed by proposed
bankruptcy legislation which would have placed the administration of failed estates
with the courts (undated, p16, 21, 26, 35). Other groups with an interest in this area
included the legal profession and merchants. These groups had formally established
organisations to protect their interests (p21). The accountants of Edinburgh and
Glasgow sought formal organisation by incorporation of professional associations by
Royal Charter. Once formed, these organisations formed alliances with other interest
groups, including the legal profession and local merchants, and successfully defeated
the proposed legislation (pp34-35).
In Australia, the perceived benefits of a Royal Charter were also clearly recognised.

It [a Royal Charter] is the academic hall-mark of Great Britain and its dependencies, and has had, . . . a particularly significant effect upon the profession of accountancy since the issue of a charter to the Scottish accountants in 1854, and to those in London and elsewhere in 1880, since which dates the appellation "Chartered Accountant" has become prima facie evidence of integrity and ability in Great Britain (Editorial, 1905a, p4).

Continuing professionalisation activities such as entrance requirements based on education and examinations, research, practice guidelines, accounting standards, conceptual framework projects and the establishment of complementary structural components in the form of research organisations and standard setting bodies are aimed at maintaining hegemonic domination. In other words, the emerging profession sought to establish itself as an obligatory passage point in the conduct of work of an accounting nature and, thereby, the exercise of power at the episodic level of the power framework. Maintaining power at this level requires continued control of the obligatory passage points.

Formal Organisation - The Moment of Problematisation

The accountants of Edinburgh were the first to establish a professional accounting body by obtaining a Royal Charter in January 1853. Accountants in Glasgow and Aberdeen followed with Royal Charters being granted in 1855 and 1867 respectively (Macdonald, 1984, p187). As already discussed, Walker's research suggests the accountants of Edinburgh and Glasgow sought Royal Charters in a bid to mobilise support in the battle against proposed bankruptcy legislation. Walker's earlier research suggests a reason why the accountants of Scotland, once formally organised, were able to achieve alliances with the legal profession and merchants. It would appear that the foundations had already been laid in that Walker considers that the
accountants of Glasgow originally achieved occupational recognition through an association with commerce and, in particular, the Glasgow Stock Exchange (1988, p16). The accountants of Edinburgh, on the other hand, attained status and prestige as a result of a long "occupational and social association" with the law which already had the prestige and status of a recognised profession (p13).

Walker further maintains that the organisation of the accountants in Scotland was aimed at achieving social closure (p37). As evidence of this, Walker cites evidence from pamphlets issued by the group which was to become the Society of Accountants in Edinburgh. These pamphlets argued that "professional trustees" should be suitably qualified. A separate professional body should be formed and only members of that organisation should undertake bankruptcy work. The objective was to exclude the incompetent (ie. non-members of the proposed professional association) from the area (pp20-21).

In England, the first accounting professional association was formed in Liverpool in 1870 (Macdonald, 1984, p187; Carr-Saunders and Wilson, 1933, p210). In 1880, the ICAEW was the first national body to receive a Royal Charter (Macdonald, p187; Carr-Saunders and Wilson, p210; Walker, 1991, p258). The impetus to organise members of the profession in England appears to have been a perceived need to preclude undesirable persons from taking up the work of accountants. In Johnson's view, the tactic of protecting society from charlatans and quacks is "a creation of professionalism" aimed at achieving and maintaining an occupational monopoly (1972, p57). The advent of the Industrial Revolution had increased the need for accounting services such as bankruptcy and liquidation work. With the introduction of more liberal incorporation rights under companies legislation from 1844 onwards, the audit of corporate accounts also provided work for accountants.
It appears the impetus to form professional accountancy associations in Australia was two-fold. First, the "boom" of the 1880's had witnessed a rapid expansion in joint stock companies to take advantage of the growth of a wide range of industries including building and manufacturing. As with the growth in foreign trade and the Industrial Revolution, this boom and its concomitant increase in capital expenditure led, in turn, to a need for more sophisticated forms of bookkeeping (Graham, 1978, p1; Marshall, 1978, pp10-11). A new area of knowledge was beginning to take on an important role in the country and the accountants of the time seized the opportunity of laying claim to it:

... if those who were holding themselves out as public practitioners were to gain the confidence and support of the public, there must be a standard fixed which would connote the possession of the necessary qualifications for this special work (Brentnall, 1938, p64).

This gave rise to the second reason for the formation of Australian accounting professional associations. This was a desire to attain for Australian accountants the perceived status and prestige of their UK counterparts (p64). Registration or licensing of accountants was sought by some members of the profession as a means of limiting the practice of accountancy to members of specified accounting associations and thereby, preclude the unqualified (eg. licensing of auditors, section 31(2), Victorian Companies Act 1896; Brentnall, 1898b, p329; Corporation of Accountants of Australia, 1904, p37). Apart from the perceived status of a Royal Charter, it was also considered this would preclude the unqualified from undertaking accountancy work or more precisely, the work of public accountants (ACPA, 1910a, pp133-134). For example, Thomas Brentnall, as President of the ACPA, recognised the value of the "general office accountant" or "highly-qualified clerk" but insisted a clear distinction should be made between the practiseing public accountant and the former (p133). Furthermore, the "professional man", in other words, the practising public accountant and, presumably, member of the ACPA, had the right to "... protect
himself against charlatanry and incompetency..." (p134). A Royal Charter was one method of providing such protection.

Brentnall went on to point out that obtaining a Royal Charter was not only in the interests of practising public accountants but also in the interests of Australia. Australia was a young country and, in order to fully utilise its "illimitable resources", it was necessary to rely on borrowed capital, particularly from the UK. In addition, it was important that such borrowings be on favourable terms. It was in this regard, that Brentnall saw the need for public accountants "... in furnishing reports upon which an absentee lender may feel that he can absolutely rely" (p134). As altruistic as this may sound, there was also an element of self-interest because, in many cases, UK investors required investees to be investigated by chartered accountants which meant that Australian public accountants were being deprived of work. The granting of a Royal Charter to Australian public accountants would overcome this (p134).

To achieve the distinction between accountants and lawyers and qualified accountants and unqualified accountants, the emerging profession adopted a "problematisation" strategy. The "problem" identified was that any person who wished, could designate themselves an accountant. This "problem" was not unique to Australia. In England, for example, not only could lawyers do work of an accounting nature but also "charlatans and rogues" and others without the requisite training. This state of affairs was argued to be detrimental to society (Howitt, 1966, p4). The "solution" was the formal establishment of a professional association, membership of which would be limited to those with the appropriate training and experience.

The petition for a charter lodged by the Institute of Accountants in Glasgow expressed similar sentiments. It also included a request for the Institute to be granted power to determine the qualifications required for membership:
... that it is obvious that to the due performance of a profession such as this a liberal education is essential...

... that the object in view in the formation of the Institute of Accountants in Glasgow... was to maintain efficiency as well as respectability of the professional body... that this object will be further greatly assisted by the formation... into a body corporate... with power to make regulations and bye-laws respecting the qualification and admission of Members (cited by Stewart, 1975, p113).

The Royal Charter petition of the ICAEW made it explicitly clear that it was thought incorporation would provide public recognition of the status of qualified accountants in society and that the public interest would be served by such recognition...

... it would greatly promote the objects for which the said societies have been instituted and would also be for the public benefit if the members thereof were incorporated as one body as besides other advantages such incorporation would be a public recognition of the importance of the profession and would tend to gradually raise its character and thus secure for the community the existence of a class of persons well qualified to be employed in the responsible and difficult duties often devolving on Public Accountants (Royal Charter of the ICAEW, 11 May 1880).

The first Australian Royal Charter application was similarly worded...

... that for divers good and meritorious causes and considerations in the said Petition mentioned it would in the judgment of the petitioners very greatly promote and further the objects for which the said Associations [Incorporated Institute of Accountants, Victoria and The Australian Institute of Accountants] were established and would also greatly redound to the public good if the members of the said associations were incorporated as one body politic... (Victorian Charter Application, 1905, p20).

Through formation of professional associations and, in some cases, the gaining of Royal Charters of Incorporation, the profession achieved a number of things. By virtue of incorporation, the title "Chartered Accountant" became legally protected
(Lubell, 1978, pp41-42) in that only members of the professional associations holding them could use it. This also provided a means whereby the public could identify "qualified" accountants in that members of the ICAEW were identifiably by the initials "FCA" or "ACA" after their names (Howitt, 1966, p25). Members of the Institute of Chartered Accountants of Scotland and its antecedent bodies, the Society of Accountants in Edinburgh, the Institute of Accountants and Actuaries in Glasgow and the Society of Accountants in Aberdeen, (Walker, 1988, p7; 1991, p258) were identified by the initials "C.A." after their name (Walker, 1988, p11). In Australia, members of the first professional accounting association, the Adelaide Society of Accountants, were identified by the initials "FASA" (being a Fellow of the Society). Members of the second association to be formed in Australia, the Incorporated Institute of Accountants, Victoria, used the designations "FIAV" (Fellows) and "AIAV" (Associates). The use of these appellations was the beginning of the formal demarcation of a boundary around the profession of accountancy. This point was recognised in the March 1907 Editorial of The Public Accountant which dealt with a UK legal decision, Society of Accountants and Auditors v Goodway and Others, preserving the right to use the designation, "Incorporated Accountant", to members of that society. The Editorial expressed the view "... that the decision would undoubtedly be followed by our courts" in similar circumstances (p106). This would provide protection to both the public and members of established accountancy associations because

...the rule of law laid down will effectively prevent unqualified adventurers from posing as members of reputable Associations of Accountants, and thus gaining confidence which the merits of their own work would never gain for them (p107).

Public recognition of distinguishing appellations also forms the basis for autonomy in the determination of work of an accounting nature and how it should be practised. In turn, public recognition of qualified accountants and the importance of their work
laid the foundation for a technological monopoly (Lubell, 1978, p42) or, in Clegg's terms, the profession sought to achieve for its members the position as "nodal points" or "obligatory passage points" through which accounting practices must pass (1989, 204-205). The term "system's closure" has also been used to describe what is effectively the enclosure of an area of knowledge to a select group (Selander, 1990, p140).

In achieving this position, the professional associations also had to convince the public that in undertaking accountancy work, special skills are required and the public interest would be best served if this work was undertaken by qualified accountants as recognised by membership of professional accounting associations. As already noted, the Victorian Institute was formed for this purpose (Brentnall, 1938, p64). Similarly, the objects of the Adelaide Society of Accountants included

(iv) to foster in commercial circles a higher sense of the importance of systematic and correct book-keeping, and to encourage a greater degree of efficiency in those engaged in accountancy and auditing (Adelaide Society of Accountants List of Members, Constitution and Rules (1886, clause 2)

In this way the profession cultivated client and societal dependency on it and its members. Walker argues the chartered accountants of Scotland did achieve this:

The distinctive professional designations adopted by the members of the three chartered societies were rapidly recognized among their clientele - the legal, commercial and manufacturing communities (1991, pp261).

Support of this contention, was evidence given before the Privy Council and the Court of Session by senior lawyers and businessmen of the time who testified, inter alia, that they would employ chartered accountants in preference to those without the same professional status, education, high character and respectability (p262). The
Australasian Insurance and Banking Record (AIBR) provides similar evidence. In a lengthy quote cited in the September 1911 Editorial of The Public Accountant, the AIBR stated:

... The Australasian Corporation of Public Accountants is the one that is most professional and therefore merits the confidence of the financial and mercantile world ... Our long experience in examining accounts and balance-sheets convinces us that the more the services of the responsible professionals, highly qualified by actual experience, are retained, the better. The Australasian Corporation of Public Accountants is gradually raising the status and utility of the profession (p199).

This would suggest that members of a profession, through extensive training and experience, are held to possess esoteric knowledge of their particular field of endeavour. This knowledge sets members of that profession apart from other groups, including other professions, and allows them to identify problems and use their professional judgment to solve those problems. Lubell, drawing on the works of Montagna, Barber and Greenwood, describes the process as follows:

Because professional services are built upon esoteric knowledge, the public tends to regard members of a profession with a certain degree of mystique. It is felt that the professional practitioner is better prepared than the client ... to determine the client's needs and the nature of services appropriate for a given situation. The client does not tell the professional what services are required. Rather, the professional tells the client what services are necessary (1978, pp62-63).

While there may be little in the way of direct evidence to support this assertion, there is evidence of its intuitive validity. A recent example is provided by the establishment in 1977 by the South Australian Government of a Committee to Inquire into the Registration and Conduct of Accountants. The Committee considered accounting to "... have been an adjunct of the organization of communities from the time of earliest civilization known to man" (South Australia, 1979, p11). In discussing the
qualifications necessary for registration, the majority of the Committee considered membership of either the Institute or the Society was appropriate because in their view, these two bodies constituted the profession and "... the profession can itself best determine the standards of academic and practical training necessary to qualify a person as an accountant" (p26).

Lee maintains that the skill and knowledge of the professional are crisis relevant in that they are intended to create in the mind of the client the impression that professional skills are a means of avoiding disaster (1990, p138). Carr-Saunders and Wilson (1933, p497), Johnson (1972, pp13-14) and Larson (1977, p58) adopt similar views. All three see claims to professional altruism as engendering in the eyes of the community, the notion that professions are a stabilising influence in society. A speech by a member of Parliament at the second annual dinner of the ACPA provides some evidence of this view: "We look upon Accountants as men closely identified with the progress of the country" (ACPA, 1910b, p170). Therefore, there is not only a client dependency on professions but also a societal one. This dependency and the autonomy and technological monopoly which accompany it are in part attributable to the mystique, indetermination and uncertainty surrounding the body of accounting knowledge. The reality constructed by accountancy and the exclusion it has perpetrated and perpetuated has not been a recent phenomenon. As already suggested, the formalisation of exclusion has been recent but the exclusionary process occurred over many centuries beginning as early as 3500BC.

The processes of achieving and maintaining domination can be seen as links in a chain whereby each link injects its own energy, shaping claims and instituting change over time (Latour, 1986, p267-268). The formation of professional associations premised on an altruistic motive to use the knowledge and skills of the profession in the public interest was the first link in the chain as it was also the first step in the specification of rules of meaning, membership and practice (Clegg, 1989, p224). Because the
profession dominates the specification of these rules, it controls the obligatory passage points which in turn facilitates autonomy in practice and also a monopoly of sorts over accounting.

However, the granting of charters to English and Scottish professional accountancy associations and incorporation of their Australian counterparts did not immediately provide accountants with a technological monopoly. At this time, they did not control the rules of practice. All the formation of professional associations did was provide a means of recognising members of those associations. At this time also, there were no rules of practice other than those governing admission to the professional associations. Membership of professional accountancy associations was not mandatory in the conduct of accountancy work. The profession needed to undertake a number of activities, including education, examination and training of members and potential members and attempts to gain statutory registration and/or Royal Charters for their associations, in order to demonstrate their superior skills in the conduct of accountancy work and thereby establish the basis of their claim to control of the obligatory passage points of the field.

The following section will examine the education and training activities of the accountancy profession in Australia and how these activities laid the foundation for further problematisation strategies in the form of attempts to attain statutory registration of accountants and a Royal Charter for public accountants. However, it is not intended to cover these areas exhaustively. The intention is to show how the profession attempted, in the early part of this century, to demonstrate its ability to dominate accountancy work. For this reason, a full history of the profession's education, registration and Royal Charter activities will not be attempted. The focus of attention will be the views of members of the profession, as expressed in *The Public Accountant*, lectures and speeches, on the need for these activities and also why some of them failed to achieve the desired end.
It is contended that the activities of Australian professional associations in their formative years helped them to eventually achieve a dominant position in the formulation of accounting standards. Even though membership of professional associations is still not mandatory, the fact that approved accounting standards have the force of law and, therefore, must be complied with in the preparation of statutory financial statements, means that the profession has achieved its goal of establishing itself as an obligatory passage point in the regulatory framework.

**Problematisation - The Australian Approach**

In Australia, the budding accountancy profession introduced entrance examinations to boost the public perception of its specialised skill and knowledge. This appears to have been particularly necessary following the land boom and crash of the late 1880's early 1890's. A number of scandals involving accountants, including members of professional accountancy associations, came to light at this time with the result that accountants were not held in high esteem in several quarters. For example, parliamentary debates dealing with the audit provisions of the 1896 Victorian Companies Act show clearly that some members of the legislature did not consider membership of the Incorporated Institute of Accountants or The Federal Institute of Accountants to be any guarantee of ability to undertake an audit (24 November, 1896, pp3606-3608). The reasons for this included a perception that accountancy work did not equate with the work of an auditor (p3607). In addition, foundation members of the above professional bodies had been admitted to membership without examination to attest to their abilities. Again, even if members had submitted to examinations, this did not qualify them as auditors (p3607). Finally, some of the auditors whose work had been called into question around this time were members of "one or other of these institutes" (p3608).
Further examples of adverse public perception of accountants and members of early professional associations are available from the *AIBR*. In 1893, it was stated

... admission into an Institute of Accountants at its inception is not necessarily a guarantee of ability, or even much knowledge ... a proportion of the public accountants practising in the colonial centres are such, not because they are the most fit but because other employments have failed them (1893, p668).

Three years later, this perception persisted

... when it is reflected that, ... most of the balance sheets of the bogus and mushroom companies of Melbourne, the administration of which has frequently been marked by the utmost unscrupulousness, have been signed from time to time by Fs.I.A.V., the pretension of the institutes to a monopoly of accountancy work ought not to be encouraged (1896, p717).

The quotes cited from the *AIBR* of 1893 and 1896 and from the Victorian parliamentary debates were quite valid in so far as foundation members of professional associations were not required to undertake examinations to demonstrate their accounting abilities. However, as noted earlier, by 1911, the *AIBR* had amended its view at least with regard to the ACPA. As will be demonstrated shortly, the *AIBR* was not alone in its view of the ACPA and other professional associations. It is contended that this change in perception was due, in part, to the education and training activities of the various professional associations and also the successful creation of a discourse through professional journals such as *The Public Accountant*.

1. Education and Training

From their inception, professional accounting associations required prospective members to sit for examinations. The Adelaide Society of Accountants, the first Australian accountancy association established in 1886, required candidates for
membership to "... submit to an examination as to [their] qualifications as an accountant" (List of Members, Constitution and Rules, 1886, clause 6). Similarly, the Incorporated Institute of Accountants, Victoria was formed and adopted its first examination regulations in March 1887 (Marshall, 1978, p11; Australian Society of Accountants, undated, p25). The first examinations, comprising four papers, were held in 1889 (Marshall, 1978, p11; Brentnall, 1938, p65). Topics examined included bookkeeping, commercial, mercantile and company law, bankruptcy, receivership, partnership, executorship contracts and auditing (Marshall, 1978, p11; Brentnall, 1938, p65). According to Marshall, the reason for the introduction of a system of entrance examinations was the "... urgent need to regulate and raise the standards of public accountants" in the wake of the boom of the 1880's and the accompanying increase in joint stock companies (1978, p11). In a lecture to accountancy students in 1908, a similar view was expressed:

... as the profession developed, and no legislation was enacted to govern it, it became necessary for the protection of the public as well as of practitioners, to form Institutes for Self-Government, and the admission of candidates by examination (Hickson, 1908, p178)

The passages from the AIBR and the Victorian parliamentary debates suggest that this may be a valid point of view.

In time, some of the associations provided for different levels of examination: preliminary, intermediate and final. The Institute of Accountants, Victoria introduced preliminary and intermediate examinations in 1895 (Australian Society of Accountants, undated, p26). The first final and intermediate ACPA examinations were held in 1908 (ACPA, 1909, p42). Passing the necessary examinations, however, was not sufficient for membership of the ACPA. Aspiring public accountants were required to undergo a minimum of three year's training in a public accountant's office (ACPA, 1911b, p232).
While the various professional associations required new members to take examinations, no educational facilities were provided for would-be examination candidates. The Society of Accountants appears to be an exception in that classes were conducted in accountancy, auditing and law (Victoria, 1904, p319). For other associations, private coaches provided what teaching was available (1904, p315; Nixon, 1936, p270). This situation was remedied to a certain extent by the formation of students' societies. In 1898, a students' society was established in Victoria by the Victorian Institute (Brentnall, 1938, p67). Students' societies were later established in Sydney in 1910 and in Adelaide and Hobart in 1911 (Australian Society of Accountants, undated, p30). In September, 1902, The Corporation of Accountants' Students' Association held its first meeting (Brierley, 1902, p21). The Federal Institute of Accountants formed a students' society in conjunction with the ACPA in 1913 (p53). These societies served at least two purposes. Firstly, for most of the professional associations, they provided the only formal educational facilities for accountancy students (Australian Society of Accountants, undated, p30). Secondly, they provided student members with experience and training in the management of the affairs of parent societies (p30). The student societies thus were instrumental in facilitating institutional isomorphism. As one historian has noted "... many members, who later served with distinction on State or General Councils, [obtained] their early experience and training in Institute affairs through their association with these Societies ..." (p30).

Initially, accountancy education, examinations and training were entirely the province of the professional associations. Lectures to student societies were given by members of the professional associations. Similarly, examinations were set and conducted by members of the associations. However, from as early as the turn of the century, the idea of formal classes in bookkeeping and accountancy was mooted. In 1904, a Royal Commission on the University of Melbourne considered, inter alia, the need for
commercial education at the university level. Evidence was presented to the Commission by representatives of commercial interests including various accountancy associations (Victoria, 1904, p70). In addition to the perceived need for formal teaching of accountancy and bookkeeping, the need for a broad based education for accountants including English, foreign languages such as French and German and commercial geography (ie. a knowledge of the products, trade and currency of different countries) was also recognised (pp316-318). This view was later expressed in *The Public Accountant* although university education was seen as an adjunct to, rather than a substitute for, professional association examinations and practical training and experience:

> It will enable them to acquire what practical experience alone, however extensive, can never give - that grasp of principle, that elevated point of view, without which no man can be thoroughly equipped for the higher branches of commercial life (Editorial, 1907a, p91).

The move towards university level commercial education began before the turn of the century. The assistance of the professional associations was also called for in this regard. For example, in 1899, the Incorporated Institute of Accountants, Victoria, was approached by the University of Melbourne to recommend a lecturer to teach accountancy and bookkeeping (Australian Society of Accountants, undated, p31). Accountancy subjects were taught at the University of Adelaide from 1902 (p31). The University of Sydney announced its intention to found a "commercial section" early in the century. Accounting was to be a compulsory subject for the first examinations. However, to the disappointment of *The Public Accountant*, the subject, accounting, was to be optional thereafter. Subjects such as physics, chemistry or geology could be substituted in subsequent examinations (Editorial, 1906a, p49).

The success of the profession's education and training activities in raising the status of professional associations was evident from the early 1890's with the AIBR, while
critical of the professional associations in some aspects, considering their education and examination activities to be a step in the direction of overcoming some of the deficiencies of then practising accountants (1893, p668; 1896, p718). By 1903, the AIBR was quite glowing in its comments regarding the Incorporated Institute of Accountants, Victoria:

They have taken a much wider view in making the Institute a great training body . . . That so many have passed the examinations of the Institute is highly gratifying. The qualifications of accountants and book-keepers in private offices have certainly been raised by the Institute system of examinations (1903, p475).

While not providing any evidence to support his contention, Thomas Brentnall, then president of the Incorporated Institute of Accountants, Victoria, testified before the Royal Commission into the University of Melbourne, that clerks were known to be rewarded with a bonus from their employer on passing Institute examinations (Victoria, 1904, p315). There is some evidence, in addition to that from the AIBR, which suggests that some professional associations were quite successful in lifting the public image of their members. For example, at the 1911 Annual Dinner of the ACPA, the editor of The Register stated:

... it should be an absolutely requisite requirement that no accounts of any public body which handles public money should be audited except by a thoroughly qualified man; and to the extent to which your association raises, and keeps raised, the standard of accountancy and insists upon the greatest care in the management of finance generally, to that extent the public is undoubtedly its debtor (ACPA, 1911b, p229).

Perhaps more concrete evidence is that members of the profession were beginning to be approached to give advice on matters of public interest. For example, members of the ACPA were appointed to investigate the costing methods of Victoria's suburban railways. The Victorian branch of the ACPA's Parliamentary and Laws Committee
was invited to make recommendations on the draft of proposed Victorian companies legislation (ACPA, 1911a, p217).

The foregoing suggests that education and training were an integral and successful part of the early professionalisation process of accountants. However, it was not sufficient to give any professional association hegemonic domination of accounting.

One reason for this was that, there was no mechanism by which the existing professional accountancy associations could prevent the formation of other such associations. For example, in Australia between 1890 and 1910, some thirteen accounting associations were formed (Graham, 1978, p3). At least three reasons can be given for this proliferation of accounting associations. The first is non-political and is based on the fact that Australia is divided into six states [or colonies prior to federation]. Given the poor state of communication between the colonies late last century (Graham, 1978, p1) and, to a certain extent, colonial/state rivalry, it is not surprising that local societies were formed rather than national societies (Graham, 1978, p1; Mackenzie, 1915, p90).

At a political level, the formation of new associations represented a threat to the dominance of those already in existence. They also were a potential threat to the attainment of high standards given that each new group formed had its own entry qualifications (Graham, 1978, p4). This was perhaps accentuated given that entry to some associations formed in Australia was limited to practising public accountants, for example, the Sydney Institute of Public Accountants (p3). The Corporation of Accountants of Australia was formed in response to the need to provide for those accountants who were not in public practice (p3). The ACPA (one of the major precursors of the Institute of Chartered Accountants in Australia) was formed in 1908. It was primarily for accountants in public practice. Many of the first office bearers of the ACPA were also office bearers of the Victorian Institute but restriction
of membership caused a rift between the two organisations which would take almost 20 years to mend (p3).

While education and training did not prevent the formation of ever more professional associations or the practice of accountancy work by non-members of professional associations, the emphasis on education and training formed the basis of the problematisation process which was used in a bid to gain statutory registration of accountants and, to a certain extent, a Royal Charter for practising public accountants.

2. **Registration**

Statutory registration of accountants appears to have been a goal shared by accountants in many parts of the world including Australia, the UK, USA, Canada, New Zealand and South Africa (ACPA, 1915, pp85-89). In Australia, the issue was more than a little contentious for at least two reasons. The first was the nature of Australian federalism and the Australian constitution which gave limited legislative powers to the Federal Government. The interpretation of these powers meant that any attempt on the part of the Federal Government to pass legislation for the registration of accountants throughout Australia would be deemed unconstitutional. The individual state parliaments could have referred their legislative powers to the Commonwealth for purposes of passing federal legislation for the registration of accountants. As this was not forthcoming, state by state legislation was required (Editorial, 1906c, pp18-19; 1906d, p35; 1907d, p156). This was one of the major barriers to statutory registration because the likelihood of achieving uniform legislation across six states was remote (Editorial, 1906c, p19; 1907d, p156; 1913a, p4).

As will be discussed in more detail shortly, the second barrier to statutory registration came from within the profession itself. Effective organisation is the key to achieving
agency relationships and control of obligatory passage points. As argued in *The Public Accountant* in 1907, "auditors ... are the agents of shareholders for the purpose of auditing the accounts" (p175). The profession's lack of unity with regard to the question of who was to be eligible for registration appears to have been one of the factors that prevented it from obtaining the statutory recognition of its control over accountancy's obligatory passage points which may have been conferred upon it by statutory registration (Priestley, 1905, p41).

In terms of the theoretical framework of this study, the major arguments for and against statutory registration were based on a problematisation process. It was argued the public interest would best be served by limiting accountancy work to those who were qualified - at least in the view of particular professional associations. For example, the December 1903 Editorial of *The Public Accountant* cited the following passage from an address by Herbert Priestley (a one time President of the New South Wales Committee of the Society of Accountants and Auditors, England) to the Students' Union:

> Look around you and see the number of so-called Public Accountants in our midst. They spring up on every hand like mushrooms. . . [T]hey are menace to the profession, and this condition of affairs is likely to continue until statutory recognition is accorded to the profession and none but those who are in every sense of the word 'duly qualified' will be able to receive the Hallmark of Registration . . . (p19).

In 1904, the President of the Corporation of Accountants of Australia expressed the view that Federal legislation to regulate accountants and, if possible, to create one "large and influential" accountancy body in Australia would be
... a measure which would confer a great benefit upon them as Accountants, and be a boon to the public, who would gain by having the services of highly-trained and properly-qualified men placed at their disposal (Corporation of Accountants of Australia, 1904, p37)

The call for one accountancy body was part of the problematisation process aimed at reducing the number of existing professional associations and preventing the formation of new ones (Priestley, 1904, p36; Editorial, 1907d, p154; 1907e, p234; 1908, p34; ACPA, 1915, p90). Again, this approach was not restricted to Australia as noted by the President of the ACPA in 1915:

Even in the home of the most highly privileged and best developed accountancy bodies, other organisations have sprung up, and there are no many new Societies of Accountants, with varying qualifications for membership, all seeking to take a part in directing, controlling and regulating the business methods of the old land (ACPA, 1915, p90).

As the author went on to observe, the situation in Australia was worse because the Commonwealth was made up of six states. Each state had its own professional associations with different membership criteria but an overall objective of "securing as large a membership as possible" (p90). To this end, qualification and examination standards were lowered so that, in some cases "... even the fool of the family" was able to qualify as an accountant (p90).

The bid to achieve statutory registration in Australia began as early as 1899 (ACPA 1911a, p203). At a conference attended by members of all Victorian accountancy institutes and societies, a committee was appointed to draft an accountants registration bill to be presented to the Victorian Legislative Assembly (ACPA, 1915, p85). The first post-federation registration bid was in Tasmania (Editorial, 1905b, p30). Other states also initiated attempts for statutory registration (ACPA, 1915, pp89-90).
While the professional associations often initiated or supported proposed statutory registration of accountants, it was a contentious issue within and between professional associations. In the first few years of this century, *The Public Accountant*, in editorials and reproductions of lectures and speeches, often made reference to the need for statutory registration and lamented the profession's inability to secure this (eg. Editorial, 1903; Corporation of Accountants of Australia, 1904; Editorial, 1905b; 1907b; 1907d). However, there were some prominent members of the profession who opposed statutory registration from the time of Victoria's first attempt in 1899. For example, Brentnall, in the inaugural address to the Incorporated Students' Society (Victoria) considered the outcome of statutory registration would "simply be appalling" because it would "necessitate the admission of all who are at present recognised as accountants in the widest interpretation of the word . . . " (1898, p329).

This result would be similar to that of section 31 of the 1896 Victorian companies legislation which provided, inter alia, for the licensing of company auditors. Section 31 also specified the qualifications necessary to obtain a licence. These qualifications included a Municipal Auditors' Board certificate and membership of various Australian and British accountancy associations. However, the section also provided that any person who could prove they had practised in Victoria as an auditor or accountant for three years could also receive a licence within five years of the commencement of the Act. Brentnall considered these provisions had set the progress of the accountancy profession back "by at least ten years" by making the qualifications of an auditor so broad that almost anyone, including a "wayfaring man, though a fool" could be a licensed auditor (p329). Brentnall was prepared to admit that there was some merit in the proposed statutory registration of accountants because subsequent admissions to the profession would be determined by examination so that in fifteen to twenty years, the beneficial effects would be felt (p329).
The passing of the New Zealand Society of Accountants Act in 1908 supported this fear of throwing open the doors of the accountancy profession to just about anyone who cared to enter. When the New Zealand legislation was initially proposed, it was greeted with enthusiasm by *The Public Accountant* as legislation aimed at "... ensuring that accountancy and auditing shall be performed only by persons who have the necessary knowledge and skill to do the same" (Preamble to the Bill, cited in Editorial, 1906c, p18). However, enthusiasm waned when the registration act was eventually passed because it allowed large numbers of "accountants" to be registered. According to figures cited by Brentnall, there were five times as many so-called public accountants in the relatively small community of New Zealand compared to the total number of public accountants in all of Australia (ACPA, 1910a, p138).

The impact of the New Zealand legislation was a trend away from calls for statutory registration (ACPA, 1910a, p138; 1911a, p203; *The Public Accountant*, 1913a, p7; Editorial, 1913c, p221). This trend was not, however, universal. In 1915, the then President of the ACPA questioned whether the argument that "a large number of unqualified and undesirable individuals" could become registered accountants was valid given that, without statutory registration, this position already prevailed (Mackenzie, 1915, p91). Arguments of this nature, including that expressed by Brentnall in 1898 that eventually all registered accountants would be duly qualified because admission to the register would be by examination, were not readily accepted. As one author of the time observed

... the Legislature is [not] justified in creating chaos, at very serious present inconvenience to the community, in the hope that at some future day order may be evolved therefrom (*The Public Accountant*, 1913a, p7).

In the absence of agreement as to qualifications for registration and, even if such agreement existed, the constitutional barriers to uniform professional accountancy
legislation throughout Australia, there appears to have been a conscious effort on the part of some professional associations to obtain public recognition through other means. For example, in two editorials in 1913, The Public Accountant expressed the view that if the ACPA maintained its high standards with regard to ethical conduct and professional qualifications through examination, training and limiting membership to practising public accountants, its members would be favourably regarded by the commercial community (1913a, p4; 1913b, p73). There is also some evidence that the ACPA's attempts to obtain a Royal Charter were part of its own particular problematisation process.

3. Royal Charters

Problematisation and the boundary it helped to create around accountancy was not sufficient to establish hegemonic domination of accountancy. The aspiring profession was threatened by competition for control of the obligatory points and, thereby, control of work of an accountancy nature. Other moments of translation had to be utilised to achieve the profession's autonomy, monopoly and, thereby, dominant position. Accountancy had sought to identify the problems corporations and society faced and, through their claim to superior knowledge and skill, held that only those with the requisite knowledge and skill, could offer the optimal solution. However, the professional associations were only one of the organisations beginning to make up the field of corporate regulation. As suggested in Chapter 2, the organisational field that is corporate regulation includes accountancy, the legal profession and State and Federal Parliaments as representatives of the public interest. In order to test and consolidate the problematisation process (Callon, 1986, p207), the accountancy profession needed to form alliances and agency relationships with other organisations within the regulatory environment. In the circuits of power framework this is termed interessement.
Interessement in the circuits of power framework is similar to structural coupling in autopoiesis. Both concepts recognise that one group, system or organisation needs to be compatible with other groups within their environment. Moreover, the formation of a boundary and the achievement of status, autonomy and monopoly of a given area of knowledge often needs the goodwill of those who will be affected by autonomy and monopoly of the field by one group.

Selander says that occupational groups form alliances or co-operate with others in order to protect themselves and strengthen their own position (1990, p140). Once a social and occupational demarcation of a boundary has been achieved, they effect a closure of the area or field of knowledge. That is to say, others or their views are called upon and taken into consideration in planning professional activities until such time as the group considers it is strong enough to stand alone. Selander considers that where an occupational group which has organised itself around a body of knowledge, but is still in a middle or subordinate position, will adopt an associative strategy to assimilate and neutralise other organised interests (p142). Alternatively, even where an occupational group or profession has achieved closure but is weakened for some reason, an associative strategy may be used to reduce conflict and mobilise resources (p143). Similarly, Callon sees interessement as a means of achieving a balance of power and curtailing competition within a given field (1986, p211).

Structural coupling is aimed at maintaining compatible relationships between one organisation and the other organisations within the environment. Interessement and structural coupling are, therefore, both aimed at maintaining and consolidating the position the organisation has achieved within its given environment.

There were three formal attempts by Australian accountants to achieve a Royal Charter of Incorporation. These were made in 1905, 1909 and 1928. The first attempt was made by the two Victorian Institutes of the time. The reasons for the
failure of this attempt laid the foundations for the compromises that were made during the second unsuccessful and the final successful attempts.

As suggested earlier in this chapter, a Royal Charter was an integral part of the problematisation process undertaken by parts of the Australian profession in their bid to secure a monopoly over work of an accounting nature for members. Securing a charter was justified in the public interest because it would allow the public to identify the "qualified" accountant, thereby, preventing the unqualified from wreaking havoc on unsuspecting clients. This theme continued throughout the second and third charter attempts. However, as will be shown, problematisation was not sufficient to achieve the charter. Those who sought the charter had to form alliances and compromise in order to achieve their overall goal. As Brentnall noted "... before we finally got the Charter ... in 1928, we had to concede almost everything which had barred the way ..." (1938, p191).

(i) First Charter Attempt

In 1905, the Victorian Institutes lodged a formal application for a Royal Charter for the accountants of Victoria. The ground-work for the petition had been carried out in trips to England some six years earlier by two members of the Incorporated Institute of Accountants, Victoria, C M Holmes and Thomas Brentnall (Brentnall, 1938, p69). The petition was supported by the Victorian Government but was doomed due to opposition from not only other accountants in Australia but also the UK (Graham, 1978, p7; Marshall, 1978, p12; Brentnall, 1938, p69).

The major arguments by Australian accountants against a Royal Charter for Victoria were explicitly set out in a counter-petition lodged by the Corporation of Accountants of Australia and the New South Wales Committee of the Society of Accountants and Auditors, England (Proposed Victorian Charter, 1905, pp38-39). These arguments included the large number of chartered accountants that would be created under the
provisions of the petition. It was estimated this number would be in excess of 600 which was more than the total number of members of all other public accountancy associations in Australia at that time (paragraphs 6 & 7). Furthermore, that 600 included some who did not practice exclusively as public accountants (paragraph 8).

A further argument was that the designation, Chartered Accountant, was not to be restricted to members practising within the State of Victoria (paragraph 10). It was considered that this would be detrimental to members of other accountancy associations (Editorial, 1905a; 1905b; Corporation of Accountants of Australia, 1906). This could be overcome by restricting use of the designation to accountants practising in Victoria or by granting a charter to a federal association of public accountants (Proposed Victorian Charter, paragraph 12) which the petitioners were attempting to form (paragraph 15). A counter-petition was also lodged by the accountants of South Australia and protests were sent to the Secretary of State from individual accountants (Editorial, 1905b).

The opposition to the Victorian Charter bid was not confined to Australia. In June 1906, The Public Accountant reproduced correspondence between the Secretary of State for the Colonies and the Under Secretary for Finance and Trade (The Treasury, New South Wales) regarding the use of the title "Chartered Accountant". This correspondence, which included a letter to the Colonial Office from the Secretary of the Institute of Chartered Accountants, London, had been forwarded for comment to the Corporation of Accountants of Australia.

The view expressed by the Secretary of State for the Colonies did not bode well for the Victorian Charter application if its success meant members of the Australian chartered body were able to adopt the initials and titles used by the English Institute. It was considered such usage "... would lead to inconvenience and misunderstanding both here and in Australia, and would give the members of the English Institute serious ground for complaint" (Letter from Lord Elgin reproduced in 141
Correspondence, 1906, p72). The basis of this contention was a letter from the Secretary of the Institute of Chartered Accountants which suggested the Colonial Office give attention

... to the public inconvenience which may arise, not only at home but all over the Empire, from the multiplication of "Institutes of Chartered Accountants", all of whom have apparently copied their title from that of this Institute, being fully aware of the value of the title "Chartered Accountant" and the respect it commands in financial circles all over the world (p73).

The letter went on to state that the Institute would oppose the Australian charter unless adequate protection was given to the title "Chartered Accountant". While the stated basis of such opposition was a lack of knowledge of the adequacy of accountancy examinations and professional standards, it is possible that such arguments were premised more on the fear that once Australian accountants could use the designation, Chartered Accountant, British chartered accountants stood to lose their monopoly on auditing the books of UK companies operating in Australia.

This contention is borne out to a certain extent in that not only did the Institute oppose the charter but also colonial legislation which could confer the title "Chartered Accountant" on members of specified professional associations or provide for registration of Australian accountants. This had already occurred in Canada and South Africa (pp72-73). This issue was again raised when a private member's bill calling for the registration of accountants was introduced into the New South Wales Parliament. Once again, the Secretary of the Institute protested via the Colonial Office arguing that the provisions of the bill could prevent members of the English Institute undertaking audits of New South Wales companies and from doing business for clients in that State (Correspondence, 1907, p147). This was claimed to disadvantage British investors who, having invested capital in the colonies should be able to appoint the auditor of their choice (pp147-148).
These fears provided the basis of an alliance strategy undertaken by the Australian professional associations. For example, the letter referred to above was forwarded for comment to the Corporation of Accountants of Australia by the New South Wales Treasury Department. The response made it clear that the Corporation considered British chartered accountants should not be debarred from undertaking accountancy work in any Australian state. Furthermore

\[...\] any Bill brought before the House affecting the profession of Accountancy will be closely watched by the Council of this Corporation, who will do all in their power to conserve the interests of the profession, not only throughout the Commonwealth, but, they trust, throughout the Empire (Correspondence, 1907, p149).

Similar sentiments were expressed in the May and June 1907 Editorials of The Public Accountant (1907c, p140; 1907d, p157 respectively). Whilst some Australian accountants quite rightly took exception to perceived slurs on the abilities of members of the Australian professional associations contained in the letter from the London Institute (Editorial, 1907a), a conciliatory approach was necessary because the support of the UK Institutes was needed if a Royal Charter was to be secured.

However, the assurances from the Corporation were to no avail, and, even if they had persuaded the English Institute to withdraw its opposition, other sections of the Australian profession continued to oppose the petition. The Royal Charter petition was officially refused on the basis that a charter should not be granted to individual associations but to one representative body (Marshall, 1978, p12; Corporation of Accountants of Australia, 1907, p96; ACPA, 1911a, p206). It was further suggested by the Colonial Office that the Australian accountancy profession should be regulated by local legislation. In the absence of such legislation, any charter application should
have the support of the Australian Federal Government (Poullaos, 1992, p79-80; 83-83). This was the starting point for the second unsuccessful charter bid.

(ii) Second Charter Attempt

As indicated in the counter-petition of the Corporation of Accountants, Australia and the New South Wales Committee of the Society of Accountants and Auditors, England, moves were already underway to form a federal association of practising public accountants (Proposed Victorian Charter, paragraph 13). This movement began in 1899 when the Institute of Accountants in South Australia, the Sydney Institute of Public Accountants and the Incorporated Institute of Accountants (Victoria) agreed to a system of uniform examinations (ACPA, 1911a, p204). In 1900, Queensland, Tasmania and New Zealand joined the scheme which operated until 1905 (p204). More concrete steps toward a unified profession of public accountants were set in motion in 1901 with agreement to draft a constitution to be commented upon at a meeting in Adelaide the following year. A further meeting in 1903 produced a series of resolutions which were later put to the members of the various Institutes throughout Australia and New Zealand. Despite protracted negotiations, agreement could not be reached and the issue was dropped (p205).

Early in 1906, the Corporation of Accountants of Australia and the Sydney Institute of Public Accountants entered into negotiations aimed at forming an association of all practising public accountants in Australia (Corporation of Accountants of Australia, 1907, p97). Later that year, the Institutes in Melbourne were invited to consider the amalgamation proposals developed by their Sydney counter-parts (ACPA, 1911a, p206). The negotiations continued into 1907 when the scheme eventually came to fruition with the formation of the Australasian Corporation of Public Accountants (ACPA) on June 14 (p207).
It appears that a desire to create an organisation, the membership of which was composed exclusively of practising public accountants, was the primary reason for the formation of the ACPA. The various Institutes already in existence in Australia had members who were not practising public accountants. The founders of the ACPA considered "... the time had arrived when we ought, in justice to ourselves, to say nothing of the advantage to the well-being of the general community, band the Public Accountants into one body" (ACPA, 1910b, pp174-175).

This exclusion of non-practising accountants, in particular, those who had passed the requisite examinations but had not yet entered private practice either in their own right or as a clerk in a private practice appears to have been the major barrier to the formation of the new association (ACPA, 1911a, p207). This factor plus the support given to the newly created ACPA by senior members of the Victorian Institute, some of whom became office bearers of the ACPA, was to cause a rift between the two bodies which persisted well into the 1920's (Graham, 1978, p5; ASA, undated, p27-28; Marshall, 1978, p13). As will be discussed shortly, the exclusion of non-practising accountants was also a major stumbling block in the ACPA's attempts to attain a Royal Charter.

Clearly, the formation of the ACPA was not for the sole purpose of obtaining a Royal Charter for a federated association of accountants. However, within two years of its creation, the ACPA lodged a petition for a Royal Charter through the Australian Federal Government (Graham, 1978, p7). The purpose of applying for a Royal Charter was to obtain for Australian public accountants the recognition and status accorded chartered accountants in the UK (ACPA, 1910b, p175; Editorial 1913b, p75). As with the charter attempt of the Victorian accountants in 1905, there was considerable opposition to the application.
Opposition was again voiced by the chartered accountants in the UK with regard to the usage of the designation "Chartered Accountant" (Graham, 1978, p7; ACPA, 1911b, p232). Frank Yarwood, a foundation member of the ACPA and long time member of the Sydney Institute of Public Accountants went to London in a bid to counter these objections (ACPA, 1911b, p232). Yarwood proposed that Australian chartered accountants be permitted to use the designation but, to remove any possible confusion, "(Aust)." be added for members of the Australian chartered body (p232). This compromise was accepted and the ICAEW promised its support for the Australian charter (p233; ACPA, 1910b, p175).

The second source of opposition was not so readily overcome. The Incorporated Institute of Accountants, Victoria objected to any charter being granted to an association consisting entirely of public accountants and was able to enlist the support of the Victorian Government in the pursuit of its opposition (Graham, 1978, p7; ACPA, 1910a, p134; ACPA, 1910b, p175).

The exclusionary tactics of the ACPA clearly had some element of snobbery attached to it. Statements in Editorials in *The Public Accountant* and by leaders of the ACPA such as Thomas Brentnall make it clear that accountants not in public practice were considered to be second-rate citizens being described as "commercial book-keepers" and "clerks" (Editorial, 1911b, p245; ACPA, 1912c, p236). Brentnall's Presidential address to the third Annual General Meeting of the ACPA clearly indicated the view held of accountants not in public practice:
A membership of 427 Public Accountants and their clerks throughout the Commonwealth . . . sufficiently indicated the approval with which the movement to differentiate the practising from the general office accountant has been received. . . . it is not intended to institute any invidious comparisons or to belittle the importance of the latter class, but one cannot lose sight of the fact that the varied nature of our work, as compared with the daily routine of the general clerk, in itself constitutes a distinction and difference which enforce recognition (1910a, p133).

In fairness to the ACPA, the insistence on members being in public practice in addition to having passed the requisite examinations was not a purely elitist stance. This approach which, in the terms of this study, can be seen as an alliance strategy or structural coupling, was necessary if the opposition to the charter application from the public accountants of the UK was to be overcome. When Yarwood visited London in 1909, the question of the charter was discussed with the accountants of England and Wales. In addition to the stipulation that a clear distinction be made between Australian chartered accountants and those in the UK, a minimum of three year's training in a public accountant's office was to be a mandatory membership requirement if the ICAEW was to support the charter application (ACPA, 1911b, pp232-233). The ICAEW had implied this stipulation as early as 1906. In November 1906, The Public Accountant reproduced an Editorial from The Accountant (England) which stated:

... it would be desirable that throughout His Majesty's dominions the term "Chartered Accountant" should be recognised as being synonymous with "qualified accountant," but that its use should be limited to those who are really qualified to practice . . . (The Public Accountant, 1906, p39).

The ACPA steadfastly adhered to this viewpoint insisting that a charter would not be granted to Australian accountants unless the application was lodged by an association consisting entirely of "bone fide" practising public accountants (ACPA, 1911b, pp232-233; 1912c, p237; Editorials, 1912, p251; 1913b, p74).
In addition to its argument that support of the UK chartered accountants rested upon the requirement that membership of the proposed Australian chartered body be restricted to those in public practice and their clerks, the ACPA also maintained that experience in public practice was essential in the public interest. From the perspective of this study, this approach is consistent with a desire to demonstrate professionalism as an altruistic motive is part of the professionalisation process.

In Editorials in *The Public Accountant*, ACPA Annual Meetings and Dinner addresses this concept of experience in addition to examinations and its relationship to the public interest was frequently raised (eg. ACPA 1910a, b; 1911a, b; 1913; 1915; Editorial, 1914). It was, for example, argued that the ability to pass examinations did not make a public accountant. Practice in the office of a public accountant was essential training for those who were to offer their services as qualified public accountants because practitioners should not learn at the expense of their clients (ACPA, 1912c, p226; Editorial 1914, p66; ACPA, 1914, p66). The objective of the ACPA was stated as being

... not so much to provide members with degrees and designations as to give the public a means of protection ... from incompetent work and also from certain malpractices ... the attainment of these objectives [made] it necessary in the interests of the public to make practical experience in the work of a Public Accountant an absolute essential for those wishing to qualify for membership (ACPA, 1913, p203).

The ACPA did attempt to overcome the opposition to the charter of the Victorian Institutes. The 1912 ACPA, Victoria Branch, Annual Report stated
The Victorian Local Council have during the year, by means of a small committee, endeavoured to bring about a better feeling between the Incorporated Institute of Accountants, Victoria, and this body, with a view to inducing the Institute to withdraw its opposition to the proposed charter (ACPA, 1912c, pp193-194).

The compromises offered by the ACPA included providing for Commercial Examinations open to "commercial book-keepers" who, if they passed, were eligible for membership if they entered public practice or became clerks in the office of a public accountant (Editorial, 1911b, p245; ACPA, 1912a, p157). Provision was also made for those who were members of "specified local" institutes to join the ACPA on commencing public practice (ACPA, 1912a, p157; ACPA, 1912c, pp237-238). This compromise was accepted by all the relevant institutes and societies except the Incorporated Institute of Accountants, Victoria (ACPA, 1912c, p238).

The other source of opposition to the ACPA's charter application came from Australian governments, in particular, the Commonwealth Government and the Victorian State Government. The support of the Commonwealth Government had been specified by the Colonial Office as a pre-requisite to the granting of a charter when the Victorian charter application was refused (Poullaos, 1992, p79-80; 83-83). Poullaos argues that the support of the Commonwealth Government was not forthcoming during the second charter bid because the ACPA had alienated it by its frequent references to the constitutional barriers to federal legislation (p84). A review of *The Public Accountant* provides ample evidence of what could be seen as a total lack of tact on the part of the ACPA with regard to this issue. For example, Brentnall argued at the Second Annual Dinner of the ACPA that a Royal Charter as a means of incorporation was sought because the Commonwealth Constitution made it impossible to achieve incorporation which would be effective throughout all of the States (1910b, p175). A slightly more pointed comment appeared in the Editorial of *The Public Accountant* in November 1912 where it was stated that it was practically impossible and unreasonable to expect all the States to submit similar legislation for
approval by the Federal Parliament (1912, p250). References to the constitutional barriers to uniform legislation also appeared in Editorials in January and May 1913 (1913a, p4; 1913b, p73). Yarwood's Presidential Address to the Fifth Annual Meeting of the ACPA was even more tactless in that references were made to State jealousies and expressed the view that "... in the present condition of Australian politics, there is [not] the slightest hope of anything being referred by all the States to the Federal Parliament" (ACPA, 1912b, p236).

However, the constitutional barrier was not the only aspect of local legislation driving the ACPA towards a Royal Charter. It appears the ACPA did not really want local incorporation even if it was Australia wide and its arguments could well be seen as a slur on the new Commonwealth. Yarwood, for example, argued that a Chartered degree would be recognised world-wide while a "purely local degree" would not (ACPA, 1912b, p239). World-wide recognition meant reciprocal agreements could be made so that Australian chartered accountants would be able to work as such in other countries (pp239-241). Similar sentiments were expressed in the May 1913 Editorial of The Public Accountant which further stated "... the object in view in connection with this application has been the obtainment of a designation and status for Australia similar to those which hold good in the Old Country..."(1913b, p74).

Given that the Commonwealth was still in its infancy, it is not unlikely that the various Australian governments would take exception to such statements even if the constitutional arguments were valid. Before embarking upon its charter bid, the ACPA had taken the trouble of seeking the opinion of "eminent Counsel" including a former UK Attorney-General and a constitutional lawyer, all of whom expressed the view that the Commonwealth Constitution would preclude the possibility of effective incorporation throughout Australia (1910b, p175).
It appears the Victorian State Government took particular exception to the idea of a Royal Charter maintaining that the process was "archaic" and therefore, Australian accountants should be regulated by local legislation rather than the "old country" (ACPA 1910b, p176). Victoria's opposition was mentioned at various ACPA meetings and annual dinners. Brentnall raised the issue at the Third Annual General Meeting in 1910 ((1910a, p134). Yarwood referred to Victoria's opposition at the ACPA's Annual Dinner in 1911 and the Fifth Annual Meeting in 1912 (ACPA, 1911b, p233; ACPA, 1912b, p235). These references suggest that the opposition of the Victorian Government was based more on its support of the Incorporated Institute of Accountants, Victoria than on any other issue. During the course of the third charter bid, Brentnall made it clear that this was the basis of the Victorian Government's opposition to the second charter application:

The action of the Incorporated Institute was the dominant factor which led to our defeat, because through their political influence the Victorian Government were induced to withhold their consent, avowedly on the ground that Australia ought to be competent to grant all the protection which was needed for the profession within its borders (ACPA, 1924a, p111).

Whatever the reasons behind the Commonwealth and Victorian Government's opposition to the charter, it was apparently too strong to turn the tide at this time. In April 1914, The Public Accountant stated "... the opposition has been politically too strong, and ... it is not likely the matter will be pursued further" (Editorial, 1914, p66). The outbreak of World War I and the necessary preoccupation of the British Government with it sealed the fate of the second charter attempt and the matter was dropped (ACPA, 1915, p85).

(iii) Third Charter Attempt

In 1923, a third and final movement was begun in the quest for a Royal Charter (Brentnall, 1938, p69). Initially, this attempt looked destined for the same fate as the
prior attempts. However, just as an autopoietic system learns to survive, it appears that the ACPA and its major protagonist, the Incorporated Institute of Accountants, Victoria, may have realised that if either organisation was to secure and maintain a prominent place in society, compromise would be necessary. Perhaps both organisations recognised the validity of an article in *The Accountant* (England) which stated

> A Charter is hardly likely to be granted, unless supported by the whole of the accountancy profession in Australia at least.

> ... if an absence of unanimity is found fatal to legislation in Australia, it is likely to be found equally fatal to any movement for the incorporation of one only of the accountancy bodies in Australasia by Royal Charter (Reproduced in *The Public Accountant*, 1913b, pp96-97).

According to Marshall, both the ACPA and the Commonwealth Institute were well-established (1978, p13). The Victorian Institute had increased its membership not only within Victoria but throughout Australia and, as a consequence, had amended its title to the Commonwealth Institute of Accountants in 1922 (p13; Graham, 1978, p8). As suggested previously, the ACPA had established itself as a well-respected professional association as early as 1912.

One of the clearest indications of a change in the approach of the ACPA towards not only their Victorian adversaries but also the Commonwealth Government was the lack of mention of the third charter attempt in *The Public Accountant* and public addresses by senior members of the ACPA. Brentnall, for example, referred to charter negotiations at the New South Wales Branch Annual Dinner in 1924 but only to say that so far no progress had been made but there was still hope (ACPA, 1924b, p178). At the Seventeenth Ordinary Meeting of Members in October of that year, Brentnall had made more extensive comment regarding the charter application but made it clear that even though the Victorian opposition was painful "beyond words" he still had
"nothing but the kindest feelings" for the Institute of which he had earlier held office as President and Vice-President (ACPA, 1924a, p112). Yarwood was a little more antagonistic stating in 1925 that Australia should not be prevented from getting what it was entitled to "through little jealousies" (New South Wales, 1925, p145). The Editorial column of The Public Accountant was remarkably silent on the issue and, in general, there was no return to the acerbity that characterised reports on the previous attempt including reference to the "antagonistic spirit" and "dog-in-the manger" tactics of the Victorian Institute being, as it was, a "less publicly important" organisation (1912, p250; 1914, p66).

There was also a clear change in the approach of the now Commonwealth Institute to the ACPA. In 1924, the ACPA once again lodged a formal charter application with the Privy Council and the Commonwealth Institute, predictably, lodged a counter-petition (Marshall, 1978, p13; ASA, undated, p28; ACPA, 1925, p114). However, in this instance, opposition was not based on the exclusion of non-practising accountants but on the granting of a charter to a specified accountancy association (Marshall, 1978, p14; ASA, undated, p28; ACPA, 1925, p114).

At the 1925 Annual General Meeting of the ACPA, Brentnall reproduced the Presidential Address of the latest Annual Meeting of the Commonwealth Institute (ACPA, 1925, pp114-115). The address set out the reasons (as indicated above) for the counter petition lodged by the Council of the Institute and suggested meetings of all practising accountants throughout the country with a view to renewing the charter application on behalf of "every reputable and genuine practising accountant throughout Australia" (p115). Brentnall expressed the view there was "little or nothing to object" to in this proposal and informed the members that meetings had already been held in Melbourne to "reconcile long-standing differences of opinion" (p115).
Early in 1926, agreement was reached between the two bodies. The terms of the resolution included that members of the Commonwealth Institute who had passed the full examinations of that body prior to the date of the granting of the charter should be eligible for membership of the chartered body on entering public practice. This was similar to the provisions the ACPA had already included in its articles except, of course, that prospective members previously had been required to sit for ACPA examinations so this represents a clear compromise on its part. In addition, the ACPA and the Commonwealth Institute were to have equal representation on the first Council of the new chartered body. It was also agreed that all negotiations and correspondence relative to this agreement be kept strictly confidential being disclosed only to members of the General Councils of the two bodies until such time as the Victorian Attorney-General withdrew that State's objection to the charter application (Graham, 1978, pp8-9). This perhaps explains the lack of public reference to the charter bid and also the scant, almost negligible, records of the negotiations (p8).

The other hurdle to be overcome in the quest for a charter was gaining the active support of the Commonwealth Government. This had been a stipulation imposed by the Colonial Office since the time of the first charter application. As discussed previously, this had not been forthcoming. In 1923, however, Stanley Melbourne Bruce became Australia's Prime Minister and lent active support to the charter bid (Graham, 1978, p11). Bruce apparently had a desire to cultivate a close relationship between Australia and Britain and, according to Graham, "... saw the Royal Charter as fitting evidence of the special nature of this relationship" (p11).

With all hurdles effectively removed, The Institute of Chartered Accountants in Australia came into existence with the granting of a Royal Charter on 19 June, 1928, to Thomas Brentnall, George Mason Allard and Henry Joshua Wise on behalf of the public accountants of Australia (Institute of Chartered Accountants in Australia. Royal Charter; Editorial, 1928, p3).
POST-PROFESSIONALISATION ACTIVITIES

As suggested in the foregoing, the Australian profession, in particular, the practising public accountants, had endeavoured to attain public recognition of their professionalism through claims to superior knowledge and skill acquired and demonstrated by the passing of examinations and practical training and experience. State and public recognition of professionalism was sought both in Australia and overseas through the acquisition of a Royal Charter incorporating the practising public accountants into one body politic, the Institute of Chartered Accountants in Australia. This was eventually achieved in 1928.

Commercial accountants, or those in private as opposed to public practice tended to be a more disparate group at this time with a large number of accountancy associations in existence. In 1952, the Australian Society of Accountants (now the Australian Society of Certified Practising Accountants), was formed through the amalgamation of the Commonwealth Institute of Accountants, the Federal Institute of Accountants and the Association of Accountants of Australia (Zeff, 1973, p1; ASA, undated, pix; Fitzgerald, 1962, p290). Fitzgerald termed the formation of the ASA "...a marked return to sanity in the organisation of a unified profession" (p290).

The ICAA and the ASCPA represent the two major accountancy associations in Australia and as such, they control entry to the profession through rules of membership in the form of education and training requirements and a code of ethics. However, membership of professional accountancy associations is not mandatory and the situation prevails whereby anyone who so wishes can call themselves an accountant even if they cannot use the designations reserved for members of professional associations. Nevertheless, membership of professional associations, as evidenced by the use of identifying initials after the members name, carries status and
prestige and this may act as an inducement for those who are qualified to join the appropriate professional association. In this sense, the formation of a professional association and the achievement of public recognition and acceptance of its autonomy and monopoly over its area of knowledge in terms of determining educational and training requirements and ethical codes is a form of mobilisation.

Mobilisation is aimed at ensuring that the enrolling agent is not betrayed by the enrolled. In other words, the representations of interest remain fixed (Clegg, 1989, p205). This is the final and, arguably, the most critical phase of the translation process as it is seeking a transition from enrolment or alliance, to active support (Callon, 1986, p218). As Callon puts it, only one voice will be heard. Mobilisation is directed towards avoiding betrayal by enrolled agencies so that relations of meaning and membership remain fixed as do rules of practice.

Until fairly recent times, accountancy had rules of entry as determined by education, training and a code of ethics but it did not have formal rules of meaning or of practice. These did not begin to emerge until towards the middle of this century and, until recently, were not binding on anyone other than members of the professional associations. The setting of accounting and auditing standards and guidelines is a form of mobilisation because of the threat of denial of membership of a professional association for non-compliance with them. This is so even if membership is not compulsory because of the perceived status and prestige attached to membership of a given professional association. As the profession in Australia exerts considerable influence on the education of aspiring accountants, normative isomorphism also helps ensure compliance with standards set by the profession.

The accomplishment of legal backing for standards approved by the AASB is another example of mobilisation by the profession, particularly since the merger of the Accounting Standards Board and the ASRB. The profession now has de facto
control of the rules of practice through its research arm, the AARF. Similarly, the statutory provisions requiring auditors to state whether or not accounting standards have been complied with may also act as incentive for management to apply the accounting standards prescribed by the accountancy profession. Therefore, not only are accounting standards a form of mobilisation but so is the company legislation which gives compliance with them legitimacy.

Accounting standards also provide the basis of the accountancy profession's exercise of episodic agency power not only over members of the profession but company management who are obliged by law to comply with accounting standards. The practitioner, particularly the auditor, also has a certain level of autonomy based on "professional expertise" in the interpretation of accounting standards and, thereby, a degree of episodic agency power over company management. Episodic agency power is the most visible of the power circuits because it is the circuit through which outcomes are secured (Clegg, 1989, p211). It is the realisation of the translation process in that in order to exercise power at this level, control of the obligatory passage points must have been achieved at the dispositional and facilitative levels.

The following section of this chapter will deal briefly with the history of the standard setting process in Australia including the achievement by the two major professional associations of control of that process with the express blessing of the State. Once again, it is not intended to attempt an exhaustive study of this aspect of the professionalisation process. Key events such as the decision to issue accounting recommendations, the establishment of research bodies and committees and, eventually, the creation of the ASRB will be used to demonstrate the professionalisation process and the activities of the two major professional bodies in attaining domination of the standard setting process. Where appropriate, the experiences of the professions in the USA and the UK will be referred to. This will
only occur, however, where the Australian profession has clearly indicated that it has been influenced by these activities.

**Australian Accounting Standards**

Australian accounting standards are a fairly recent phenomenon arising, it would seem, not out of any pressing urgency on the part of the accountancy profession to protect the public interest but out of a desire to maintain professional autonomy. As noted above, the formation of professional associations, registration of the profession and the attainment of a Royal Charter for practising public accountants were all argued for on the premise of their desirability in the public interest. Accounting standards, on the other hand, appear to have been in response to a perception that if the profession did not set them, the legislators would. For example, in discussing A. A. Fitzgerald's paper dealing with accounting standards presented at the Australian Congress on Accounting in Sydney in 1949, C W M Court, State Registrar of the Western Australian branch of the ICAA, stated that "[c]omplacency on the part of the profession will mean compulsion, regimentation and legislation" and, therefore, the profession should act and ". . . give the legislators no excuse to legislate for improvement of our standards" (Fitzgerald, 1949, p40). This fear of legislative interference appears to have been based on the position in which the establishment of the Securities and Exchange Commission (SEC) placed the profession in the USA. Fitzgerald made specific and detailed reference to instances in the USA and UK which should serve as warnings to the Australian profession.

**Learning From Others**

(i) The USA Experience

During the 1920's, the profession in the USA was subjected to increasing criticism for failure to produce financial statements which provided adequate information for the use of shareholders, the state and the general public (Ripley, 1972, p165). One
suggestion was that the Federal Trade Commission, created by statute in 1914, to require corporations to file special and annual reports in accordance with rules specified and prescribed by the Commission (p215). As one would expect, the profession disagreed with this course of action. G. O. May, a prominent member of the American Institute of Accountants, suggested instead that efforts should be made to determine the proper responsibilities of auditors (who at this time bore the brunt of the criticism for inadequate financial statements) and how to ensure that these responsibilities were carried out (May, 1936, p54). It was further suggested that cooperation with other bodies, including stock exchanges and banks, should be sought in this endeavour (p56). Hence, May was suggesting what this study would term an alliance strategy in overcoming the threat of legislative interference.

However, this scheme did not come to fruition and the stock market crash of 1929 brought more extensive criticism of the accountancy profession:

The stock market crash in the fall of 1929 was a catastrophe beyond the worst predictions of the most pessimistic observers. The financial community was in a state of shock. Thirty billion dollars of quoted value of securities vanished in less than a month. Banks failed and, in some states, were closed. Financial paralysis gripped the country. Public reaction was bitter, and a critical review of the process of the financial market, including financial reporting practices, became an obvious political necessity. (Carey, 1979, p245)

In the wake of this catastrophe, the New York Stock Exchange issued an invitation to the American Institute to appoint a committee to work in cooperation with the Exchange with a view to improving financial reporting, including a reduction of the number of accounting methods used to deal with similar transactions (Zeff, 1971, p121). The invitation was accepted and the Special Committee on Cooperation with Stock Exchanges, with May as chairman, was appointed. Thus began the first formal attempt to develop a set of agreed upon accounting principles although it was not
considered appropriate to specify detailed methods of accounting. Individual corporations were to be left to select, within the broad principles formulated, the methods most suited to their business (May, 1936, p120). However, despite the formulation of a number of recommendations, no substantive action was taken by the profession.

In 1933 and 1934, federal legislation was introduced for the regulation of interstate securities markets and national securities exchanges. The Securities and Exchange Commission (SEC) was created to administer these Acts and, most importantly, from the profession's viewpoint, had the power to prescribe the accounting and auditing practices to be adopted in the preparation of financial reports filed with it under the Acts. The SEC did not invoke its powers in this regard other than to require the audit and certification of financial statements and annual reports by an independent public accountant (Zeff, 1971, p130). However, when, by 1935-36, there were still a number and variety of accounting practices in use, the SEC began to issue threats to use its powers to improve accounting practices. Initially, such threats were somewhat veiled. For example, in 1937, the then SEC Commissioner, Robert Healy, stated:

It seems to me, that one great difficulty has been that there has been no body which had the authority to fix and maintain standards [of accounting]. I believe that such a body now exists in the Securities and Exchange Commission. (1938 p5)

By 1939, the threat was quite explicit. In its report to Congress, the SEC stated that if the profession was "unwilling or unable" to "maintain and improve the standards of accounting practice", the SEC would use their statutory powers to do so (Zeff, 1971, p139).

The profession's response, via the American Institute, was to increase the membership of its Committee on Accounting Procedures (which was appointed in 1933 under the
Special Committee on the Development of Accounting Procedure and renamed in 1936) from seven members to twenty-one members. The composition of membership was also changed to no longer include members of the large accounting firms only but also those of the smaller firms and representatives from accounting academia.

At its initial meeting the Committee discussed the feasibility and desirability of developing a comprehensive statement of accounting principles as a guide to day to day practice. However, it was concluded that such a task would be too time consuming and the SEC may not be prepared to await the outcome. The plan was rejected and the Committee instead addressed specific problems as and when they arose. In addition, both the American Institute of Certified Public Accountants (AICPA) and American Accounting Association (AAA) commissioned studies of accounting principles while an independent study was also conducted. These were:

1936 Tentative Statement of Corporate Accounting Principles Underlying Corporate Financial Statements, AAA

1938 A Statement of Accounting Principles, AICPA

1940 An Introduction to Corporate Accounting Standards, Paton and Littleton

The major purpose of these studies was to describe existing practice rather than prescribe accounting practice.

The activities of the USA profession can be seen as taking place within the circuit of dispositional power at the level of social integration. Co-operation with other organisations is not only a process of creating alliances but also of constructing an "actor-network", "organisational field" or "field of force" (Clegg, 1989, p225). As
noted in Chapter 2, accountancy is only one element of the regulatory framework. By seeking to involve stock exchanges and banks in its attempts to discover the principles of accounting, the American Institute was attempting to enlist their support by recognising their existence within the regulatory framework.

The attempts to formulate accounting principles were efforts to establish rules of practice or modes of rationality which would provide the solutions to the problems facing not only accountancy, but others within the business and regulatory field. In particular, by assisting corporations and accountants, including auditors, to prepare more useful financial statements for the information of users. In this respect, the move to identify and formulate accounting principles appears to have been a problematisation process in response to exogenous forces arising from innovation in techniques of discipline and production within the facilitative circuit at the level of systems integration (Clegg, 1989, p224). The Wall Street crash and other corporate failures of the 1930's, for example the Kreuger and McKesson and Robbins cases (Fitzgerald, 1949, pl7) forced the profession to acknowledge the need for change in the existing rules of practice which, prior to the establishment of the SEC, extended only to incorporation. There were no controls over disclosure in published financial statements. At the professional level, attention had previously focused on terminology and auditing procedures (Zeff, 1971, p119). Now, in response to corporate failures and the criticism of the accountancy profession which followed it, the profession re-directed its attention to accounting methods.

By directing its attention to formulating accounting principles in response to corporate failures, the American Institute was also using the translation process of interessement. Interessement means to come between (Callon, 1986, p208; Clegg, 1989, p205). Hence, there must be at least three groups or elements in this process. As already discussed, Lee (1990, p138), Larson (1977, p58) and Johnson (1972, pp13-14) see the work of the professional as crisis relevant, that is, the professional
stands between the client and disaster. The professional thus is attempting to put itself in an agency relationship by avowedly using its expert knowledge and skill for the benefit of those in crisis. In this particular case, the American Institute appears to have been attempting to not only assist business but to also ensure that published financial statements were useful to those who relied on them. Hence, the American Institute was attempting to form an agency relationship between itself and the users of financial statements.

The activities of the profession in establishing committees to consider accounting procedures and commissioning independent studies were methods of "organisational outflanking" (Clegg, 1989, p19; 218-240). The profession appears to have been attempting to outmanoeuvre the government and any others who sought to assume control of accounting practices by using resources such as its experience and accounting knowledge to maintain its autonomy. The success of the profession is evident in that the SEC did not invoke its statutory powers with regard to prescribing accounting practices to be used in the preparation of financial statements.

(ii) The UK Experience

With regard to the UK, Fitzgerald contended that interest in accounting practice was sparked by the Royal Mail case (1949, p14). Prior to this, accounting practice in the UK was a matter of individual judgment and any attempt to prescribe the form or content of financial statements was frowned upon (1949, p14). During the 1930's, there was a progressive change in this approach. This change was clearly designed to forestall government interference and, as such, can be seen as "organisational outflanking" in much the same way as the activities of the American Institute. However, the UK approach was, perhaps, a more blatant and calculated example of organisational outflanking. In 1932, the then president of the ICAEW, H L H Hill, in discussing company law with regard, inter alia, to the duties of auditors recognised the inadequacies of the law and the fact that it was not difficult to stay within the law
and at the same time, prepare accounts that did not provide useful information or could even be misleading (The Accountant, 1932, p45). Hill did not consider that auditors should hide behind inadequate legislation nor should they be content with meeting the minimum obligations of the law (p45, 46). The profession should, in fact, lead the way:

There is always a lag, and legislation with which we are concerned is always framed upon the best accountancy practice. We must, therefore, take the lead so that, if and when fresh legislation is enacted, there may be by that time an established practice in accountancy in advance of the requirements of present-day legislation, and established practice that will assist and direct those who frame the law to institute further safeguards for investors and the public (p45).

The risk in not taking such a leading role was that legislation could be instituted which would reduce auditors to "mere automata" obeying "audit programmes laid down by statute" (p46). In other words, auditors would lose their ability to exercise professional judgment. Hill also specifically discussed the Royal Mail case and its impact on the profession and again expressed the view that the profession should not be content to restrict their responsibilities and obligations to the minimum requirements of the law (p46). The profession had a responsibility to those who relied on the balance sheet and accounts to ensure that they did not present an incorrect view or wrong impression. From this last, it is clear that Hill was also indicating a form of agency relationship between the profession and the users of financial statements (p46).

The accountants in the UK did not follow the same path as their USA counterparts in that they appear to have initially concentrated on influencing company legislation. However, in 1942, the ICAEW began issuing recommendations on accounting principles (Fitzgerald, 1949, p16).
(iii) Australia's Tepid Response

It is clear from Fitzgerald's paper and the commentary and discussion which followed it, that not only Fitzgerald but other members of the profession saw the need for Australian accountants to learn from the experiences of both the USA and the UK and to develop standards of practice. In particular, Fitzgerald saw the lack of "authoritatively expressed accounting standards" as an unsuspected weakness of the profession which was brought to light by abuses of the corporate form. In turn, abuses of the corporate form highlighted the limitations of accounting practice based on convention (pp17-18). Fitzgerald urged the profession in Australia to "actively" pursue research into accounting standards and not wait for "atomic bombs" such as those in the USA and the UK to shatter their complacency and arouse their self-interest (p18).

Both the ICAA and the Commonwealth Institute of Accountants had, by this time, begun issuing guidelines to their members. The Commonwealth Institute had established a Committee on Accounting Principles in 1938 (ASA, undated, p47; Zeff, 1973, p29). This committee issued a pronouncement on cash discounts allowable and receivable in 1940 (ASA, undated, p47; Zeff, 1973, pp29-30). No further pronouncements had been produced by the time of the Australian Accountancy Congress in 1949. However, an Accounting Research Committee had been established in 1948 (Zeff, 1973, p32).

The ICAA issued five Recommendations on Accounting Principles in 1946 with two more being issued in 1947 and 1948 (Zeff, 1973, p3). The titles of these pronouncements were identical to those issued by the ICAEW:

- Form of Balance Sheet and Profit and Loss Account
- The Treatment of Taxation in Accounts
- The Inclusion in Accounts of Proposed Profit Appropriations
Reserves and Provisions

Disclosure of the Financial Position and Results of Subsidiary Companies in the Accounts of Holding Companies

Depreciation of Fixed Assets

The Valuation of Stock in Trade

The use of the overall designation, Recommendations on Accounting Principles, and their content, was also taken from the ICAEW (ICAA, 1966, p3; Zeff, 1973, p3). The content of the Recommendations was modified in light of local conditions (ICAA, 1966, p3).

This is an example of mimetic isomorphism in that the ICAA was deliberately imitating the ICAEW. As discussed in Chapter 2, an organisation will imitate what it considers to be a more legitimate or successful organisation when there is uncertainty or ambiguity arising from innovation in techniques of discipline or production (DiMaggio and Powell, 1983, p152). Ambiguity and uncertainty would have arisen in part because accountancy, as an organised profession, was only just beginning to establish rules of practice and meaning. There was no tried and tested mechanism for the process and, perhaps more importantly, both accountants and corporate management had been autonomous in determining appropriate accounting methods and practices in individual situations. Ambiguity, therefore, could be seen as arising from a lack of knowledge of what practices were generally in use. Uncertainty would have existed as to how accountants and directors might respond to any attempt by a professional association to prescribe accounting practices.

The ICAA was relatively "young" compared to the ICAEW. It had already styled itself on the ICAEW in terms of its rules of membership. Therefore, it is not unusual that the rules of practice formulated by the ICAEW were also adopted by the ICAA. Zeff’s research supports this contention. In a study of the development of accounting
principles in Australia sponsored by the ASA, Zeff found that some members of the ICAA considered it appropriate to follow the Recommendations of the ICAEW in light of its "more mature professional experience" (1973, p9).

Despite this early start into the arena of formally determining accounting practices, the profession in Australia made little progress towards the setting of accounting standards during the 1950's and early 1960's other than the establishment of various research committees such as the Australian Chartered Accountants' Research and Service Foundation created by the ICAA in 1956 (Zeff, 1973, p6). This dearth of Australian progress in developing accounting standards was raised by Fitzgerald in 1962. Fitzgerald reiterated the view that what had spurred the research activities of the 1930's and 1940's had been corporate failures and scandals and expressed the hope that the profession in Australia would not wait for "another series of financial cataclysms" to spur it to action (1962, p293, 294). It was, in fact, a series of corporate failures that brought criticism of the Australian profession and finally prompted it to more significant action than what had been taken in the past.

Australian Accountancy's "Atomic Bombs"

The 1960's saw the failure of some of Australia's most prominent companies including Reid Murray Holdings Ltd, Stanhill Development Finance Ltd and H. G. Palmer (Consolidated) Ltd (ASA, 1966; Birkett & Walker, 1971). The failure of these companies and the subsequent investigations into them brought considerable criticism of the accountancy profession. To quote Birkett and Walker:
Many of the failures followed hard on the heels of the publication of audited financial statements depicting a profitable past and an apparently sound present. The inspectors' reports later documented breakdowns in accountability. Many of the failed companies had been in a state of crisis for some considerable period prior to their ultimate collapse. Their financial statements had not only failed to inform investors - they had also been misleading. These financial statements had been prepared by accountants, signed by auditors. In the public's eye they were the responsibility of the accounting profession (1971, p131).

It appears that both the ICAA and the ASA were somewhat slow in accepting responsibility for the inadequacy of financial statements of failed companies. However, in 1964, the General Council of the ASA expressed its concern at the publicity which inspectors' reports into failed companies was generating in the press and instituted a study of some of these reports (ASA, 1966, p4; Zeff, 1973, p37). The results of the study were issued in 1966 under the title, *Accounting Principles and Practices Discussed in Reports on Company Failures* (ASA, 1966). The General Council argued that many of the criticisms of accounting principles found in the inspectors' reports were either unjustified or unsoundly based (p5). However, it was conceded that criticisms of directors, management and financial policies did have implications for the profession as did the many departures from generally accepted accounting principles detailed in the reports (p5).

In response to these criticisms and their implications for the accountancy profession, General Council considered there should be proper control and development of the profession and its members (p28). The matters which General Council considered to be of prime importance to the profession were:

(a) the establishment and promulgation of generally accepted accounting principles and standards of conduct

(b) the continued adherence to these by members of the profession

(c) disciplinary action to be taken by the profession against members for conduct derogatory to the profession of an accountant
The Accounting Research Committee of General Council was instructed to undertake research with a view to the formulation, promulgation and review of accounting principles for the guidance of members. Care was to be taken, however, that these activities did not inhibit continuing enquiry or future changes in accounting practices in response to changing circumstances (p28). There was, however, a difficulty with this. The ASA had, as yet, not issued any statements dealing with recommended practice. This was partly due to the cost involved in formulating and promulgating such statements. A further consideration was that such activities would put the ASA in direct competition with the ICAA which had issued Recommendations to its members (Zeff, 1973, p37). The alternative, the creation of a jointly sponsored research foundation, had been proposed in 1964 (Zeff, 1973, p11). In 1965, the Accountancy Research Foundation came into existence (p43).

The aim of the Accountancy Research Foundation was "... the consolidation and dissemination of extant accounting and auditing principles and unresolved problems of accounting and auditing ..." (Boehme & Braddock, 1965, p318). However, its functions did not extend to issuing Recommendations which remained the prerogative of the ICAA and the ASA (Zeff, 1973, p44). Both associations continued to formulate their own principle statements with a consequent duplication of effort. In 1971, the futility of this exercise was identified and moves were made to bring the standard setting processes under the umbrella of the Research Foundation (p21). 1973 saw the separate standard setting activities of the ICAA and ASA brought under the auspices of a restructured and renamed research foundation, the Australian Accounting Research Foundation (AARF) (Gibson, 1988, p29). In 1974, the Australian Accounting Standards Committee assumed, as part of the AARF, the responsibility for developing accounting standards (Balmford, 1977, p546).
The profession was finally united in terms of formulating rules of practice at least. This was an essential step if the profession was to achieve episodic agency power because the key to this circuit of the power framework is the creation of agency relationships through effective organisation. As suggested in the discussion of the corporate failures in the USA and the UK which led to the moves in those countries to formulate accounting principles, the agency relationship the profession was to forge was between it and the public, in particular, the investing public. This relationship will be discussed in more detail in the next chapter.

**The Role of Accounting Standards - Uniformity v Disclosure**

As noted previously, the General Council of the ASA had not only seen the establishment and promulgation of generally accepted accounting principles and standards of conduct as pressing matters for the profession, but also the adherence to these by members of the profession. Failure to do so would, ideally, result not only in disciplinary action but its publication (ASA, 1966, pp31-32). This approach was consistent with a need to reduce diversity in accounting practice identified as early as 1953 with the establishment of the ASA’s Research Committee.

The aim of the Research Committee was ". . . to narrow areas of difference and inconsistency in accounting practice and to further the development and recognition of generally accepted accounting standards . . . by means of Statements of Accounting Practice . . . " (The Australian Accountant, 1977, p539). However, as a Senate Select Committee on Securities and Exchange discovered some 20 years later, this goal had not been achieved. In 1974, the Australian Securities Markets and Their Regulation report (the Rae Committee report) expressed concern at the ". . . lack of uniformity in the preparation and presentation of the financial accounts of members of the different stock exchanges" (Australia, 1974, 3.81). In addition, surveys conducted by the New South Wales Corporate Affairs Commission in the mid-1970’s showed
that even where the profession had issued statements of accounting practice, there was substantial evidence of non-compliance with them (Ryan, 1977, p559).

Moves to enforce compliance with accounting standards by members of the ICAA and the ASA had begun as early as 1969 when the Research Committee of the ICAA issued three exposure drafts containing a paragraph stating that the provisions of the pronouncement must be followed except in "exceptional circumstances" (Zeff, 1973, pp16-17). The General Council removed these clauses (p17). In 1971, however, the General Council issued *Conformity with Institute Technical Statements* which stated, inter alia, that members

\[\ldots\] should observe the accounting practices and principles set out in the Institute Statements and Recommendations, knowing that they will be under an obligation to the Institute to disclose significant departures therefrom and to justify their concurrence with any deviations from recommendations of the Institute (reproduced in Zeff, 1973, p22).

In 1976 an amended version of this statement, *KI/300 Conformity with Accounting Standards*, was issued jointly by the ICAA and the ASA. The amended statement was not as strongly worded in that it required members of the Australian accountancy profession to support the standards promulgated by the profession (paragraph 4) and to make appropriate disclosure of any departures from the profession's accounting standards (paragraph 5). It was further stated that failure to observe accounting standards or disclose departures therefrom would be investigated. Disciplinary action would be taken in the event that the member's explanation of the apparent failure was not satisfactory (paragraph 11).

During the course of the 1977 Annual Research Lecture of the Victorian Division of the Society, John Balmford, a practitioner and member of the National Council of the ICAA, expressed the view that the emphasis on disclosure and explanation of
departures was more appropriate than mandatory compliance because it provided the user of the accounts "with information on which he can make up his own mind" (1977, p554).

In commenting on Balmford's paper and this point in particular, the New South Wales Commissioner for Corporate Affairs, F J O Ryan, disagreed saying the approach "... simply does not meet the needs of the times ..." (1977, p560). He used an example which had actually come before the Commission earlier in 1977 in which a company reported a half-yearly profit of $81,247. The auditors, however, considered the appropriate accounting principles to be applied in the circumstances would have shown a loss of $1.6 million. Nonetheless, they were unable to prove to the Commission's satisfaction that the profit of $81,247 was not an honest or reasonable result (p560). As noted by Ryan:

The principal point of concern is not the disparity of $1.7m between the two figures. Rather it is the fact that it arose from the absence of enforceable and universally accepted standards, so that in any given case the difference can be open-ended. This leads to the result that where a contest as to the truth and fairness of accounts can be made to turn upon a difference of opinion between directors and auditors as to the appropriate principle to be applied, a prosecution will only succeed in those cases where no reasonable man could possibly have arrived at the same figure as the directors (p560).

The Birth of the Accounting Standards Review Board

In Ryan's view, the profession was incapable of solving this problem without "... legislative support for the standard setting process and legislative endorsement of the standards so produced" (p560). This had, in fact, been one of the recommendations of the ASA's General Council in its report on Accounting Principles and Practices Discussed in Reports on Company Failures (ASA, 1966). In dealing with adherence to generally accepted accounting principles by members of the profession, the General Council stated that there was little use in having rules and regulations unless members
were compelled to comply with them (ASA, 1966, p28). Council, therefore, called for disciplinary action against members of the profession who failed to adhere to the accounting principles promulgated by the profession to be enforced by statute (p32). However, the General Council made it clear that this authority should be vested in the profession itself and not in some "statutory authority" (p30). The basis of the contention was that an outside authority would not be competent to deal with the ethical, educational and other aspects of the profession which may arise from instances of non-compliance and weaknesses in professional standards (p29). Furthermore, control by an outside authority may prevent new thought and progress (p29).

The response to Ryan's suggestion was similar. To some this did not appear to be a viable proposition if it meant the establishment of a body similar to the SEC although this was seen as perhaps the only way to ensure compliance with accounting standards:

This [the establishment of a quasi-governing body to prescribe, inter alia, reporting standards] is not imminent while sufficient opposition to the equivalent of a Securities and Exchange Commission exists in Australia. However, the very absence of an SEC in Australia could limit the effectiveness of any new standards-setting body which the Institute and Society may voluntarily set up (Taylor, 1977a, p21).

While not strictly the equivalent of the SEC, the National Companies and Securities Commission was established in 1980 on the recommendation of the Rae Committee (Australia, 1974, 1.1). The NCSC was actually a compromise arrangement in that the Rae Committee recommended the creation by the Federal Government of an Australian Securities Commission (1.1). The NCSC was in fact a joint commission established by a grouping together of individual State Corporate Affairs Commissions which the Rae Committee had specifically rejected (16.14). However, as will be
discussed in more detail in a subsequent chapter, perceived constitutional impediments to Federal corporate legislation precluded the creation of a Federal securities regulatory scheme.

In 1984, the Accounting Standards Review Board was created. The impetus for the establishment of the ASRB appears to have been the 1981 *Final Report of the Committee of Inquiry into the Australian Financial System* (Campbell Committee). On the basis of evidence supplied by the New South Wales Corporate Affairs Commission, the Committee criticised the accounting profession for its failure to pay sufficient attention to the enforcement of accounting standards (Australia, 1981, 21.58, p372). According to this evidence, the Commission examined 2463 company accounts in 1979. Of these accounts, 45 per cent had not complied with accounting standards (21.58, pp372-373).

A further concern of the Commission was the incidence of apparently misleading financial reporting. As noted above, Birkett and Walker found that many of the corporate failures of the 1960's occurred after the companies concerned reported profits (1971, p131). The Campbell Committee noted a similar phenomenon

Critics point out that some major company collapses during the 1970's closely followed the publication of audited financial accounts ... which showed the companies to be solvent and even profitable (1981, 21.47, p371).

In this regard, the Campbell Committee went on to state, on the basis of The Sandilands Committee (UK) findings, that the major problem was "the imprecise nature of accounting standards" (21.48, p371). Furthermore, stringent reporting requirements would not benefit users of accounts if imprecise standards meant the "true state of affairs or a trend" could not be assessed (21.49, p371).
For the above reasons, the Committee recommended

(a) The two professional accounting bodies should continue to be responsible for the design and development of accounting standards.

(b) An Accounting Standards Review Board should be established with responsibility for deciding on the adoption of accounting standards, having regard to the needs of different users; the NCSC, professional accounting bodies and other interested parties should be represented on the Board.

(c) Accounting standards recommended by such a board should be given legislative support (21.57, p372).

The Committee considered the professional accounting bodies should continue to develop and design standards because they had the "necessary expertise" and furthermore, if standards were to be designed and developed by government

... it is questionable whether the standards would be as soundly based or as closely attuned to the needs of users of accounts as standards developed by those actively involved in accounting practice (21.55, p372).

However, in the adoption of standards which have legal backing to facilitate enforcement, there should be a balancing of interests (21.56, p372). In making this observation, the Committee recognised the political nature of accounting standards in that such standards had the potential to affect the economy through investment behaviour, and therefore should not be solely determined by the accountancy profession (21.46, p370).

Similar sentiments as to the flexibility of accounting standards, the political nature of accounting standards, problems of enforcement and the need for an Accounting Standards Review Board had been expressed by the New South Wales Attorney-General, Frank Walker (1981a, b). For example, Walker stated that on becoming Attorney-General in 1976 he was "... shocked to discover important prosecutions
failing through lack of certainty as to what were proper accounting standards" (p235). The fact that the selective application of accounting principles could, on the one hand, produce a loss of $3 million while on the other give a profit of $100000 was also cause for concern particularly when both results were deemed to give a true and fair view (p235). In order to overcome the deficiencies of accounting standards, Walker recommended the establishment of an independent Accounting Standards Review Board with representatives drawn not only from the accountancy profession but also from industry, commerce, law, economics and Government (p235). Such a representative board was necessary because mandatory compliance could be onerous and costly particularly if the standards were inflexible (1981b, p23).

Substantive moves towards the establishment of an ASRB began in 1980 when the Ministerial Council resolved that such a body should be considered and requested the NCSC to formulate a proposal for its creation (NCSC, 1982, p21). In response to this request, the NCSC recommended, inter alia, the establishment of an ASRB which was to be independent of the professional accounting bodies. However, the ASRB was not to design and develop accounting standards. Instead, the ASRB was to review accounting standards set by the accounting bodies and, if acceptable, recommend NCSC endorsement (1982). In November 1981, the NCSC issued a media release detailing its recommendations and calling for submissions from interested parties. A joint submission was made by the ICAA, the ASA and the AARF.

In its submission, the profession accepted the need for legislative backing for Australian accounting standards because such backing would:

a. Focus greater public attention on the content and importance of accounting standards . . .

However, the profession considered that the most simple and economical method of achieving legislative backing for accounting standards was to follow the Canadian approach and give legislative support to standards set by the accountancy profession (C.1). The profession argued that it had the expertise to not only develop accounting standards but also to determine priorities in the preparation and revision of them (B.6). The establishment of a government-sponsored ASRB should only be considered if this was considered essential to the achievement of legislative backing for accounting standards (D.1d).

The NCSC was not persuaded by the profession's arguments. In December 1982, the NCSC issued a media release detailing its report to the Ministerial Council with regard to the establishment of an ASRB. The NCSC maintained its stance on the independence from the professional bodies of the ASRB (NCSC, 1982b, paragraph 6(i)). The basis of its recommendations included a perception by the NCSC that the "... profession had difficulty in securing the acceptance of its accounting standards by the business community" and "... the business community could be expected to resist the imposition of standards set unilaterally either by government or by the accounting bodies" (paragraph 7). Furthermore, the NCSC Media Release stated that those who had advocated legislative support for the accounting profession's standards had done so in general terms and few had addressed the issue of benefits to users of statutory backing for those standards (paragraph 34).
Leigh Masel, then NCSC Chairman, elaborated on these views stating that the NCSC was not convinced by the profession's case for legislative backing for standards set by it (1982, p12). In Masel's view, legislative backing for the profession's standards represented a transfer of a form of voluntary restraint to a form of compulsory restraint backed by government enforcement (p10). Masel also raised the point made in the NCSC Media Release that those who advocated legislative backing for the profession's accounting standards did so in very general terms only (p11). The accountancy profession, as noted above, based its claim on its expertise in the area. However, neither the accountancy profession nor any of the other respondents addressed the possible impact on the capital formation process of the exploitation of uncertainties in existing accounting standards (p11). As noted previously, the imprecise nature of accounting standards was highlighted by the Campbell Committee as a factor in the unexpectedness of some of the corporate failures of the 1970's.

Masel also pointed out there was a difference between devising accounting standards to reduce the likelihood of misleading information and enforcing them (p9). A private standard setting agency faced problems not only of authority to enforce standards but also gaining acceptance of its standards (p10). In this regard, Masel considered the accounting profession needed to realise that in seeking legislative support for its standards, it was in the realm of politics (pp3-4). One of the reasons advanced for this is that accounting standards can have significant wealth distribution implications. Masel expressed concern that the profession could be subject to political pressures and influences such that it would not be responsive to all interests but to particular business interest or of members of the profession who were able to exercise the most pressure (p9). Politicians were, admittedly, also susceptible to political influences and pressure from special interest groups. However, politicians were responsible to Parliament whereas the accounting profession was not. This represented an impediment to delegating enforcement of accounting standards to the profession (p9).
Masel also raised the issue of the lack of authority and enforcement power of a private standard setting agency and saw this as a major weakness (p10). The profession's difficulty in attaining compliance with its standards has already been discussed. The profession recognised this difficulty itself in its submission to the NCSC (Australian Accountancy Profession Joint Submission, B.3). Non-compliance suggests that the profession's standards were not generally accepted by the business community. However, the NCSC also recognised that the business community may not accept accounting standards set unilaterally by a government body (NCSC, 1982b, paragraph 7). As discussed in Chapter 2, such an attitude is consistent with the notions of dissidence and resistance which represent an impediment to the exercise of episodic agency power. This concept will be discussed in more detail in the standard setting context in a later chapter. In the face of likely opposition to accounting standards set by the professional accountancy associations and for the other reasons outlined above, the NCSC accordingly recommended to the Ministerial Council the establishment of an ASRB. Its recommendations were submitted jointly with the New South Wales Corporate Affairs Commission (NCSC, 1983, p48). The recommendations were accepted by the Ministerial Council on 25 March 1983 and the ASRB became a reality in January 1984 (pp48-49).

The establishment of the ASRB appears to have been what the General Council of the ASA was trying to avoid in its recommendations in 1966 (ASA, 1966). A further blow to the profession was the ASRB's disinclination to simply rubber-stamp the accounting standards already promulgated by the AARF. As the president of the ICAA at the time stated:
Given the exhaustive process in the development of accounting standards and their extensive application and acceptance within the business community, it was generally expected that the Board, . . . would give approval, or at least some form of provisional approval, to all existing standards. However, the terms of reference given to the Board were not seen to permit such a course of action (Edwards, 1985, p6)

**Autonomy Lost, Control Achieved**

To many, the creation of the ASRB could be seen as a loss of autonomy on the part of the accountancy profession. However, it would seem that the reality of the situation was that the profession would maintain its control of the standard setting process through the AARF.

The ASRB was established to, inter alia, review standards referred to it and sponsor the development of standards (ASRB, 1985a, paragraph 3.1). While the ASRB was empowered to consider for approval standards emanating from the AARF and other interested parties, the professional associations through the AARF were clearly expected to maintain responsibility for the design and development of accounting standards. To be specific, Release 200 paragraphs 3 and 4 states that the Ministerial Council endorsed the view that proposed approved accounting standards would normally originate from the AARF. Those standards emanating from other sources would be referred to the AARF for comment. Between 1984 and 1988, only three standards were presented for approval by sources other than the AARF: the Australian Shareholders' Association, the NCSC and the Merchant Bankers Association. Only one of these proposed standards, that from the NCSC, ever attained approved accounting standard status and it has since been withdrawn.

Hence, when looked at from another perspective, the establishment of the ASRB can be seen as an example of bifurcation resulting from a change in the rules of practice, membership and meaning. Previously, compliance with accounting standards was not
binding. Therefore, there was a change in the rules of practice. There was also a change in the rules of membership in that the profession could only compel compliance from its own members. Statutory backing for accounting standards meant that members of the business community coming within the provisions of the Companies Act and Codes now came within the membership of those who must comply with accounting standards. The creation of a government-sponsored ASRB was considered necessary to enforce compliance. In other words, the profession could not resolve the issue of compliance at the level of social integration so a new organisation was created at the level of systems integration to facilitate enforcement of accounting standards. However, institutional isomorphism ensured there was no radical change in the setting of accounting standards.

A review of the composition of the ASRB shows that most of its members had accounting backgrounds and some had been senior office bearers of either the ICAA, ASA or other accountancy professional associations. For example, the affiliations and designations of some of the members of the ASRB in its first four years of operations included past presidents and vice-presidents of the Australasian Institute of Cost Accountants, the ASA, ICAA and the International Congress of Accountants 1972; a past chairman and members of the International Committee of the Accountancy Profession; International Federation of Accountants and the AARF. Some ASRB members were also partners in large public accounting firms (ASRB, 1987a, pp6-7; ASRB, 1987-88, pp5-7).

As discussed in Chapter 2, normative isomorphism is usually associated with professionalism (Clegg, 1989, p229; DiMaggio and Powell, 1983, p152). Through formal education and training, specific ideas, such as the notion that only those with such education and training are capable of undertaking accounting work including the design and development of accounting standards, become recognised as norms and are, thereby, institutionalised. Therefore, while the profession had lost control of the
standards setting process in so far as a government-sponsored organisation assumed the function of reviewing accounting standards which were to have legislative backing, it maintained control through normative isomorphism. Institutional isomorphism, in this case, normative isomorphism, ensured there would be no radical change as a result of the establishment of a government-sponsored ASRB. Subsequent chapters, in particular the chapter dealing with the promulgation of the foreign currency standard, will demonstrate that imprecise or flexible and ambiguous accounting standards continued to be issued despite the establishment of a new standard setting organisation.

In 1988, the profession secured even tighter control of the standard setting process. In its 1987-88 Annual Report, the ASRB announced that a call had been made during the year by the Joint Accounting Bodies for a merger of the ASRB and the Accounting Standards Board of the AARF (1987-88, p1). The Annual Report further stated that the ASRB and the Joint Accounting Bodies had worked together to formulate agreed terms of the merger for approval by the Ministerial Council (p1). The merger was approved at the fortieth meeting of the Ministerial Council (NCSC 1988-89, p65). The newly reconstituted standards board has responsibility for the development and promulgation of both approved accounting standards and Australian accounting standards. As a result of the merger, the ASRB sets all accounting standards for the private sector (p66). The membership of the ASRB was increased from 7 to 9. Four members of the ASRB were to be nominated by the professional associations. Technical support in the standard setting process was still to be provided by the AARF which continued to be funded by the accounting bodies (p66).

This chapter has traced the professionalisation of accountancy in Australia from the formation of professional associations late last century until 1988. In that time, accountants have proceeded from a position where they were looked upon with some measure of disdain as evidenced by comments in the press and in parliamentary
debates to a situation where they dominated the setting of accounting standards with statutory backing. Furthermore, their domination was with the express approval of the State and Federal Governments as represented by the Ministerial Council. As will be discussed in a later chapter, there have been further changes in the structure of the standard setting organisation including the establishment of the Australian Accounting Standards Board by the Australian Securities Commission Act. The AASB replaced the ASRB but there was little substantive change in the manner in which standards were developed and promulgated. The profession now controls not only the rules of membership of professional associations but perhaps, more importantly, it is able to exercise episodic agency power over not only its members but all those who come within the provisions of Company Law.

This study maintains that this achievement has been reached through a process of translation whereby the profession has used its claims to expert knowledge and skill as demonstrated through its commitment to education and training to convince the State and the public that it is the appropriate arbiter of accounting practices.
DOMINATION, AUTOPOIESIS AND REGULATORY FAILURE:
THE ACCOUNTANCY CONNECTION

VOLUME TWO
In the previous chapter it was demonstrated that the accountancy profession used the altruistic motive of the public interest to justify its claims to exclusive practice of work of an accounting nature and its domination of the design, development and enforcement of accounting standards. This chapter will consider the nature of the public interest and how accounting is claimed to serve it. It is acknowledged that there are limitations to theories of the public interest. Mitnick, for example, argues:

Public interest theories can be viewed as vague and indeterminate because views of the public interest are often vague and can be conflicting (1980, p91)

and

... the breadth and diversity with which the concept is used is such that it reduces in effect to "whatever the government does" (p242).

Nonetheless, given that a public interest motive is integral to claims for professional domination of accounting and that the profession and others have attempted to detail how accounting can serve it, these limitations will be ignored for purposes of this chapter.

As statutory account and audit provisions are part of corporate regulation, it is necessary to specify the nature of regulation in analysing the public interest claims of
the profession. As with the concept of the public interest, regulation has different meanings and interpretations. Dubnick and Gitelson refer to the definition of regulation as "a conceptual quagmire" because it cannot be defined "to anyone's satisfaction" (1982, p424). For present purposes, regulation is used to mean the statutory duty imposed on directors to prepare and present to shareholders, audited financial statements which both comply with accounting standards and show a true and fair view. Regulation, therefore, extends to accounting standards.

In this study, the interpretation of accounting standards as a form of regulation is not restricted to approved accounting standards which now have statutory backing. As was discussed in the previous chapter, statutory backing for accounting standards is a recent achievement. However, as will be discussed in a later chapter, the obligation for financial statements to show a true and fair view implied compliance with accounting standards. Accounting standards could, therefore, be said to have had a form of quasi-judicial backing even before they had legislative backing.

This chapter will briefly provide some insights into the original intentions of UK and Australian account and audit provisions in corporate legislation. The UK situation will be discussed because Australia, as a British colony, originally adopted its legislation. Government enquiries, such as the Rae and Campbell committees will also be used to demonstrate the public perception of the need for regulation and how it serves the public interest. The profession's own perception of the public interest will be addressed in the context of SAC 2.

The purpose of this chapter is initially to establish the relationship between the public interest and the account and audit provisions of corporate legislation. This, in turn, will provide the basis of an examination of how well the profession has served the public interest through its domination of accounting practice and in the determination of accounting practices to be used in the preparation of external financial reports and
their audit. For this purpose, some of Australia's notable corporate failures will be discussed. Emphasis will be placed on instances where accounting has been shown to have been used to conceal rather than reveal losses and/or liquidity problems facing the relevant companies. A further point of this discussion is to show that, over time, similar accounting ploys have been used by companies to conceal losses and liquidity problems. This has occurred despite actions that purportedly aimed to prevent the use of accounting techniques for such purposes. In other words, accounting practice guidelines and standards, even those with statutory backing, have not removed the flexibility or the exercise of professional judgment which have facilitated the masking of company weaknesses.

It will be contended that the concealment of impending corporate failure by use of accounting techniques cannot be claimed to be isolated instances even if they are not the norm. In an examination of white collar crime in Australia, Grabosky and Sutton observed "... the harmful practices in question were not unprecedented and, as some of the cases reveal, Australia is by no means free from similar corporate behaviour today" (1989, pxvi). Similarly, Sykes maintains that corporate collapses are not a recent phenomenon nor are they an aberration (1988, px). The causes of the major collapses of the 1970's and 1980's bear a striking resemblance to the corporate collapses of the last century. This has led Sykes to conclude that corporate collapses are "... a recurrent malaise and endemic to the private enterprise system as it presently functions" (px).

The "harmful practices" identified in the white collar crime study included accounting:

The lack of objective, consistently applied accounting standards has been recognised for years as a factor which serves to facilitate, if not invite, white collar crime (Grabosky, pp21-22).
Sykes also saw accounting and accountants as implicated in some of Australia's notable corporate failures in that "... an amazing amount of money has been raised by Australian companies on the basis of inaccurate accounts" (1988, p551). This is not to say there was a conspiracy to deceive on the part of management and the accountant. However, as suggested in Chapter 2, accounting practice has become increasingly abstract over the centuries and the body of accounting knowledge is not clearly defined. The result is that there is ample room for professional judgment on the part of the accountant. In some instances of corporate failures, it appears the company accountant has assisted management, some of whom have also been qualified accountants, to conceal impending disaster. In this regard, management has been assisted by accounting in some circumstances. Sykes contends "[c]reative accounting ... can mask the frailties of a company for a long time (1988, p552).

Auditors also have been identified as playing a role in the unexpectedness of corporate failure in that the published financial statements of some of these companies have received unqualified audit reports. Sykes, for example, questions whether it is worth having auditors when financial statements have received unqualified audit reports despite the fact that relevant records may not exist, debts may not be recoverable, accounts have been falsified and assets plundered (pp551-552). As will be discussed in the second half of this chapter, investigators into corporate failures have also levelled criticism at auditors for similar reasons.

**CORPORATE LEGISLATION - HISTORICAL BACKGROUND**

In Chapter 2, it was shown that accounting, in some form, has existed for hundreds of centuries. History also shows that for much of its existence, accounting has been used for accountability purposes. Since the advent of the modern corporation, it has also been a regulatory mechanism.
Formal regulation of corporations using accounting has been a recent development and has, in general, followed revelations of abuse of the corporate form (refer to works such as Littleton and Yamey, 1978; Hunt, 1936; Gibson, 1971). As early as 1833, the periodic publication of accounts was seen as one way of combating this problem. Hunt, for example, cites a letter to The Times in April 1833 suggesting promoters of ventures should be accountable to investors for the funds entrusted to them and that there should be some form of stewardship reporting (1936, p56). Chambers provides evidence that the keeping of accounts and periodical financial reporting were used for accountability purposes from at least the eighteenth century (1991, p10). Between 1827 and 1843, the deeds of settlement of some 26 companies contained requirements for the keeping of accounting records and the regular preparation of a statement of the stock and capital of the company (p11). Even before this, partnership agreements included requirements to keep accounts as a means of ensuring partners were accountable to each other (p10).

In 1844, the UK Parliament enacted the Joint Stock Companies Registration and Regulation Act which required, inter alia, periodic publication of accounts. While it is clear that accounting had been in use for some time, the 1844 Act was clearly a landmark piece of legislation because it provided, for the first time, for general incorporation. The act was the result of the Report of the Select Committee to enquire into the laws respecting Joint Stock Companies (except Banking Companies). The Committee was appointed in 1841 and issued its report in March 1844. The purpose of the enquiry was "the better security of the public". To this end, the Committee made a number of recommendations including the periodical balancing, auditing and publication of accounts (Select Committee on Joint Stock Companies, First Report, pv). As Chambers observes, it is unlikely that those who framed the 1844 Act were not aware of the provisions of the deeds of settlement mentioned previously. They would also have been aware of the perceived protection periodical
financial reporting could provide to company members and creditors against self-serving directors and officers (1991, p11).

However, the recommendations were not seen as a panacea for the instances of abuse uncovered by the Committee. They were seen more as a means of making directors and management accountable for their actions and also of providing investors and creditors with an indication of the state of affairs of a company:

Periodical accounts, if honestly made and fairly audited, cannot fail to excite attention to the real state of a concern; and by means of improved remedies, parties to mismanagement may be made more amenable for acts of fraud and illegality (p5).

Furthermore, it was thought:

... probably the greatest benefit in this direction will be produced by enabling the sharebrokers and other persons professionally employed in making investments of this kind to learn more easily and accurately the real nature of these Companies; so that, at least, the ignorant may not be so much misled (pvi).

In 1855, the general right of incorporation was enhanced by the introduction of limited liability. The 1855 Limited Liability Act provided for additional safeguards over and above those of the Joint Stock Companies Act of 1844. These additional safeguards included a requirement that the Board of Trade approve the auditors (Gower et al, 1969, p48). The following year saw the Limited Liability Act of 1855 incorporated into the Joint Stock Companies Act which Gower et al term the first modern Companies Act (p49). Many of the safeguards stipulated in the acts of 1844 and 1855 were deleted from the 1856 act. The requirements as to the periodical publication of audited financial reports were relegated to an optional set of articles. The appointment of auditors and approval by the Board of Trade were no longer required (p49). Subsequent amendments were incorporated into the Companies Act
of 1862 (p50-51). The keeping of accounts and the audit of financial statements remained optional until the turn of the century when the requirements to annually provide shareholders with an audited balance sheet were reintroduced.

The 1862 Companies Act was adopted throughout the Australian colonies during the mid-1860's. It appears there was little or no debate as to the appropriateness of the legislation to the Australian situation. The rationale for the adoption of the English legislation appears to have been a perception that it was necessary to maintain British investment in the colonies (McQueen, 1991, p24). Australia did not have a Board of Trade to administer the legislation with the result that administration was on an ad hoc basis from state to state. This, in turn, resulted in the provisions of the legislation not being used as a regulatory device but for procedural matters such as company formation and verifying that documents required to be lodged under the provisions of the legislation were in proper form (p25). The Victorian land boom of the 1880's and its subsequent collapse heralded a change in this approach.

In the wake of the Victorian land boom and the disastrous consequences of its collapse, it was decided that more comprehensive corporate legislation was required to prevent the frauds and consequent losses to investors and creditors arising from corporate activities. For example, Isaacs, who was largely responsible for the contents of the Victorian legislation, argued for it on the basis that the Government was trying to ensure that the catastrophes of the boom were not repeated and to remedy the evils of the past (Victoria. Votes & Proceedings, 1895, p3338).

Cannon has undertaken a study of the land boom, the major companies involved and the impact of the collapse of the boom on the population. The evidence uncovered by Cannon clearly demonstrates the validity of the comments of Grabosky and Sutton (1989) and Sykes (1988) suggesting that accounting had been used for some time to conceal impending failures:
The falsifying of balance sheets, the payment of dividends from non-existent profits were among the shocking features of the crash. . . . At the annual meeting of the Real Estate Bank on 7 August 1891, James Munro said: "The properties of the bank are in splendid order". Four months later it collapsed. At the meeting of the Land Credit Bank on 31 October 1891, a 10 per cent dividend was declared, although by that date the bank had lost all its capital and reserves. On the same day, Sir Matthew Davies's Freehold Investment Co. Ltd. declared an 8 per cent dividend and went into liquidation exactly three months later (1972, p28).

The Victorian Companies Act, 1896, required the keeping of proper books of account and the annual presentation to shareholders of an audited balance sheet which was to be in narrative form as specified in the Act. The sequence of items appearing in the balance sheet was also specified. Debtors were to be categorised and shown after deducting bad or doubtful debts expense. Other assets such as property and investments and liabilities were also to be reported by class. The legislation also required directors to certify that the balance sheet was "true and correct". Managers were required to make a statutory declaration to similar effect. The Act further provided for the appointment by public companies of a qualified auditor. Details of dealings between companies and their officers, advances to directors, in particular, were to be disclosed (Gibson, 1971, pp44-47).

Perceived Purposes of Regulation

1. Accountability & Investor Protection

Chapter 2 provided an overview of the progressive abstraction of accounting from the clay tokens of ancient civilisations, through the emergence of a commercial rather than an agricultural means of existence in mediaeval Italy which, in turn, appears to have given rise to double entry bookkeeping, the further refinements and abstraction of accounting as a result of the introduction of the notion of the going concern and permanent capital, and finally, the impact of the Industrial Revolution. The abstraction of accounting was complemented in the latter half of the nineteenth
century with the legislative creation of corporations with limited liability. As Chambers notes, the corporation is itself an abstraction (1991, p11). It has no feelings of shame or remorse and no concept of ethics, morals or fair dealings. Corporate directors act on its behalf and the responsibility of directors to shareholders and creditors arises through the articles of association and statute. In Chambers' view, the principal link between directors and shareholders is the annual report and financial statements (p11; 1973, p172). Similarly, Stamp maintains that financial reports provide a link between management and owners (1969, p32).

The advent of accounting and audit provisions in corporate legislation is clearly associated with management's accountability for their actions to shareholders and creditors. The need for legislative intervention has arisen from the separation of management from ownership (Stamp, 1969, p32; Chen, 1975, p538). Schoenbaum maintains that the principal objective of legislation requiring disclosure of financial information is to ensure potential investors that adequate information about the investment can be obtained (1972, p575). Furthermore, legislation provided assurance that the information obtained would be neither fraudulent nor misleading (p576). The report of the enquiry into Australian Securities Markets and Their Regulation (the Rae Committee) also identified investor protection as a major reason for companies and securities law (Australia, 1974, 16.17). The Committee based its view on evidence of a long and repetitive history of exploitation of investors through fraud, abuse and incompetence (15.3).

In a classical sense, management is the steward and as such, is responsible to those who have invested in a company (Briloff, 1972, p5; Chambers, 1973, p31; Chen, 1975, p539). Stewardship also extends beyond a narrow responsibility to existing investors to potential investors and also to creditors and potential creditors at the very least. It also is not restricted to a simple accounting for the funds entrusted to
management but to whether those funds have been used efficiently and effectively and for authorised purposes (Briloff, 1972, p5; 1990, p6; Chambers, 1973, p41).

Chen has traced the origins of the stewardship function from its religious basis in early civilisations to its application to modern business enterprises (1975). In this time, the concept has gone from a broad base to a narrow and then back to an approximation of its religious origins. According to Chen, the religious basis of stewardship was premised on the view that all things were created by God for use by all humans. If ownership of things, property, was required in order to use them then the human owner must use those property rights to satisfy the needs of society as a whole (p534). Chen argues that social responsibility was the primary stewardship function because the "owner of the property" was the steward of God (p535).

With the advent of the feudal system, a secondary stewardship responsibility emerged in that property, land, was given to nobles and lords by the king to be used in a specified way to benefit the manor. Hence, the nobles and lords, and the serfs and vassals who subsequently assumed responsibility for working the land, were agents of the king. Stewardship still had a primary function being to society or the manor but it also had a secondary function in that the land was to be used in accordance with rules specified by the king (pp535-536).

As discussed in the previous chapter, civilisation experienced a change from, or an extension of, the agricultural mode of existence with the beginning of the crusades. The mediaeval era introduced commerce and the burgeoning of trade for profit. Chen argues that the spread of capitalism and the growth of the business organisation brought an end to the mediaeval period and, as a survival of the fittest mentality emerged, progressively eroded the social responsibility aspects of stewardship. Managers were responsible only to the owners of business organisations (p537). Social responsibility again became an aspect of stewardship with the expansion of
business and an increase in the size of business organisation (p538). Progressively larger business concerns meant that ownership became more and more diffused (p539) so that individual shareholders had very little power in terms of the operation of the business (p538). As business became larger and more complex, management has had more and more power to control the business organisation. This, in turn, led to a return of the primary stewardship function in that management has social responsibility for the activities of business organisations. Therefore, management has again become not only the steward of owners but also of employees, customers and society in general (p539). Given the size of corporations today and their potential impact on society, this view of stewardship is appropriate. As the chief judge of the New South Wales Supreme Court, Justice Rogers, recently observed:

... company directors may through their actions, their behaviour, and their standard of morality, destroy the health of an economy and of a community for a decade (1991, p1).

The broader view of stewardship suggested by Chen is evident in current professional pronouncements. For example, SAC 2 confirms the need to protect investors and others who deal with corporations but replaces the notion of stewardship with accountability. Accountability, in this sense, extends beyond a mere accounting for funds entrusted to management to the manner in which resources have been used and whether they have been used efficiently and effectively. This view is also evident in SAC 2 paragraph 5 which defines "accountability" as

... the responsibility to provide information to enable users to make informed judgments about the performance, financial position, financing and investing, and compliance of the reporting entity.

Paragraph 14 then links this definition of "accountability" with the objective of general purpose financial reporting
Managements and governing bodies are accountable to those who provide resources to the entity for planning and controlling the operations of the entity.

SAC 2 paragraph 14, goes on to confirm that financial statements are a link between management and resource providers by stating that general purpose financial reporting is a means by which this accountability may be discharged. Furthermore, SAC 2 paragraph 14 extends management's accountability to the general public:

... because of the influence reporting entities exert on members of the community at both the microeconomic and macroeconomic levels, they are accountable to the public at large.

On the basis of the foregoing, accounting and audit provisions of corporate legislation could, therefore, be seen as being not only in the interests of those who deal with corporations but also in the public interest.

2. Public Interest

It was noted in Chapter 2 and earlier in this chapter that defining the public interest is problematic because it is impossible to determine what exactly it is in the first place. What is professed to be in the public interest often begins as one person's point of view. In this sense, the public interest is really a private interest that has gained support within the community. For this reason, a definition of the public interest will not be attempted here. Rather, a description will be offered of how accounting and audit provisions of corporate legislation are held to serve the public interest.

As outlined above, stewardship and accountability have primary and secondary functions. The primary function is applicable to the public interest in that it means that management will use resources entrusted to them in a manner which will benefit society. Hence, the accounting and audit provisions of corporate legislation could be
said to be in the public interest because such provisions are "... in the best interests of all the ... people" or because policies of this nature are "... beneficial to all citizens or beneficial to large portions of the population generally" (Ippolito and Walker, 1980, p302). The Rae Committee report could be seen as supporting this view in that one of the objectives of legislative action with regard to the securities market was identified as being to "... maintain, facilitate and improve the performance of the capital market in the interests of economic development, efficiency and stability" (1974, 16.15).

Corporate regulation, therefore, can be seen as having both economic and social implications. Regulation on economic grounds may be seen as facilitating an efficient allocation of resources which essentially means that financial resources will be directed towards efficient companies as opposed to less efficient companies. The report of the Campbell Committee supports this view in that it states the disclosure of financial information

... helps investors and other members of the community assess risks and make decisions. ... accurate and timely disclosure ... has an important role in the mobilisation of savings and the pricing and allocation of funds to efficient users (1981, 21.29, p368).

Corporate regulation, and disclosure of financial information, can be seen to have social consequences because when resources are directed towards more efficient companies, the community is likely to benefit from increased employment and distribution of wealth. This interpretation of the economic and social consequences of regulation is supported by Charles Williams, one time Deputy Chairman of the National Companies and Securities Commission, who stated that securities regulation in Australia has two major objectives:
1. promoting commercial certainty, reducing business costs and making capital markets more efficient.

2. investor protection by strengthening markets through the confident participation of savers, large and small, in the markets (1987, p7).

Chambers et al provide further elucidation of the economic and social impact of the disclosure of financial information. The securities market is seen as a mechanism for rationing of a limited supply of funds "... in favour of companies having a more satisfactory record of performance than others" (1978, p20). Information on the financial performance of a company depends on a combination of

... the efficiencies with which it conducts its manufacturing, merchandising, and financial operations, and the effectiveness of its labour-relations, customer-relations and other like policies (p20).

Chambers et al see three effects of the publication of this information:

Actual and prospective investors are enabled to make comparative judgements, bidding the prices of securities up or down, to the consequential advantage or disadvantage of particular companies.

... directors and managers are able to compare the performance of one company with the performance of others.

The information published may enable customers, suppliers, workers and other parties to make comparative judgements of companies, and to seek to vary the terms of their relationships with any company in the light of those judgements (p21).

Friend also argues that securities regulation is necessary due to the impact of the stock market on the economy:
The stock market affects the functioning of the economy in two principal ways. First, market developments may affect the national income through their influence on the aggregate propensities to consume, to save and to invest. Second, even with a given level of saving and investment, market arrangements can affect the efficiency of the allocation of investment funds (1976, p3).

The disclosure of financial information, therefore, can arguably improve the efficiency of companies, and in turn, the economy as a whole. This issue of efficiency and its economic and social consequences was central to the recommendations of the Campbell Committee, including the establishment of the ASRB (1981, p1) and the Rae Committee's call for the establishment of an Australian Securities Commission (1974, 1.1).

From the foregoing it is clear that management owes a responsibility, or is accountable, to investors and creditors, both current and potential, and others who deal or are contemplating dealing with the organisation. In addition, management is accountable to society at large because of the impact corporations can have on the well-being of all members of society whether they deal directly with the corporation or not. This impact on society may be direct, such as pollution, or indirect through relationships between corporations and those who deal with them. If a company's financial reports indicate that it is a profitable and well-managed organisation, existing investors and creditors may be encouraged to continue their relationship with the company. Potential investors and creditors may be prompted to establish a relationship with the company through the purchase of shares or debentures or making deposits with or loans to the company, in other words, the allocation of resources to the company. If the financial statements have misrepresented the company's profit and the expertise of its management, there will not have been an economic allocation of resources. Should the company fail and be unable to meet its commitments to investors and creditors, the impact will be felt not only by the
investors and creditors but by the general community through, perhaps, loss of employment in some sections of society which will have a flow through effect on other sections of society through the loss of spending occasioned by the loss of employment.

Regulation of corporations through, inter alia, accounting and audit provisions in corporate legislation, has been justified as being in the public interest. However, the Campbell Committee also made it clear that the securities market should be as free as possible of government intervention because "... the most efficient way to organise economic activity" was through a competitive market system (1.1, p1). Therefore, there must be a trade-off between free competition and regulation in the public interest. The notion of an efficient and competitive market is the basis of the efficient capital markets theory that is often used to argue the case against regulation of the securities market. The next section will provide an overview of the theory of efficient capital markets and why regulation instead of market forces is necessary to achieve an economic allocation of resources.

3. Competition vs The Public Interest

Proponents of the efficient capital markets theory argue that accounting information is a commodity and can be subjected to the same forces of supply and demand as other commodities traded in the market. That is, there is a competitive but uncertain market for accounting information such that the forces of supply, demand and price interact to the extent that, at equilibrium, it is impossible, on average, to make economic profits (Watts and Zimmerman, 1986, p17). In other words, no one market participant will consistently earn more than the risk-adjusted market rate of return. This is the basis of the efficient market hypothesis (Watts & Zimmerman, 1986, p17; Friend, 1976, p4). Efficiency is taken as meaning that the market is efficient in that all publicly available information is impounded in the share price. New information is taken up quickly so that investors cannot make abnormal gains (Friend, 1976, p4).
Furthermore the information is available at low cost. Therefore, the regulation of the disclosure of financial information is not necessary and the capital market should be left to determine the appropriate amount of disclosure required (Weiss, 1979, p576; Kripke, 1980, p219)

In support of the free versus regulated market, Kripke points out that mandated disclosure by the SEC has not prevented "instances of inadequate or fraudulent disclosure" from occurring (1980, p217). Trevor Sykes made a similar statement recently with regard to the Australian situation. Sykes examined a number of instances of creative accounting including Cambridge Credit Corporation, Bond Corporation and Industrial Equity Ltd. According to Sykes:

As receivers and investigators gradually strip bare the recent corporate scandals in Australia, one factor becoming apparent is that the accounts of the companies concerned have been sins of omission. Important items were either left out of accounts completely, or the necessary background on material figures was not given (1990, p43).

These corporate scandals have taken place even though Schedule 5 (and its predecessors) to the Companies Code specifies, in detail, the format and content of published financial statements and many accounting standards have statutory backing. Nonetheless, management is still able to "fudge the accounts". Sykes argues that investors have an alternative to financial statements, the share prices:

Watch the share price, because it is remarkable how often the market senses that a company is in deep trouble . . .

. . . if the published accounts are saying one thing, and the market is saying another, always believe the market (1990, p46).
In Chambers' view, it is not the market which is deficient but the regulation of the disclosure of financial information:

Atlantic Acceptance, Reid Murray, Pergamon, Continental Vending, Pacific Acceptance, Westec, BarChris, Yale Express - such companies as these have provided the 'spice' of commercial and financial journalism in the last decade or so.

One thing common to all the companies mentioned is that the financial information they published was seriously deficient in quality. . . . because prevailing laws and practices under them give rise, almost universally, to distorted representations of the financial results and affairs of companies (1973, Preface, no pagination).

A similar perspective can be found in the Rae Committee findings

While we have expressed our concern and, in some instances, alarm at the actions of people in relation to certain practices, our overriding objective has been to find out what steps, if any, were taken by the regulatory authorities to check the practices described.

Some of these practices which we have investigated appear to be of long standing, and we recognise that those engaging in them may claim that all the existing authorities have permitted the practices, to the extent that the authorities were aware of them (1974, 1.2).

A number of arguments related to the situation where false or misleading information is given or inappropriate practices have been adopted have also been raised against the efficient market hypothesis. Langfield-Smith, for example, argues that even if the market for securities does impound publicly available information in the share prices, the absolute or relative prices may not be appropriately determined in the short to medium term. This is because the market cannot distinguish between false and valid information in the short to medium term. Consequently, investor protection through
the market mechanism may not be adequate when creative accounting techniques are used (p8, 1990).

Friend similarly raises doubts about the validity of the efficient market hypothesis:

First, the market . . . must reflect all available information. The important question is the relevance of the information to the subsequent earnings or riskiness of the stock. How is information to be distinguished from misinformation? Second, is a market in which prices fully reflect the scanty information available as efficient as a market in which more information is available and reflected in stock prices? . . . what is the justification for considering the information set fixed? Third, is the efficiency of the market independent of the costs incurred? (1976, pp4-5).

In summary, Friend argues for regulation of disclosure on the grounds that disclosure is necessary if capital markets are to be efficient (p7). Clarke and Dean provide a recent Australian example where the market does not appear to have been entirely efficient. In 1992, Westpac revised a provision relating to its commercial property and property-related loans portfolio. This revision resulted in a $2.6 billion write-off of asset values. The company maintained that it was making public something that "was already well known". Clarke and Dean debate the validity of this on the basis of the "surprise and bewilderment on the part of some financial press commentators following the announcement of the size of the write-downs . . . ", and " . . . post-announcement price declines . . . " on UK and Australian stock markets even though such declines were relatively minor. Further evidence that the market was not fully informed was provided by rating agencies decisions to reassess Westpac in the wake of the announcements (1992, p187).

Efficiency of the capital markets can be seen in three ways: allocative efficiency being an efficient allocation of resources, operational efficiency which pertains to the minimisation of resource costs and dynamic efficiency which is the ability of the
system to change and generate innovations (Campbell Committee, 1981, 1.9, p2). The Campbell Committee considered that the securities market in Australia was efficient in that it permitted an economically neutral flow of funds within the market (1.5; 1.6, p1). The market could be seen to be operationally efficient in that regard. However, the Campbell Committee recognised that an economically neutral flow of funds may not be in accord with social priorities (1.6, p1). In other words, there may not be an efficient allocation of resources which in this context includes equity considerations. For purposes of this discussion, the focus will be on allocative efficiency as this is considered most relevant to the relationship between accounting and the public interest.

Allocative efficiency pertains to the quality of the information provided (Friend, 1976, p5). Kripke argues that those who wish to sell securities in a company and maintain an active market in those securities must supply sufficient information to attract purchasers (1980, p204-205). This notion appears to be based on the assumption that management acts in the interests of the shareholders (Friend, 1976, p4). Puxty et al point to arguments in the literature that suggest that similar forces would result in the audit of such information in the absence of regulation (1987, p278). In other words, management would publish audited financial statements even if they were not required to do so by law. This could be seen as management wishing to ensure that their company is seen as a good corporate citizen (Tomasic & Bottomley, 1991).

Tomasic and Bottomley interviewed officers of Australia’s top 500 listed public companies (p55) and found that being perceived publicly as a good corporate citizen was very important to many of those interviewed (p56). The reasons for this included viewing the good corporate citizen tag as a “marketing ploy” (p57). Being a good corporate citizen was considered to instil public confidence in the company which, in turn, would be to the commercial advantage of the company (p57-58) presumably because the public would be prepared to purchase company goods and services. In
addition, being perceived as a good corporate citizen was important because it would encourage people to invest in or extend credit to or make loans to the company (p61). It was also seen as useful in “placating” government and regulators and, thereby, avoided “excessive concern with legal rules and regulations” (pp61-62). However, there was clearly a limit to the extent to which the good corporate citizen image would be taken. That limit was profitability and the interests of shareholders (pp61-62). In other words, management desired their companies to be seen as good corporate citizens but apparently would be prepared to stretch the point where profits and the perceived interests of shareholders were concerned. However, this ignores the duty corporations owe to the community. Furthermore, what management may see as being in the interests of shareholders may really be in the interests of management in presenting to the public an image of a profitable and well-managed company. Evidence of this will be provided later in the chapter by reference to some of Australia’s notable corporate failures. In some cases, directors of these failed companies admitted that the accounting practices adopted in the preparation of financial statements were geared towards maintaining and encouraging the inflow of equity and debt capital. It is precisely this mentality which makes regulation rather than reliance upon market forces a necessity. This limitation is reflected in the views of Chambers and also the findings of the Rae Committee.

Chambers, for example, has questioned how market forces will ensure that the information provided in financial statements will not be misleading:

It has been held that if all business firms (and their accountants) were free to exercise their initiative in accounting "market forces" would eliminate misleading and defective practices. But by what mechanism no one has yet explained (1981, p370).
The investigations and conclusions of the Rae Committee suggest the validity of this argument and also support Chambers' view cited previously, that "prevailing laws and practices . . . give rise . . . to distorted" financial reports (1973, Preface, unpaginated).

One of the reasons for this is that the corporation is a monopoly supplier of information about itself. Therefore, the possibility exists for management to disclose information best suited to its purposes or may even issue misleading information. As discovered in the course of the Rae Committee investigations, Minerals Securities Australia Limited (Minsec), provides a good example of this sort of activity. On the basis of evidence, the Rae Committee stated

Few companies can ever have experienced as sudden and [drastic] a reversal of profit trend as Mineral Securities began to experience after the first weeks of the new financial year in July 1970. Though the public had no inkling of it, the directors had reason to know that the real share-trading profit in the year ended 30 June had been $15.2 million instead of the declared figure of $12.4 million, but that the annual rate of loss being suffered in the first half of 1970-71 was running at more than $10 million (1974, p14.39-14.40).

The objective in down-grading the 1969-1970 profit was to allow directors to report half-yearly profits in excess of $3.5 million on share trading activities in the first half of the 1970-71 financial year and, thereby, conceal the fact that the company, which had previously been earning record profits, was now experiencing large losses (1974, 14.42-14.43). In discussing the accounting treatment of the write-down of the 1969-1970 profit, the Committee made reference to the notes, in fine print, appended to the balance sheet which included a statement regarding the calculation of the market value of group investments. This note stated that one of the investments had been "... written down in the light of post-balance date events to the realised value". The Committee branded the note as "uninformative or misleading in several ways". It did not provide any indication of the amount of the write-down or the impact, if any, on
declared profits. Furthermore, the note could be interpreted as applying to investments actually held at balance date rather than to investments bought and sold at a loss after that date. The interpretation of the Rae Committee appears to be that the note referred to investments bought after 30 June 1970 and subsequently sold at a loss (14.42).

The auditors of the company were criticised for issuing an unqualified audit report and certifying that the financial statements gave a true and fair view of the company's state of affairs at 30 June 1970:

We have been astonished that auditors should have said that the profit and loss account for Minsec for the year ended June 1970 was 'true and fair'. In our view, the accounts were not 'true', and we cannot see how, in the circumstances, the auditors were properly fulfilling their role as the guardians of the shareholders and the public (14.43).

The activities of the directors of Minsec, would suggest that neither management nor the auditors were acting in the shareholders' interests nor were their activities likely to ensure an efficient allocation of resources. Rather, the activities outlined above were clearly calculated to conceal the company's changing fortunes. In the Rae Committee's calculations, the overall impact of the accounting and reporting deception outlined above and other "remarkable accountancy heterodoxies" (14.44) was a distortion of the announced half-yearly profit of at least $9.5 million. Burton suggests that this sort of activity is not unusual

Under conditions of economic stress . . . an enterprise seeking capital may have powerful short-run incentives to hide the current state of its affairs from potential investors (1980, p79).
On this line of reasoning, the deception by the management of Minsec would have potentially directed resources away from efficient companies toward the inefficient Minsec.

Even if management does act in the shareholders' interest, and, thereby, the public interest, either voluntarily or through the competitive discipline of the market, relevant information may be withheld. The Rae Committee's investigations also found evidence that the directors of Minsec used privileged information about its subsidiaries for purposes of profitable trading in their shares (1974, 14.23). Evidence was also produced which suggested that not only did Minsec use inside information to buy shares but to influence the price of the shares after purchase (14.31). In one particular instance, the shares of one company which were issued at $1 sold at a premium of 60 cents in their first day on the market. The Official Liquidator for Minsec stated in evidence to the Rae Committee that there was no doubt that the share trading activities of the Minsec group was responsible for the escalation of the share price to around $3 (14.28). It would seem that share traders can make economic profits in the short term at least. If Minsec had not failed shortly after these activities, it is questionable how long it would have continued to make such profits.

The Rae Committee recognised that it was impossible to lay down rules to prevent all occurrences of market manipulation or the issuing of misleading statements and that business errors could not be legislated against. However, it was considered that

Full and truthful publication would not only be a deterrent to some forms of extravagance, but gives fair warning to lenders and investors of the ventures they are invited to support (14.130).

Similar conclusions were reached by the Campbell Committee. It was concluded, for example, that depositors and investors face a number of risks including losses due to market imperfections. Market imperfections refer to the quality of the information
Market stability and confidence is important not only to shareholders, investors, creditors and the public but also to companies that do not adopt creative accounting techniques. Henry Bosch, former Chairman of the NCSC, has recounted the story of a conversation between himself and the finance director of a large and respected Australian company. The director argued that accounting standards were arbitrary and tended to reduce the truth and fairness of financial reports. The implication appeared to be that accounting standards were not necessary and directors should be left to determine what was true and fair for each individual company. Bosch detailed some increasingly common practices among companies and considered the director came to the conclusion that accounting standards may have faults but provided protection for both companies and the values of directors who used conservative and objective accounting methods (1987 pp2-3).
Grabosky and Sutton have argued that corporate crime disadvantages honest business people by tarnishing "... the image and the legitimacy of the entire system of Australian enterprise" (1989, pxi). Smark has supported this view stating that "... pulling Lazarus up from the dead would be simple compared with the task of raising a single dollar for an Australian company from maimed and bleeding foreign investors" (1990, p31). Sykes provides evidence of this in the form of a "money panic" in the wake of the collapse of Cambridge Credit which in turn led to a collapse of investor confidence (1988, p467). Investors in building societies situated in Queensland, Victoria and South Australia began withdrawing their money (p468). The fact that most of these financial institutions were perfectly sound, had solid backing from banks and or the government and were not in any danger of collapse did not matter to those who were intent on withdrawing their deposits. Despite assurances from Federal and State Governments, the run on these institutions lasted for up to four days. Withdrawals of $10 million were made from one institution alone (p470). According to a research team which interviewed people queuing outside one South Australian building society, half of those withdrawing their money thought there was a possibility it would collapse (p473). Most of the money was re-deposited in the following weeks. Nonetheless, without the support of the Reserve Bank and other banks, some of these building societies may have, in fact, collapsed through no fault of their own.

The situation related by Sykes has parallels with the October 1987 stock market crash. In Farrell's view, the October 19 crash of the New York Exchange was a result of "herd instinct" (1988, p38). Farrell's argument was made in the context of the efficient market hypothesis and two of its underlying assumptions being that investors are rational and that stock prices only change in response to fresh news and not crowd psychology:
What new information jarred investors into slashing their estimate of the value of Corporate America's assets by some 23% in the 6 1/2 hours the New York Stock Exchange was open? Hardly enough news came out that day, or over the weekend, to account for the plunge (p38).

The stance adopted by Farrell is similar to the view expressed by Sykes that the "money panic" was sparked by the collapse of Cambridge Credit. For example, Farrell cites a Yale University survey of nearly 1000 investors which indicated that the trigger for the panic was the decline of the market on the previous Thursday and Friday and on the morning of Monday October 19:

> Lots of nervous people came to believe the price drops themselves signalled a crash, and everyone tried to be the first out the door (Robert Shiller, Yale University, cited by Farrell, p38).

From this, Farrell concludes investors, both large and small, did not behave rationally but on "herd instinct" in response to the falling market (p38).

What this suggests is that corporate failures can have an adverse impact on companies which in the normal course of events are quite sound and, to all intents and purposes, efficient and effective users of resources. The overall result may be, that as in the "money panic" related by Sykes and the stock market crash of October 1987, investors may withdraw their resources from the market altogether and keep them in so-called safe investments such as banks or, worse still, in a box under the bed! This means that the public interest will not be served in that there will not be an efficient allocation of resources throughout the community.

The argument that an efficient capital market negates the need for regulation does not appear to be sound. As indicated above, there is sufficient evidence to suggest that the market is not always efficient and because of this, regulation is necessary to protect those who deal directly with corporations. By ensuring that those who deal
with corporations are adequately informed, the public interest is also served. This is because resources will be directed to those corporations that will use them efficiently and effectively. The next section will address the accountancy profession’s role in this process.

4. Accountability and the Profession

Accountability or stewardship is not restricted to management even though, under the law, management is responsible for the preparation of financial statements. As detailed in the last chapter, the accountancy profession went to great lengths to establish itself as the arbiter of appropriate accounting methods to be used in the preparation of financial statements. The profession has itself identified the link between financial statements and the accountability of management. SAC 2 states

... the objective of general purpose financial reporting is to provide information to users that is useful for making and evaluating decisions about the allocation of scarce resources (paragraph 26).

When general purpose financial reports meet this objective they will also be the means by which managements and governing bodies discharge their accountability to the users of the reports... the rendering of accountability by reporting entities through general purpose financial reporting is encompassed by the broader objective of providing information useful for making and evaluating decisions about the allocation of scarce resources, since users will ultimately require the information for resource allocation decisions (paragraph 27).

Clearly, the profession is accountable to users of financial statements because the profession determines the rules to be used in the preparation of financial statements. Furthermore, on the basis of the specialised skills and training of members of professional accountancy associations, the profession argued that the audit of financial statements should only be undertaken by their members. As Chambers has noted, to the extent that accountants, as auditors, attest to the truth and fairness of annual
financial statements, the "mantle of greatness" was placed on them because they are "... instrumental in preserving fair dealing in a world of abstract corporations having no ethical sensibility" (1991, p12). Preserving fair dealings should lead to the allocation of resources so that the profession is not only answerable or accountable to those who use financial reports but also to the wider community if decisions based on those reports are to provide for such an economic allocation of resources. Briloff sees the role and responsibility of the accountancy profession as "absolutely essential" to the maintenance of a "constitutional, capitalistic, democratic society" because

... such a society is rooted in the delegation of enormous pools of power, necessitating a full and equal measure of reciprocal accountability (1990, pp6-7).

While SAC 2 and the views expressed by the UK Select Committee Report of 1844 and the Rae and Campbell committees appear to focus attention on management and governing bodies, the implications for accountants of the views expressed cannot be denied. As noted above, accountants, by law, are not responsible for the preparation and presentation of financial reports to shareholders. This is management's duty. However, accountants, by virtue of their professional status, share this responsibility because it is their skill and expertise which is used to prepare financial reports and the General Council of the ASA has stated "... the accountancy profession has a general responsibility to ensure that published financial statements provide information that is not irrelevant or misleading ..." (1966, p7). Auditors also share the responsibility by virtue of their duty, under the law, to attest to the truth and fairness of financial reports and to ensure that there has been compliance with approved accounting standards. The role of the accountant in this process is to ensure that adequate information is provided. As discussed in Chapters 2 and 3, the accountant effectively becomes the agent of the investor.
Given the view of the public interest outlined above, SAC 2, by implication, extends "accountability" in a manner which is significant for the profession in its dominant role in the standard setting process. Paragraph 5 defines "compliance" as

... adherence to those statutory requirements, regulations, rules, ordinances, directives or other externally-imposed requirements in respect of which non-compliance may have, or may have had, a financial effect on the reporting entity.

From this it could be concluded that accountants and auditors must not only ensure compliance with accounting standards and the law but also, in their capacity as promulgators of accounting standards, they have a responsibility to ensure that the rules and regulations they develop are consistent with the objective of enabling management and governing bodies to discharge their accountability to resource providers and the public at large.

5. Regulation, Fairness and Morality

This discussion of the perceived purposes of regulation and the link between accountancy and the public interest suggests that financial information is intended to provide a means by which corporate management is accountable to investors, creditors and the general public. Regulation, including disclosure of financial information, is necessary to not only protect those who deal with corporations but also to ensure an economic allocation of resources. This is held to be achieved by maintaining a stable securities market so that investors and creditors are confident in the efficiency and effectiveness of the market. The Rae Committee summarises the need for corporate regulation in the following terms:
There is a tendency on the part of some to argue the question of regulation purely in economic terms. However, theft has been outlawed to protect individuals, not simply because of its economic consequences. Similarly modern trade practices and consumer protection laws are motivated by a desire to prevent exploitation of the individual by those with greater economic power, greater access to information or greater bargaining strength. More adequate and effective company and securities laws are required on grounds of fairness and commercial morality (1974, 15.2).

The balance of this chapter will provide evidence which suggests that the accountancy profession has failed in its claim to serve the public interest by ensuring that the information contained in audited financial statements will facilitate the making of decisions which, in turn, will result in an economic allocation of resources throughout the community.

THE PUBLIC BENEFIT FORSAKEN

The details of the Minsec deception outlined above suggest that, in that particular case, the financial information disclosed was not in the public interest in that it had the potential to divert resources to an inefficient company, Minsec, and, therefore, away from efficient resource users. It could, of course, be argued that this was a one-off case rather than the norm. However, the Rae Committee report provides ample evidence that it was not. Furthermore, while the findings of the Rae Committee did lead to the establishment of a co-operative regulatory scheme aimed at preventing such abuses of the corporate form, the necessity to appoint the Campbell Committee less than ten years later suggests that this initiative was not successful. Its findings support this contention. A similar result appears to have followed the establishment of the ASRB and statutory backing for approved accounting standards. The quote from Sykes given previously indicates that the financial information disclosed by companies can still be misleading despite the existence of several standards with statutory backing.
The balance of this chapter will endeavour to show that it is questionable whether accounting is in fact serving the public interest by ensuring an efficient allocation of resources. Corporate failures have continued with often devastating effects on the community. Clarke and Dean, for example, cite evidence from the AMP Society which estimates that corporate failures of the late 1980's and early 1990's have cost shareholders some $8 billion (1992, p181). These failures are often unexpected as financial statements have indicated the companies concerned were operating successfully. In some cases, companies have continued to operate even though activities once reported as profitable have subsequently been shown to have given rise to large losses, these losses having been hidden for a time by selective use of accounting practices. This has led Clarke and Dean to maintain that misleading financial statements have been as much the result of compliance with accounting standards as non-compliance (p186). Similarly, Chambers has argued that many of the instances of fraud and mismanagement that have continued over a long period of time, could not have taken place without “lax accounting practices” (1972, p182). It is not unusual, therefore, that accountants and auditors are often implicated in the deception of users of financial reports when investigations reveal that the financial reports were misleading. Such revelations cast doubt on the professionalism of accountants and on the profession's ability to design and develop accounting standards directed at achieving stable, efficient and effective capital markets and, thereby, an efficient allocation of resources.

The corporate failures examined in this section of the study have been selected on the basis of their notoriety and potential adverse impact on the status of accountancy. The large losses incurred by these companies were, in general, borne by shareholders and unsecured creditors. In some cases, creditors who thought their investments were secured, also incurred substantial losses. Specific corporate failures have also been selected because of the timing of collapse which, in some cases, occurred after
regulatory measures were taken in a bid to prevent the concealment of impending financial disaster. It will be argued in this and subsequent chapters that the continued cycle of corporate failure, regulatory reform is the result of flexible, vague and ambiguous laws and accounting practices. Grabosky and Sutton contend "[t]he criminal law as it applies to corporate conduct is at times flexible, at times ambiguous. . . . In the area of company law, precisely what constitutes a true and fair account is unclear" (1989, pxiii). A similar argument can be made with regard to accounting and what, for example, constitutes profit and when should the various components which make up profit be recognised and how should they be measured. As will be demonstrated, the determination of profit, in particular the recognition of revenue and losses, and the measurement of assets have been key factors in the unexpectedness of the corporate failures under examination.

The examination will begin with the collapse of the Reid Murray Group in 1963. This is not to suggest that there were no significant corporate failures between the time of the land boom of the 1880's, 1890's and the 1960's. Sykes has chronicled a number of corporate failures during this time (1988). However, as the Final Report of the investigators into Reid Murray (hereafter referred to as the Final Report) showed, the loss incurred by the Group was in excess of the equivalent of $40 million (Victoria, 1966, p78). This was an Australian record at the time (Sykes, 1988, p322). It also brought criticism of the accountancy profession.

One of the things most striking to a layman which was disclosed in the course of the investigation was that different methods of preparing the same company accounts are regarded by accountants as acceptable even though results using another method may be very different (Victoria, 1966, p79).

This and further criticisms of not only accounting methods but also auditors which will be discussed in the next section, appear to have been what Fitzgerald had urged against in 1949 when making calls for the profession to take a lead in the development
and publication of guidelines to members of the professional associations. Note that Australia adopted decimal currency in February 1966 on the basis that one pound equalled $2. For simplicity, decimal currency will be adopted in the discussion of the Reid Murray Group collapse.

Reid Murray Holdings and Related Corporations

In April 1963, the Legislative Assembly of the Victorian Parliament ordered an investigation into the affairs of Reid Murray Holdings Limited and certain of its subsidiaries including Reid Murray Acceptance. An interim report (hereafter referred to as the Interim Report) was made to Parliament by December 1963 (Victoria, 1963, p3). The Final Report was not finalised until 1966. The length of time involved in the investigation suggests the complex nature of the Reid Murray Group. In making its Interim Report, the investigators alluded to this complexity and indicated that subsequent investigation may vary the details contained in the Interim Report but doubted if the substance of their conclusions would be altered (p3). This view was verified in the Final Report (Victoria, 1966, p93). For this reason, much of the following discussion will centre on the findings set out in the investigators' Interim Report.

In both the Interim and Final Reports, it was demonstrated that poor management was the major factor in the demise of the Reid Murray Group. The Final Report stated clearly there was no apparent fraud but that the directors of the Group adopted a "no-management theory". Each company in the Group was left to its own devices (p92). Its public image, however, was of a "large, well run and profitable concern" (Victoria, 1963, p9). In order to maintain this image, generous dividends were paid and less than conservative accounting policies were adopted to conceal its lack of liquidity and unprofitable activities (p9). In the Interim Report, the inspectors stated that in their view, the published reports and accounts of the group were deceptive or inaccurate
and that they had been "... startled by the complete lack of reality shown in the 1961 accounts published by the group" (p107). The investigators admitted that they were not accountants and that the accountancy profession would not accept their conclusions but that common sense compelled the rejection of "... a number of the accounting practices used in the group ..." even though such practices were "... regarded as acceptable by accountants" (p107). Furthermore, even if the methods used were acceptable, the published accounts of the Group and its companies were misleading because the accounting methods used to arrive at reported profits were not disclosed (p66).

The fact that attempts to remedy this situation were made in the accounts for the year ending 31 August, 1961, was largely irrelevant. The investigators considered that the accounts for 1958, 1959 and 1960 and the indication they gave of a profitable and booming concern, were what prompted the investment of large sums of money in the company. For example, Reid Murray Acceptance Limited issued three prospectuses in the 1959-60 financial year. These issues brought public subscriptions in cash of $17 million (October, 1959), $11.2 million (March 1960) and $18.4 million (May 1960)(p65). Most of this money and that of other investors who subscribed to issues in response to a series of prospectuses issued up to and including May 1962 was subsequently lost (p66). The boom in investment in the Reid Murray Group and the rapid expansion of the Group may have been slower if the published accounts had reported more moderate figures. Without the great influx of cash, the expansionist activities of the Group may have been checked and the Group may never have failed (p66). The investigators also considered that while some attempts to disclose the manner in which profits were calculated in the August 1961 accounts, changes in accounting methods within the Group and dubious accounting methods used in the financial statements of subsidiaries inflated reported profits for that year. This, coupled with the misleading nature of the Directors' Report for that year, resulted in further credit being extended to the Group. Some of these funds were also lost in the
subsequent collapse of the Group (p81). As Chambers has observed changes in accounting methods could not have made the company better than it was. To the extent that accounting methods made it appear so, investors were fooled (1972, p183). In terms of the public interest objectives outlined previously, the accounting methods adopted by the Reid Murray Group for the years 1958 to 1961 appear to have resulted in an inefficient allocation of resources. For example, Chambers has argued that if it had not been for the overstatement of profits and assets, the Reid Murray Group would not have been able to raise some $34 million in debentures after May 1960 (p189).

The Final Report into the collapse of the Group suggests the validity of this view. A number of serious questions relevant to the accountancy profession are raised in the Report's conclusions:

If the group was badly run and was engaged in unprofitable enterprises and suffered its losses for these reasons, how was it that the group appeared for so long to be both well and profitably run? How did it come about that in 1961 the group published cheerful accounts showing substantial profits and the directors made a cautiously optimistic report to shareholders when by the time the 1962 accounts came to be published it was clear that disaster had befallen the group? How was it, that in May, 1962, Reid Murray Acceptance was able to put out an equally cheerful prospectus, and how was it that prospectus should have been kept open to public subscription until mid-October, 1962, when in November and December, 1962, it became clear that the group had collapsed? (Victoria, 1966, p93).

The Final Report stated the balance sheets of the Reid Murray companies frequently provided inadequate information about the items included in them (p79) and that the profit and loss accounts were at times misleading (p80). The fact that the auditors of Reid Murray Holdings were either too lazy or timid to properly qualify the accounts meant that shareholders did not receive the information the Companies Act intended them to receive (p91). The accounting treatment of real estate acquired for re-sale,
fixed real estate, interest on loans to acquire and develop real estate, debtors and intra-group transactions were targeted and criticised in both the Interim and Final Reports. The Interim Report provides details of these accounting treatments. It further states that in the opinion of the investigators, the accounting techniques were questionable particularly given the poor management of the Group. In some cases the accounting methods adopted produced completely unreal results and failed to present a true and fair view of the accounts (Victoria, 1963, p63).

Debts and real estate acquired for re-sale represented the two most significant assets in the balance sheets of the Reid Murray Group companies (Victoria, 1966, p79). Prior to 1959, the Reid Murray Group had been involved in the business of selling soft goods and electrical appliances on credit terms. Credit was provided by the Reid Murray Group to its customers and in the opinion of the investigators, the granting of credit was vital not only to the operations of the Group but also in its development and growth (Victoria, 1963, p58). Evidence of this was the low ratio of cash to credit sales of one to nine (p58). This, in itself, was not a matter of concern to the investigators. However, the treatment of profit on sales was.

In general, the retail companies of the group recognised the entire profit on credit sales at the time of sale. Given that the retailers themselves were the major financiers of credit sales and that credit was often extended in circumstances that would not have been acceptable to a finance company, the investigators argued that the profit on the sale should have been spread over the period of the credit terms. This was particularly the case where credit terms extended over a number of years (p58). The investigators accepted the fact that the approach adopted by the retail companies was consistent with generally accepted accounting practice. However, they argued that this practice should only be followed where there was strict control of credit and where adequate provision for bad debts was made. As already noted, the retail companies extended credit where, in the opinion of the investigators, a finance
company would not. For example, goods were sold on "no deposit" terms (p63). There was also evidence by the time of the publication of the August 1960 accounts that the time period of repayment for credit sales was increasing (p63). Even after the beginning of the credit squeeze in November 1960, little attention was given to debt collection by the managers of retail companies. Sales personnel were remunerated on the basis of sales not on debt collection. Emphasis, therefore, was on increasing sales volume with little regard for whether the purchasers could ultimately repay the debt (p67). Poor credit control was compounded by a failure on the part of some of the retail companies to make provision for doubtful debts. Instead, bad debts were written off as incurred. However, as the investigators pointed out, in the absence of strict credit controls, it is debatable whether the retail companies would have been in a position to readily identify bad debts (p59).

The overall impact of the methods used for accounting for retail sales made on credit was that profits and assets may have been overstated. The investigators suggested profits were overstated because profits were recognised that "... the companies concerned had not received and were not then entitled to receive but which would only be received in full with the passage of time and in some cases of many years" (p63). Profits were further overstated because no provision was made for bad and doubtful debts. Expenses, therefore, were understated and assets overstated (p63).

Similar arguments were raised with regard to the land dealings of the Group. As the investigators noted, the entry by the Group into the real estate market had a significant impact on the apparent prosperity of the Group and its subsequent demise (p61).

The years 1958, 1959 and 1960 saw the emergence of yet another land boom in Australia and the directors of Reid Murray Holdings seized the opportunity for the Group to profit from this boom. The Group accordingly established subsidiaries to
enter the land market (p61). The accounts of the Group ended 31 August 1959 show for the first time the item "Real estate acquired for re-sale with improvements to date at cost". This item was disclosed as a current asset amounting to $2.8 million (pp60-61). A number of aspects of the accounting for this land were of concern to the investigators.

Reid Murray Holdings lent money to its land company subsidiaries to finance the purchase and development of the land. Reid Murray Holdings itself had borrowed the money from its subsidiary Reid Murray Acceptance Limited (p61). Reid Murray Acceptance Limited was a listed finance company formed in June 1958 specifically to finance the expansionist activities of the Reid Murray Group (p8).

In principle, the land company subsidiaries paid interest to the Holding Company which in turn paid interest to Reid Murray Acceptance Limited. As the amount of interest notionally paid by the holding company was less than that paid to it by the land company subsidiaries, Reid Murray Holdings effectively made a profit on the transactions (p52). In April 1960, a further company, Re-Mur Finance Company, was created. This company was formed with the sole purpose of avoiding the payment of tax on the profits earned from interest on loans from Reid Murray Acceptance Limited to Reid Murray Holdings and then to the land companies (p51). As Sykes has argued, the "... utilization of tax losses is an accounting game which can be played with great skill and complexity" (1988, p309). It appears that the Reid Murray Group played it well and, at the same time, managed to lull investors in Reid Murray Acceptance Limited into a false sense of security.

The members of Re-Mur Finance Company comprised five companies all of which had ceased trading and had accumulated tax losses. All but one of the companies was insolvent (Victoria, 1963, p51). Re-Mur Finance Co. was effectively nothing more than a shell being administered by Reid Murray Holdings (p52). Interest bearing loans
to Reid Murray Holdings and then to the land company subsidiaries were systematically transferred to Re-Mur Finance Company at the end of the financial year of each subsidiary. Profits arising from the notional interest payments were divided amongst the five partners of Re-Mur Finance Company. These profits were set off against the accumulated tax losses of the partners with the result that no tax was paid. As the tax losses of each partner were absorbed, the companies gradually withdrew from the partnership (p52).

A more sinister aspect of the arrangement was the lack of protection afforded to investors in Reid Murray Acceptance Limited. As noted earlier, public subscriptions to the company amounting to $46.6 million were made during the 1959-1960 financial year. Six more public issues were made during the life of the Group. The prospectus for each issue clearly stated the investment being called for was in first mortgage debenture stock (pp46-47) secured by a registered mortgage over the assets of Reid Murray Acceptance Limited (p52). However, as the investigators noted, unsecured loans of some $52 million were made by Reid Murray Acceptance Limited to Reid Murray companies. These loans represented the major asset of Reid Murray Acceptance Limited (p52). The investigators estimated that by December 1961, unsecured loans represented approximately five-sixths of the company's tangible assets (p85). The deception of debenture holders was deepened in that the loans were then systematically transferred to Re-Mur Finance Company, a company without independent existence and comprised of "... a partnership of companies whose history was a history of losses" (p52). In short, their investment was unsecured and when the Group failed, there was no recourse for them to recover.

The investigators also expressed doubt over the manner in which the land company subsidiaries accounted for interest charges and development costs. As noted by the investigators, there is often a long time lapse between the time land is acquired and developed to the stage where houses have been built and are ready for sale. If the
land companies had disclosed interest payments and development costs as expenses, their profitability would have been eroded in the early stages of the land development projects. The solution was the capitalisation of interest charges and development costs with a consequent writing up of land values (p61). The investigators considered that this practice was justifiable if used in conjunction with planned development but if this plan was disrupted for an uncertain time period, the practice should be discontinued. A further consideration, in the view of the investigators, was that the practice should not be undertaken when the developer had to continue to borrow funds to complete the project (p62). As already indicated, the land companies financed development by borrowings from Reid Murray Holdings. In addition, it appears the practice of capitalising interest and development costs continued after the announcement in November 1960 of a Federal Government imposed credit squeeze which reduced the likelihood of successful sale of properties at other than what the investigators termed "sacrifice prices" (p12, p67). In addition, the practice was continued into the 1961 accounts at a time when lack of funds prevented further development (p78). In some instances, land was sold without being developed and on terms that were "longer" and "easier" than the terms on which Reid Murray land companies had purchased the land (p64). The investigators expressed further concern that the financial statements did not disclose the fact that interest and development costs had been capitalised. The first time this fact was disclosed was in the 1961 accounts (p63). Even then, however, insufficient information was given to allow a determination of how much of the value of the Group's investment in land consisted of capitalised interest as opposed to tangible development or improvements (p108). This perhaps became more pertinent when the land was appraised by sworn valuers in August 1962. Land values in the books of group companies at that time were considered to be overstated by $1,533,880. It was considered that later valuations would prove land values had fallen even more (p13).
A further area of concern for the investigators was the treatment of trading profits on
land. As with retail transactions, most of the land dealings were on credit terms
sometimes extending over long time periods. This was particularly the case with land
and housing. All of the profit on sale was taken into the accounts at the time of sale,
even though the contracts were often framed in such a way that the contract could
later be avoided. Furthermore, it appears that, as with retail sales, there was a lack of
control over the granting of credit (p62). The investigators argued that under the
circumstances of the Reid Murray Group, profits on the sale of real estate should not
be recognised in full at the time of sale. A provision for unaccrued profit should be
made and deducted from the total profit on the sale. The balance should be reported
as profit (p63).

In addition to the problem of recognising profits at the time of sale, the investigators
noted a lack of consistency in reporting within the Group. One member of the Group
calculated tax on the "profit emerging basis" (p62). Under this method profits are
recognised in each accounting period on the basis of the relationship between gross
profit on the sale and the ratio of cash actually received during the year to the total
sale price (ASA, 1966, p17). This had the effect of showing one figure for gross
profit for tax purposes and a completely different figure for gross profit in the
accounts. This approach was used for three consecutive years by the subsidiary in
question. The most marked difference in the two amounts was for the 1959-1960
financial year when gross profit for tax purposes was $61,450 compared to $385,628
gross profit for purposes of the accounts. Once again, the accounting methods used
were not disclosed in the published accounts of the Group (Victoria, 1963, p62).

According to the investigators, the 1960-1961 financial year of the Group saw a
change in its fortunes. The Directors' Report stated that consolidated profit after tax
for the year was $1,791,784 compared with $3,090,680 for 1960 and $1,702,650 for
1959 (p69). The investigators considered the comparison made between the three
years' results was totally misleading. In many instances, accounting changes were made either by individual companies within the Group or by the holding company. The Directors' Report for the year stated that some accounting changes had been made but the investigators observed that the statements "represented only a half-truth" in that the stated reason for at least one change was given as being to standardise the calculation of unearned income within the Group. The purpose of this and other changes, in the opinion of the investigators, was for no other reason than to increase reported profits (p69). The impact of the changes in accounting methods was estimated to be some $1,959,414 (p73).

The changes questioned by the investigators included the adoption of the Rule of 78 for the calculation of unearned income by both retail and land companies within the Group. This increased the profit for the year by $765,214. Contrary to the statement in the Directors' Report, the investigators found little evidence to suggest this method had been used to any extent within the Group prior to this time (p69). The investigators also noted that during 1961 the Rule of 78 had been recommended for hire purchase and finance companies at a conference of hire purchase companies and also by the General Council of the ICAA. However, there was no evidence to suggest these recommendations had influenced the decision to adopt the method within the Reid Murray Group. It was concluded, therefore, that the technique was used to increase reported profits for the year (p70).

The auditors confirmed that it was probable that the reported profit for the year would not have been as high if the Rule of 78 had been used in previous years. The introduction of this method meant that not only were profits for 1961 included in the calculation but also profits which would have been brought to account in prior years if the method had been used during those years (p70). The investigators also questioned the propriety of the application of the Rule of 78 to credit retailers given the poor control of credit that was evident throughout the Group (p70-71).
Criticism was also levelled at a newly adopted method of accounting for rental income introduced by one company within the Group. Prior to the 1961 accounts, rental income was taken into account as it fell due over a fixed term. Under the new accounting system, all rental revenue due over a fixed term was recognised when the rental agreement was entered into. This change increased reported profits by $272,032 (p71).

Group profits were further inflated by an amount of $170,168 by a dubious treatment of what the investigators considered were essentially pre-acquisition profits of a subsidiary and a change in accounting methods within that subsidiary imposed by the holding company (p72). With regard to the pre-acquisition profits, the investigators argued that "deferred" profits which were subsequently included in the 1961 accounts had been earned prior to the acquisition of the subsidiary in the year ending August 1960. The "deferred profits" arose because the company in question had previously used the profits emerging basis of recognising profits on land transactions (ASA, 1966, p17). However, for the purposes of the 1961 accounts, the subsidiary was forced to abandon this method and adopt the method of recognising profits at the time of sale even when the sale was on terms (Victoria, 1963, p72). Hence, even if the "deferred profits" could not rightly be called "pre-acquisition profits", the overall impact of the change in accounting methods was to recognise in the current year's profit, profits which had been earned in prior years.

As noted previously, it was uncommon for companies within the Group to provide for doubtful debts. Bad debts were written-off as incurred. In November 1961, the auditors raised this matter with the holding company (pp72-73). As a consequence of the insistence of the auditors, a provision for doubtful debts of $700,000 was raised. However, it was not written-off against the current profits of the subsidiaries or of Reid Murray Holdings. Instead, it was made as an appropriation from the retained
profits of Reid Murray Holdings (p73). This apparently was a compromise arrived at by a director of Reid Murray Holdings and the auditors. The director was loath to have any further provisions created (p79). Firstly, the investigators considered the provision should have been raised in the books of the subsidiaries and written-off against the gross profit for the year of the individual companies particularly as the companies involved had been identified. The method adopted did not affect profits for the year either in the accounts of the subsidiaries or in those of Reid Murray Holdings (p73). In addition, it appears that even this provision was grossly understated. Doubtful debts in the Group at the time were estimated to be approximately $3 million (p79).

In addition to the changes in accounting methods, the investigators considered the consolidated profit and loss for the year would have shown a substantial loss if the accounts of some of the subsidiaries had been properly prepared (p79). For example, one subsidiary included profits of $300,454 on the sale of property. At the time the accounts were prepared, the transaction was not complete. The auditors report of the subsidiary was qualified with respect to this transaction (pp76-77). The auditors of Reid Murray Holdings approached the auditors of the subsidiary but were refused any information regarding the qualification. They then contacted a director of Reid Murray Holdings who assured them the transaction was bone fide (p84). The auditors accepted these assurances and their report for the Group was accordingly unqualified (p84). The accounts of another subsidiary included as revenue a procurement fee for services which had not been rendered and for a transaction which was not completed in 1961. A cheque for the fee had been drawn in August 1961 but was cancelled in December 1961 (p53). A further "procurement fee" initially recorded as revenue was subsequently recorded as "goodwill" (p77). In a further example, profit on the sale of a number of houses was recognised despite the fact the houses had not yet been built. The accounting method adopted was to recognise the
profit as soon as the agreements for the building of the houses were entered into. A corresponding liability was raised for estimated construction costs (p77).

The investigators also questioned balance sheet classifications. As discussed previously, real estate held for re-sale was classified in the balance sheet as a current asset. The investigators had no complaint with this in the event the land was expected to be sold within a relatively short time period such as twelve months (p80). However, given the credit squeeze and drop in land sales, the continuation of classifying the land as a current asset was questioned. In addition, the lack of land sales at other than "sacrifice prices" (p12, p67) meant that the land was over-valued in the accounts (p80). Sworn valuations in 1962 confirmed this (p13).

Reference was also made by the investigators to the classification as current assets of amounts owed by subsidiary companies to Reid Murray Holdings. Admittedly, these amounts were payable on demand but, as the investigators pointed out, such a demand would have forced most of the subsidiaries into liquidation. Recovery of the advances would have taken years and, therefore, they should not have been classified as current assets (p80).

In summary, the investigators maintained that the financial statements for the year ending August 1961 were misleading. By way of explanation of the actions of the directors and other officers of the Group, the investigators pointed to the situation the Reid Murray Group found itself in at this time (p81). As noted earlier, the directors of the Group had an obsession with presenting an impression of a profitable organisation. However, profitability is one thing and liquidity quite another and from April 1960, the Group was faced with liquidity problems (p9). These problems continued and steadily increased culminating in an order for the winding up of Reid Murray and its subsidiaries in May 1963 (p14).
This is not to say that cash was not coming into the Group. The debenture issues of Reid Murray Acceptance Limited generated the inflow of $86 million in cash between July 1958 and October 1962. However, no provision for the retirement of debentures was made (p39). In general, it appears there was an assumption the public would continue to subscribe to debenture issues so that later issues would be used to meet interest payments and retirement of earlier issues (p39). The lack of any plan for the retirement of debentures appears to have been compounded by a complete lack of planning for how the money from debentures was to be utilised or how much income would be generated by the funds employed (p49). In addition, prior to 1961, there was no control of the terms of subscriptions or of debenture maturity dates (p49).

This attitude was exacerbated by the rapid rate at which cash paid on debentures was spent or committed by companies within the Group. As borrowed money came in, it was used to fund the expansion of credit in retail and land divisions (p58-59), the takeover or formation of new subsidiaries (p8, p59-60) and the purchase and development of real estate (p61). As already discussed, the bulk of the retail and land sales were on credit with credit being provided by the selling company. If credit control had been maintained, self financing would not have been a problem. As was revealed in the course of the investigation, this was not the case. The repayment period for credit sales became increasingly long (p63). The proceeds of debenture issues was also used to finance the take-over of other companies. The Reid Murray Group expanded to such an extent that at the time of its demise, it comprised more than 200 companies (Stamp, 1964, p2). Some of these companies were of doubtful profitability at the time of take-over (Victoria, 1963, pp59-60). In commenting on the managing director of Reid Murray Holdings, the investigators stated "... he was selling cash: and he sold cash in great and increasing amounts, without planning the provision of the funds necessary to pay to-morrow's bills" (p64).
This use of borrowed money, in particular on "fixed or semi-fixed assets" was a major weakness in the Group's financial structure because when a downturn in the economy came, the inflow of debenture money declined. As the Group had not provided for the retirement of earlier debentures, it needed to realise some of its assets to meet its commitments. However, such realisation was difficult because of the then prevailing economic climate (p60). This meant the Group had to rely on an ever increasing bank overdraft and stand-by arrangements which stood at $11.6 million by the end of the 1961 financial year. The Group's trade creditors and other liabilities also began to accumulate and a current liability for these items amounted to $12.2 million in 1961. It therefore was necessary to maintain public confidence in the Group to ensure a steady, albeit reduced, stream of debenture subscriptions (p49) and, to a certain extent, the maintenance of bank overdraft and credit facilities. The scene was thus set for the preparation of the August 1961 financial statements which managed to show a profit, albeit a smaller profit compared to prior years.

The Group succeeded in that further debenture monies were subscribed in response to a prospectus issued in December 1961 and another issued in May 1962 (pp12-13). However, the amounts subscribed were considerably less than previous issues and by October 1962 outflows exceeded inflows by $432,500. Debentures due to mature in 1963, 1964 and 1965 amounted to $38 million. In the absence of any plan for retirement of these debentures utilising funds already within the Group or subsequent operating activities further borrowing would be needed to meet these debts (p108). The banks continued to provide overdraft and stand-by arrangements but in September 1962 refused a request to increase the over-draft limit. In December 1962, Reid Murray Acceptance Limited was unable to meet a $1.2 million debenture interest payment (Stamp, 1964, p2). Thus despite attempts to maintain its public image as a well-run and profitable organisation, Reid Murray Holdings and its subsidiaries entered an agreement on 10 January 1963 with the debenture trustees to appoint a receiver. An order for the winding up of the Group was made in May 1963 (p14).

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The foregoing narrative has not attempted to question the criticisms levelled by the investigators at the accounting methods adopted by Reid Murray Holdings and its subsidiaries. The purpose has been to provide some insight into the nature of the accounting methods used to conceal the failing liquidity and profitability of the Group as evidenced by the modest profit reported in the 1961 annual reports. A profit which the investigators suggest should have been a significant loss had it not been for the accounting methods adopted within the Group (p79).

In response to the investigators' reports on Reid Murray Holdings and other failed corporations in the early 1960's, the General Council of the ASA undertook an examination of the findings set out in these reports (ASA, 1966). In general, the ASA report agreed that there was a lack of compliance with a number of generally accepted accounting principles in the accounts of the Reid Murray Group such as the failure to provide adequate provision for doubtful debts and the raising of a provision against the retained profits of the holding company (p23), the treatment of pre-acquisition profits as being available for distribution by the holding company, including unearned profits in group profit for the year by recognising profits on transactions which were fictional or not completed at balance date such as land sales or agreement to build houses and inappropriate classification, description or valuation of assets in the financial statements (pp25-26). Even where General Council disagreed with the investigators' report, for example with regard to the recognition of profit at the point of sale even for hire purchase and extended credit transactions, it was prepared to admit that whether the criticisms of generally accepted accounting principles were valid or not, there were deficiencies within the accountancy profession. These deficiencies related, inter alia, to the formulation, promulgation and regular review of accounting principles and compliance with them by members of the profession (p5). Furthermore, with regard to the number of acceptable methods of reporting essentially the same transaction, it was recognised that financial statements could be
misleading to investors, creditors and shareholders who are unaware of the limitations of statements prepared in this manner (p7).

As noted in Chapter 3, the collapse of the Reid Murray Group and other companies prompted calls for the formulation and promulgation of accounting standards. These calls led to a co-operative effort between the ASA and ICAA to promulgate accounting standards through the jointly sponsored AARF. However, as subsequent events have shown, corporate failures have continued and often, the accounting methods used to conceal impending failure have been similar to those used in the Reid Murray Group.

Cambridge Credit Corporation Limited

On 30 September 1974 Cambridge Credit Corporation Limited (hereafter referred to as Cambridge) defaulted on the payment of $2 million interest due to debenture and note holders on that date. As a consequence, Cambridge and those of its subsidiaries guaranteeing debentures and notes were placed in receivership (New South Wales (NSW), 1977, p15, 2.1). Just fourteen days earlier, the directors of Cambridge had issued a press release announcing profits of $3,055,635 after tax. The press release further stated the results were audited and represented a 33.2 per cent increase in profits compared to the previous year (p15, 2.2). Some six months earlier, a press release had announced interim results for the six months to 31 December 1973 which showed a 99.8 per cent increase in profitability over the same period for the 1972-73 financial year (pp15-16, 2.4).

In the wake of the Cambridge collapse, the New South Wales Corporate Affairs Commission was appointed by the State Attorney-General to undertake an investigation of Cambridge and related corporations. The investigation was to include the press release profit announcements of March and September 1974, the Group
profit for the year ended 30 June 1974 and how these profits had been determined. A prospectus had been issued in May 1974. The investigation was also to extend to the auditors' and directors' reports in the prospectus (p11, 1.1, 1.2, 1.3).

In 1978, the scope of the investigation was widened to include what the investigators termed Hutcheson Family Companies (NSW, 1979, p3; p15,1.4). The period under investigation was extended to commence from 1 July, 1965 including every prospectus dated after 30 June 1966 up to the time of the last prospectus dated 6 May, 1974 (p1.5, 1.5, 1.6). The reason for this was that the investigators considered that the Cambridge Group and the Hutcheson Family Companies were not independent. The investigators referred to the overall Group as the Hutcheson Conglomerate as this was consistent with a group managed and operated as one company (p21, 2.7).

The first interim report appeared in 1977. The second report was published in 1979. Both reports were highly critical of the auditors of the Group. For example, the conclusion of the first Interim Report stated:

We are of the opinion that the firm failed to take proper steps to plan and control their audits for the periods ended 31st December, 1973, and 30th June, 1974, and that they were negligent in the performance of their statutory duties both as auditors of the Cambridge group for those periods and as reporting accountants in the Prospectus dated 6th May, 1974 (NSW, 1977, p281, 12.18).

In the second report, the investigators comments were even more pointed:

... had ... the auditors of all the relevant Conglomerate companies since 1966, adopted a competent, critical and independent approach in their work, the ultimately disastrous situation of Cambridge and Northumberland could never have developed (NSW, 1979, p5).
Northumberland Insurance Company Ltd was one of the Hutcheson Family Companies and effectively had been a Cambridge subsidiary since April 1971 (p3).

The two Cambridge reports deal extensively with the accounts of the Group and the Hutcheson Family Companies and their audit. A thorough analysis of all aspects of the reports is neither possible nor necessary in the present context. As with the Reid Murray investigation commented on previously, some key elements of the reports will be identified and discussed in a bid to establish the lack of due regard for the interests of investors and creditors and the public in ensuring an efficient allocation of resources. The lack of concern for those who dealt with Cambridge was commented upon in the second report with regard to the relationship between Cambridge and the Hutcheson Family Companies:

The Conglomerate for many years had been suffering large cash losses and had survived only by reason of public borrowing through Cambridge. These losses and, indeed, the links between the Cambridge group and other Conglomerate members had never been disclosed by Cambridge, and when regard is had to them, the situation of Cambridge must have been precarious since before 1966. This non-disclosure . . . was such as to deceive all who dealt with Cambridge or with Northumberland . . . Their concealment of the true situation of these companies was assisted by the auditors who failed to appreciate, let alone report on the way the Conglomerate was being used to this end (p21, 2.7).

Much of the first report concentrated on the profit announcements of March and September 1974. Reported profits were determined on an ad hoc basis to achieve a pre-determined result and, at the same time, to smooth income (NSW, 1977, p140, 8.8, 8.9). Management made no attempt to conceal this fact from the auditors (p261, 11.6). In the opinion of the investigators, Cambridge management would have accepted the auditors' advice regarding appropriate accounting methods had this been forthcoming. Such advice was apparently not made available and the audit partner in
charge simply accepted the accounting policies adopted by Cambridge management. This led the investigators to conclude that Cambridge did not "...receive the benefit of the expertise they were entitled to expect" (p261, 11.7).

On the basis of the evidence before them, the investigators concluded in the first Interim Report that the profits for the six months to 31 December 1973 and for the year ended 30 June 1974 were "materially overstated" (p278, 12.3; p280, 12.11). The Auditors' Report in the Prospectus issued on 6 May 1974 was also considered to include false statements as to the liquid assets of the Group and reported consolidated net profits (pp278-279, 12.5-12.7). Further evidence detailed in the second report led the investigators to conclude that the net profits before tax for each six monthly and annual period recorded in the Auditors' Reports included in prospectuses from 30 June, 1966 onwards were false (NSW, 1979, p5). When the position of the Hutcheson Conglomerate as a whole was considered, the investigators considered Cambridge could well have been insolvent since before 1966 (p3).

In analysing the investigators reports into Cambridge, it is possible to draw parallels with Reid Murray Holdings. For example, both groups encountered persistent and increasing liquidity problems. Cambridge's liquidity problems did not stem necessarily from poor management as in Reid Murray Holdings but from increasing activities in real estate development. The nature of these activities was such that large capital outlays were required without any prospect of cash inflows until projects were subsequently developed and sold. The Group was diversified in that in addition to land development, it was involved in share trading, hire purchase operations, film production, hotel management and aerial photographic servicing companies. However, many of these activities sustained losses and, thereby, added to the Group's liquidity problems rather than alleviating them (p16, 2.6).
Given insufficient cash flow from its real estate activities and the lack of profitability of its other activities, Cambridge, like Reid Murray Holdings, was dependent for its continued existence on public borrowing. Public borrowing, however, required public confidence in the Group which in turn was seen to be contingent upon the Group's profitability (p16, 2.6). The Group's managing director agreed with the investigator's contention that

... it was Cambridge's objective to produce a "reasonable profit" for each half-yearly period, not only for the purpose of paying dividends but also for the purposes of borrowing funds, and that unless the company could show a profit for each 6 months' period the ability of the group to raise debt finance would be considerably impaired (p140, 8.7).

To meet this objective, profits were "internally generated" through the capitalisation of interest on loans and what was termed "front end" transactions (p280, 12.13). Briefly, front end sales were described in evidence as a process whereby A Company and B Company form a joint venture to purchase land. A third company, C, is formed and the land is subsequently sold to a second joint venture, ABC Company. C Company undertakes to provide finance at an agreed interest rate for the development of the land and also to those who subsequently purchase it (pp52-53, 4.9).

One of Cambridge's major partners in these ventures was a company called Intercapital which became a subsidiary of Cambridge in 1973. Other companies were formed specifically for the purpose of front end transactions. For example, Mt. Warren was incorporated in April 1970 to serve as a joint venture with Cambridge and Intercapital for the acquisition and development of land and its subsequent sale. It was owned equally by Cambridge and Intercapital (p69, 4.51). Another company, Southern Pacific was incorporated in February 1971. It was specifically formed as a tri-venture vehicle also for the acquisition, development and sale of land (pp69-70,
Ownership of Southern Pacific was 40 per cent Cambridge and 60 per cent Intercapital (p70, 4.54).

Front end transactions allowed Cambridge to recognise "profits" in the early development stages of real estate projects (p16, 2.6). From 1970, front end transactions accounted for an increasing proportion of the reported profits of the Cambridge Group (p52, 4.7). The investigators did not cast doubt on the propriety of this method of calculating profits per se but did question the recognition of those profits given that Cambridge invariably maintained an interest in the ultimate purchaser of the land:

The essential ingredient of front end transactions with which we are concerned is that Cambridge, as vendor, or having a significant equity interest in the vendor, retained an interest in the subject property by virtue of its holding a significant equity interest as a venturer or shareholder in the purchaser. It was the practice in the Cambridge published accounts for Cambridge's full share of vendors' profits from front end sales to be included without allowance for or disclosure of the proportion attributable to Cambridge's interest in the purchaser (p52, 4.7).

It would appear the investigators' concerns were well-founded. Evidence to the enquiry included correspondence from within Fell & Starkey, the auditors of Cambridge and most of its subsidiary and related companies. This evidence clearly indicated Cambridge's treatment of the profits was a matter of concern (pp53-54, 4.10; p55, 4.13; p62, 4.27; p64, 4.34; p65, 4.39). For example, one member of the firm stated the Cambridge approach was "outside . . . generally accepted accounting principles" (p64, 4.34) as " . . . profits are not earned and . . . it is a very dangerous procedure . . . " (p62, 4.27). Another member expressed the view
... the basis on which the profit has been brought to account in Cambridge is not correct. ... It does not seem right for a profit to be "engineered" simply by moving a small percentage of a project ownership to another party so that it can be said that an actual cash profit has emerged which can be taken in as income in the accounts of one of the original parties to the full extent of the percentage ownership in the project when a major portion of the ownership is still actually retained (p65, 4.39).

The investigators accepted, in principle, the right of the audit partner in charge to disagree with these views. What was criticised, however, was the failure of the auditor to ensure consistency within the Group allowing an "ad hoc approach to front end sales" and also the failure to verify the validity of transactions:

... the auditors failed to have any critical regard to the bona fides or the substance of the transactions in question; ... it is as important for an auditor to satisfy himself as to the genuineness of a transaction as it is to debate the principles applicable to any profit apparently arising therefrom (p54, 4.11).

In particular, while the investigators were prepared to accept front end transactions as legitimate devices, the inter-relationships between the parties to the transactions were "no more than the "churning" of real estate" (p74, 4.75) and profits, therefore, were neither earned nor realised (p167, 8.119).

According to the investigators, Cambridge effectively "engineered" at least part of its 99.8 per cent increase in profits for the six months to 31 December 1973 and its overall 33.2 per cent increase in profitability for the year ended 30 June 1974. This was achieved by the use of front end profit techniques and the failure to eliminate intra-group transactions from the Group results.

As already noted, in March 1974, Cambridge issued a press release announcing a net operating profit after tax of $1,970,697 for the six months to 31 December, 1973.
Profit before tax was $3,755,601. The major contributors and their respective after tax contributions were as follows:

<table>
<thead>
<tr>
<th>Entity</th>
<th>Contribution ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambridge</td>
<td>749,454</td>
</tr>
<tr>
<td>Burhead</td>
<td>921,109</td>
</tr>
<tr>
<td>Elbrook</td>
<td>33,256</td>
</tr>
<tr>
<td>Leonda</td>
<td>39,181</td>
</tr>
<tr>
<td>Preston Markets</td>
<td>38,235</td>
</tr>
<tr>
<td>Sunderland Holdings</td>
<td>131,983</td>
</tr>
<tr>
<td>26 other subsidiaries</td>
<td>127,594</td>
</tr>
<tr>
<td>2 subsidiaries contributed</td>
<td>(70,115)</td>
</tr>
<tr>
<td>31 other subsidiaries</td>
<td>(70,115)</td>
</tr>
<tr>
<td>Total contribution</td>
<td>$1,970,697</td>
</tr>
</tbody>
</table>

On analysis of the transactions giving rise to Group profitability, the investigators concluded the profit had been overstated by at least $3,952,691 by inclusion of $40,000 interest income which was brought to account twice and the following transactions:

- Sale by Burhead to Group Housing
  - Burhead: $1,754,493
  - Cambridge: $1,621,828
- Sale by Sunderland to Group Housing: $251,397
- Sale by Cambridge to Loftus: $284,973

On the surface, the two sets of figures above do not pose any problems. However, all of the transactions represented intra-group sales. Elbrook was a wholly-owned
subsidiary of Cambridge while Loftus was 75 per cent owned (p48, 3.10). The $40,000 interest income was the result of a land sale from Elbrook to Loftus (p168, 8.119). Clearly, the transactions between Elbrook, Loftus and Cambridge should have been eliminated from the Group results.

The dealings with Group Housing were even more suspect and provided ample grounds for criticism of the auditors by the investigators. There was some doubt as to the percentage ownership that Cambridge held in Group Housing but it appears it was either 50 per cent or 75 per cent. The auditors failed to verify Cambridge's beneficial ownership (p150, 8.61). In addition

Cambridge had supplied all the moneys paid by Group Housing and it alone was obliged under the terms of the tri-venture agreement to find all finance for the venture (p169, 8.124).

Therefore, even if Group Housing was not a subsidiary, the transactions should have been excluded from Group results as Cambridge had financed them (p152, 8.64).

This, however, was not the end of the story. As is clear from the above, Cambridge's own accounts had included a profit before tax of $1,621,828 on the sale of land between Burhead and Group Housing. Cambridge's share of the profit stemmed from a 50:50 joint venture with Burhead (p145, 8.39). The joint venture agreement was not executed until June 1974 but was back-dated to May 1973 to authenticate the inclusion of the profit (p145, 8.39; p155, 8.73). The major significance of this is that without the share of the Burhead profits, Cambridge would have shown a loss for the six months to 30 December, 1973 (p159, 8.81).

A similar back-dating of a joint venture agreement occurred with regards to profits on land sales between two other Cambridge subsidiaries. The profits in this instance were included in the financial statements of 30 June, 1974 (p153, 8.68). The
transaction in question was apparently completed prior to 31 December 1973 but the profit of $3,000,548 was not brought to account until 30 June 1974 (p221, 9.72). A joint venture agreement was executed in June 1974 and back-dated to February 1973. Cambridge's share of the profit, as included in the 1974 financial statement, was $1,500,274 (p224, 9.81). The investigators argued that even if the sale between the two subsidiaries was a bone fide front end transaction, Cambridge's share should have been eliminated from the Group result due to its ownership interest in the vendor (p225, 9.87).

A further area of contention was the inconsistent and arbitrary use of at least three different accounting methods for virtually identical transactions (pp140, 8.8; 142, 8.16). There were three reasons for the adoption of different accounting methods to suit particular circumstances. The reasons amounted to desires to maximise profits, tailor profits to a pre-set target or avoid violent fluctuations in profits from one period to the next (p140, 8.8). The methods in question were the accrual, cash emergence and profit emergence bases of determining profits on real estate sales.

The basis of measuring profits for the six months to 31 December 1973 in Sunderland was the cash emerging basis (p161, 8.91). A note to the draft profit and loss statement explained that the terms of the contract extended from 1973 to 1983 and "conservative accounting" dictated the cash emerging basis for the calculation of profits. The balance owing under the contract was recorded as deferred profits (p161, 8.92). However, further evidence demonstrated that the accrual basis had originally been adopted in the calculation of Sunderland's profits but this was changed to facilitate achievement of the pre-determined Group result (p164, 8.100).

On the other hand, Burhead profits for the same time period were determined on an accrual basis. The reason again being matching reported profits with a pre-determined target (p164, 8.101). However, the method of accounting was changed
for both companies during the subsequent six months. For the year ended 30 June 1974, the same transactions were accounted for using a profit emerging basis for Burhead and an accrual basis for Sunderland (p166, 8.103).

The profit emerging basis had not previously been used within the Cambridge Group (p207, 9.55). Its introduction with regard to the Burhead profits was effectively to smooth income over a number of years. The Burhead profit of $3 million was the largest six months profit ever made within the Group and had been derived almost entirely from one transaction (p209, 9.55). The decision to account on the profit emerging basis and apportion it over ten years was based, in part, on a perception that no one would believe profits of that magnitude had been earned (p210, 9.55). Furthermore, the economic climate was such that now the Group was looking at a large profit while in the future, it may be trying to find profits. In other words, the purpose of the change in accounting methods was to spread the profits over several time periods (p210, 9.56).

Evidence to the investigation provided by the two directors responsible for the determination of accounting methods suggested they were

... unconcerned that the achievement of an acceptable final group profit total for a given period might result in different and inconsistent bases of profit calculation being used by the same parties for different transactions, or by different members of the Cambridge group for the same transactions. Nor were they concerned that the bases used for the calculation of the group profit total for a full twelve month period might be different from and inconsistent with those used either for the first six months of such period or for the preceding year (p141, 8.12).

According to investigators, the above activities led to a material overstatement of profits after tax of $3,055,635 for the year ended 30 June 1974. The overstatement was at least $3,732,629. The investigators qualified their conclusion by the term "at
least" because only specified items, in particular, land sales between Group members, were included in the calculation (p225, 9.89). Furthermore, the investigators concluded that the accounts for Cambridge and the Group were misleading because the method of calculating profits was not disclosed (p179, 8.152).

The first report into the Cambridge Group also levelled criticism at the auditors with regard to Prospectus 31 issued in May 1974. This criticism included the profit calculations discussed previously (pp255-257, 10.52-10.57). In addition, investigators came to the conclusion that the debenture issue should not have been made as Cambridge had effectively been without additional borrowing capacity since at least 1969 (p226, 10.2; p251, 10.39). Under the debenture and unsecured note trust deeds, Cambridge's borrowing ability was limited to the lesser of three quarters of liquid assets and five times shareholders funds (p20, 2.23). Prior to the issue of Prospectus 31, the operative borrowing limitation had been five times shareholders' funds (p226, 10.2). The Share Capital and Reserves of Cambridge totalled $15.5 million in December 1973. Five times this amount is $77.5 million. Cambridge's borrowings at the time were $77,247,600 which meant it had no further borrowing capacity in terms of that criterion. It appears that Cambridge management set out to manipulate shareholders' funds to allow a further debenture issue to be made.

In November-December 1973, independent valuations of all real estate and other assets held by the Group were commissioned by the Managing Director of Cambridge (pp226-227, 10.4). It was stated in evidence that the purpose of the valuations was to avert a possible takeover bid by informing shareholders that the asset backing per share was in fact $2.90 rather than the 60 cents indicated by the published accounts. This information was conveyed to shareholders via a press release and circular in December 1973 which also stated the licensed valuations had resulted in a net surplus of $43 million (p227,10.5). A further effect of the revaluation which was not
disclosed was that it altered the operative borrowing limit to three quarters of liquid assets and paved the way for Cambridge to extend its borrowings (p234, 10.16).

The revaluation of assets was not of primary concern to the investigators. Rather, it was the underlying motive for the revaluations and the failure of the auditor to recognise it or to realise the alteration in the borrowing benchmark which occupied the minds of investigators who contended "the dominant, if not sole purpose" of the revaluation was to permit Cambridge to make further debenture borrowings (p226, 10.2; p233, 10.16). This conclusion was based, in part, on the manner in which the revaluation was treated in the accounts and Prospectus 31. Investigators argued that if the sole purpose of the revaluation had been to inform shareholders of the wealth of the firm, this objective had already been achieved through the press release and circularisation of shareholders (p233, 10.16). However, as the investigation revealed, Cambridge management went to great lengths to have the revaluation included in the accounts in one way or another.

It appears that Cambridge management initially wanted to include the effect of the revaluation in the balance sheet as an increase in the relevant assets and by raising an asset revaluation reserve (p227, 10.7). Members of Fell and Starkey, however, argued that this was not in the interests of shareholders for a number of reasons including taxation complications which could have adverse affects on cash flows, difficulties in interpreting borrowing limitations and trust deeds and that it would invite rather than deter a takeover bid (p228, 10.9).

Cambridge sought legal advice on the matter and initially found support for the proposed treatment of the revaluation (p228, 10.11). However, on further discussion between Fell and Starkey, Cambridge and legal counsel, the revaluation was disclosed in note form in the financial statements and in Prospectus 31 (pp232-233, 10.13, 10.14). This approach allowed Cambridge to avoid any adverse consequences of
formally including the revaluation in the accounts but, questionably, allowed it to use the revaluation in recalculating its borrowing limit. The Managing Director of Cambridge reluctantly agreed during examination that this was the purpose of disclosing the revaluation in the notes to the balance sheet.

It appears that this underlying motive for including the revaluation in notes to the accounts and prospectus was not recognised by Fell and Starkey, and in particular, by the partner in charge of the audit. The auditor also failed to realise that the basis of calculating the borrowing limit under the trust deeds had changed. These conclusions are readily apparent from the transcript of evidence given by the auditor during the course of the investigation (pp237-241, 10.18; pp241-243, 10.20). Further evidence that Fell and Starkey were unaware of or had not considered the borrowing implications of the revaluation was that on the appointment of the Receiver, advice was sought as to the propriety of taking the valuation into account in the calculation of the borrowing limitation (p243, 10.22).

This issue was further complicated by the fact that liquid assets were inflated by the inclusion, in full, of advances by Cambridge to joint ventures in which it held a 50 per cent or greater interest (p247, 10.32; p250, 10.38). These advances amounted to at least $88 million as at 31 December 1973 and $102 million as at 30 June 1974 (p247, 10.32).

From 1969, when such advances began to represent a significant amount (p251, 10.39), a note to the accounts stated that "Mortgages and Other Receivables" included secured loans to joint ventures (p247, 10.33). However, the fact that Cambridge held an interest of 40 to 45 per cent in the joint ventures was not disclosed (pp248, 249, 10.35). A further point of contention for investigators was that Cambridge's interest in the joint ventures was not considered in the calculation of liquid assets for purposes of determining the borrowing capacity of Cambridge under
the debenture trust deed particularly when, in 1973-74, liquid assets became the relevant benchmark (p249, 10.37).

The view expressed by the investigators was that only "advances or loans" to "clients or customers" should have been included in the calculation of liquid assets (p249, 10.38). Therefore, advances or loans to joint ventures in which Cambridge itself was a participant should have been excluded from the calculation of liquid assets. Investigators calculated that a relatively minor reduction in liquid assets, approximately $26 million, would have meant Cambridge was without further borrowing capacity when it issued Prospectus 31. When the same logic was applied to previous years, investigators contended that advances and loans to joint ventures in which Cambridge had an interest had been significant and increasing in amount since 1969 and that Cambridge had actually been without borrowing capacity since that time (p251, 10.39).

The investigators also questioned the propriety of issuing in September 1974 the press release announcing record profits at the time the Group was facing a liquidity crisis (p181, 9.3). According to evidence to the investigation, liquidity had always been a problem for Cambridge due to the nature of its activities (p16, 2.5; p181, 9.3). Between March and August 1974, these problems steadily increased to the point where it was estimated that even if new debenture borrowings of $5 million were received and all other loans renewed, the Group faced a deficit of $3.5 million by October 1974 (p181, 9.3). However, the expected inflow from debenture borrowings did not eventuate. The fall in expected debenture takings was exacerbated by an increase in redemptions. Cambridge's liquidity situation was also worsened by the refusal of banks and finance companies to roll over existing debts or provide further funding. This effectively meant Cambridge would be unable to meet its $2 million debenture interest commitment (p188-191, 9.14).
In justification of the profit announcement given the liquidity crisis, one director stated that negotiations aimed at raising funds from overseas were in process. If the profit figures were not announced as was traditional Cambridge practice, people would realise there was a problem and the whole thing would "blow up" (p191, 9.14).

A further reason for the profit announcement was that Mainline and Home Units had recently collapsed and there was a general nervousness in the investment market which meant investors preferred to maintain liquidity rather than invest (p192, 9.15).

There seemed to be an implication that the profit announcement was necessary to maintain the facade of a stable company and attract further debenture money and bring to fruition the loan negotiations with overseas parties. To fail to make the profit announcement would be to set in motion a self-fulfilling prophesy. Furthermore, it appears that at least some members of the Cambridge board were confident financial disaster would ultimately be avoided (p192, 9.15). In light of the second Cambridge report (NSW, 1979), it appears this confidence was ill-founded.

As noted earlier, the second Cambridge report extended the scope of the investigation to cover transactions from 1965 and, in particular, the prospectuses issued since 30 June, 1966 (p3). The investigation revealed that not only had Cambridge been without further borrowing capacity when Prospectus 31 was issued in 1974 but that it had exceeded its borrowing capacity in every year since 30 June, 1966 (p277, 6.5, 6.6). The extent of the excess debentures issued increased over the period being $4,436,987 for Prospectus 15 dated 21 September, 1966, peaking at $45,223,706 for Prospectus 28 issued on 20 November, 1972 and falling back to $38,075,645 for Prospectus 20 on 12 November, 1973 (p278, 6.6).

The deception of the borrowing public was achieved by the use of "faulty practices and principles" adopted specifically for that purpose (p20. 2.3). The "faulty practices and principles" identified by investigators in the second report stemmed mainly from the non-consolidation of the accounts of companies comprising the Hutcheson
Conglomerate. As investigators observed, the managing director and secretary of Cambridge considered that consolidation was only necessary if ownership of another company exceeded 50 per cent of its voting shares. The fact that the companies comprising the Conglomerate were controlled by and financially dependent upon Cambridge was ignored. Furthermore, Cambridge management used nominee rather than beneficial ownership of shares to avoid the 50 per cent ownership criterion set by them. As with the back-dating of joint ventures discussed previously, Cambridge also manipulated share ownership to suit its purposes. Hence, despite having complete control, if not direct ownership, of Conglomerate companies, no consolidated accounts for these companies was ever prepared (p22, 2.10). Investigators considered that the losses incurred by Conglomerate members and the financial links between them and Cambridge had placed Cambridge in a precarious situation since before 1966 (p21, 2.7). Without Cambridge's financial support through continued public borrowing, the Conglomerate would not have survived as long as it did (p21, 2.7).

In calculating the excess debenture issues for the years 1966 to 1973, investigators prepared consolidated statements for each year and made adjustments for losses, intangibles, bad debts, advances to conglomerate companies and overstatement of other assets including goodwill (pp46-54, 2.146-2.176). Investigators formed the view that the auditors either knew of the existence of the Conglomerate and that it was being used to disguise the nature and profitability of company members or at least had sufficient material to do so (p22, 2.10; p276, 5.62-5.64). For example, according to investigators, between March 1966 and September 1974, advances were made to Conglomerate members of at least $15,318,139 (p20, 2.5). These "advances" largely represented trading losses but this was not disclosed in Cambridge accounts. Instead, in the financial reports and prospectuses the advances were disclosed as ordinary receivables and at full value. Accounting for the advances in this way was with the knowledge and approval of the auditors (p5). Investigators also considered the Fell &
Starkey partner in charge of the Cambridge audit was aware of other methods used to manipulate Group results by engineering profits and concealing realised losses (p276, 5.62-5.64).

The overall assessment by investigators was that the auditors had been negligent in the performance of their statutory duties in the conduct of the audit of Cambridge and its affiliates. This negligence led to and possibly encouraged the issue by Cambridge of false and misleading statements which were without audit qualification (p276, 5.63). If the auditors had been competent, critical and independent in their work, investigators considered the formation of the Conglomerate and its subsequent demise would not have occurred (p282, 6.39). In particular, investigators concluded the partner in charge of the Cambridge audit had neither the technical nor perceptive skills to conduct such a large and complex audit (p263, 5.5; p275, 5.61). The auditor was not independent nor objective in that statements and assurances given by Cambridge management were accepted without independent verification (p263, 5.5).

Investigators considered that the financial dependence of Conglomerate members on Cambridge and Cambridge's own dependence for survival on debenture borrowings should have put the auditor on alert as to the interrelatedness of Conglomerate companies and the possibility that accounting techniques may have been used to produce desired profit levels so as to encourage continued public investment (p276, 5.62, 5.63). In spite of this, the accounts of Conglomerate members, other than recognised subsidiaries, were not considered during the audit of the Cambridge Group. This occurred even though Fell & Starkey were the auditors, tax agents and accountants not only for all members of the recognised Cambridge Group but for most of the Conglomerate companies (p263, 5.4).

Furthermore, the auditors were criticised for the lack of an audit programme or system of review of work delegated to others (p263, 5.5; 1977, p262, 11.11).
As stated earlier, there are definite similarities between the accounting methods implicated in both the Reid Murray and Cambridge collapses. Some of the Reid Murray accounting practices were defended in the 1966 ASA report on company failures (ASA, 1966). In particular, this report provided some authoritative support for the accrual basis of calculating profits on long term credit sales. The ASA report also cast doubt on some other activities which Cambridge engaged in up to eight years after the report was published.

Investigators into Reid Murray had suggested that the profits or cash emerging bases were more appropriate than the accrual basis given the Reid Murray sales were not only on credit but that Reid Murray itself provided the finance (Victoria, 1963, p58). This has some bearing on the treatment of profits on similar transactions by Cambridge. As outlined earlier, Cambridge used three methods of accounting for sales, accrual, cash emerging and profit emerging. The only method sanctioned by the General Council of the ASA in 1966 was the accrual basis. The other two methods were stated as being contrary to the basis of modern accounting practice (ASA, 1966, p12). If this is a valid argument, why were the emerging bases accepted by the auditors even if management claimed the methods were used because they were conservative (NSW, 1977, p161, 8.92)? The ASA report suggested that accounting methods should not be adopted purely because they are conservative (1966, p46).

As noted with regard to Reid Murray, the ASA also recognised that the use of different measurement methods has the potential to mislead those who use financial reports (p7). This point was also raised by Reid Murray investigators who stated that the failure to disclose accounting methods resulted in misleading financial reports (Victoria, 1963, p66). Cambridge did not disclose the manner in which profits were determined nor that the methods were changed to suit changing conditions. Given the
criticisms of Reid Murray and its auditors, it appears somewhat unusual that the Cambridge auditors did not act in this regard.

The ASA report also has a bearing on Cambridge's front end transactions and the failure to eliminate intra-group transactions. As indicated previously, Cambridge's profits were inflated by the recognition of profits from front end transactions between members of the Cambridge Group. The possibility of manipulation or window dressing of results of individual companies was recognised in the ASA report. This possibility was given as a reason for the elimination of the effect of intra-group transactions (1966, p19). In addition, the investigators noted in their report that in 1969 there was a directive from within Fell & Starkey that effective rather than legal control of another company should determine whether or not consolidated accounts were prepared. This approach appears to have been based on the view that using ownership as the sole consolidation criterion allowed companies to comply with the letter of the law but not the spirit in that in some cases, Cambridge being one, the resulting accounts did not show a true and fair view (NSW, 1979, p267-268, 5.21-5.23). This view was apparently conveyed to Cambridge management by the auditor but no further action was taken (p268, 5.23). The failure of the auditor to take action in this regard appears to have prompted investigators to conclude that the auditor's basic objective was to cater to the interests of Cambridge management (p276, 5.64).

Cambridge management's defence of issuing the press release announcing record profits at the time the company was facing a severe liquidity crisis would also not have been acceptable in terms of the ASA's 1966 report. As noted above, management claimed that if they had not issued the press release at the traditional time, the situation would have "blown up" (NSW, 1977, p192, 9.15). In other words, potential investors and creditors would have realised Cambridge was in financial distress and further funds would not have been forthcoming. The ASA stated that elimination of the practice of not disclosing "bad news" on the basis that it might
affect share prices or borrowing ability would go a long way towards the production of more informative accounts (1966, p42).

It appears clear that at least some of the accounting methods adopted by Cambridge were not consistent with generally accepted principles or practices. The investigators concluded that the manipulation of the accounts by the use of dubious accounting methods such as front end transactions and including intra-group transactions in consolidated accounts, the arbitrary use of accounting methods and the back-dating of joint venture agreements and nominee share holdings was at the instigation of the managing director and secretary/director of Cambridge (p282, 6.37-6.38). The fact that both were described in the report as "qualified accountants" would suggest such practices were totally contrary to their education and training as accountants.

The events leading to the collapse of Cambridge and its affiliates and the manner in which they were concealed make it clear that the financial reports were not aimed at facilitating an economic allocation of resources. In fact, investigators concluded many of the activities detailed in the second report in particular, were aimed at benefiting the Hutcheson family (p21, 2.8). Hutcheson was the managing director of Cambridge. Investigators concluded there was "little regard for truth in [the] documentation of transactions and maintenance of accounting records" (p282, 6.38) and that the structure and accounts of the Hutcheson Conglomerate were manipulated with the express purpose of "deceiving all who dealt with Cambridge" (p282, 6.37). Given the 1966 report of the ASA, there was little authoritative support for some of the accounting methods adopted by Cambridge and approved by the auditor. This disregard of views expressed and endorsed by what would be seen as leaders of the profession gives some credence to the argument that research is undertaken but the results are ignored (Lee, 1990, Introduction and Explanation, unpaginated).
Similar comments are relevant to the failure of the auditor to be independent and objective and to exercise due skill and care in the collection of evidence and to plan, document and supervise the audit of Cambridge. In their report, the investigators made reference to CS 1 *General standards in the Statement of Auditing Standards of the National Council of the Institute of Chartered Accountants in Australia* which outlines the duties of auditors which included the need for the auditor to have the technical and perceptive skills necessary to perform the audit, to be independent, to take reasonable professional care in gathering and evaluating the evidence required to conduct the audit, to plan, supervise and review the audit and adequately document these activities. While noting that this statement had not been promulgated at the time of the relevant Cambridge audits, investigators nonetheless considered it represented a fair summary of accepted audit practices and standards of the time (p276, 5.64). In the investigators' view, however, the auditor failed in these duties (NSW, 1977, p277 11.59-11.61). Similar criticisms were directed at the auditor of the failed merchant bank, Rothwells.

**Rothwells Ltd**

The collapse of Rothwells in 1988 and the subsequent investigation into its affairs is more an example of audit failure than the manipulation of accounting reports by the selective use of accounting methods and practices although this also did occur to a comparatively minor extent. Rothwells was placed in liquidation on 3 November, 1988 (Australia, undated, p10, 1.14). In March 1989, Malcolm McCusker, QC, was appointed Special Investigator into the affairs of Rothwells from the period commencing 1 January 1985 to 31 December 1988. This appointment followed private hearings conducted by the NCSC which indicated that offences may have been committed involving breaches of the Companies and Securities legislation, fraud and dishonesty (p1, 1.2). McCusker's terms of reference focused on all matters concerning the affairs of Rothwells and specified associated corporations including
dealings in money and other property by way of loan, purchase or otherwise. In particular, McCusker's investigation was to centre on matters related, directly or indirectly, to the failure of Rothwells (p3, 1.5). McCusker's report was issued in two parts. Part 1 deals extensively with the investigation into the causes of the Rothwells' collapse and is publicly available. On the recommendation of McCusker, Part 2, which deals with evidence given under privilege and recommendations as to further charges to be laid in the wake of the investigation, has not been published (p21, 1.29).

From the outset of the investigation, McCusker set out to determine what the "true" financial position of Rothwells was in 1985, 1986 and 1987 and the half year to 31 January, 1988. In particular, McCusker was concerned to know whether profits, as reported, had really been earned and whether adequate provision for doubtful debts had been made (p9, 1.11; p17, 1.23). As part of the investigation, the accounting firm of Deloitte Haskins & Sells (now Deloitte Ross Tohmatsu) was engaged to help determine the true position of Rothwells from 1984 to 1988. This was a difficult task made more difficult by the lack of adequate records (p9, 1.11).

According to McCusker, there was one outstanding aspect of the collapse of Rothwells which ranked in importance above all other matters under investigation and that was "... the falsity of the 1986 and 1987 published accounts ..." (p19, 1.25). Of particular concern to McCusker was the state of Rothwells' receivables which, as a bank, represented its major asset and which McCusker concluded was the "cause" of the failure (p26, 2.2). The problem presented by Rothwells' receivables was two fold. Firstly, there was an element of poor management. Rothwells was described as a lender at the high risk end of the market in that it lent funds to ventures that other banks would not consider. In spite of this, there was a lack of debtor control and supervision and records and files were inadequately maintained. Overdue debts were rolled-over with unpaid interest added to the amount of the loan but recognised as income in the profit and loss account (p26-27, 2.2). This state of affairs was
compounded by the borrowing of "huge sums" on an unsecured basis by the chairman of Rothwells, Laurie Connell, through two companies, L. R. Connell & Partners, being a partnership between Connell and his wife, and Oakhill Pty Ltd, of which Connell and his wife were directors. For the years 1985, 1986 and 1987, the level of debt to Rothwells incurred by Connell amounted to $35 million, $138 million and $324 million respectively. However, this indebtedness was not disclosed in the financial statements. It was systematically "removed" from the accounts at the balance date of each financial year and re-instated early in the subsequent financial year (p7, 1.10). A major method used to "remove" Connell-related debt was the purported assignment of debts to $2 shelf companies. These assignments were never fully completed and, in many cases, the purportedly assigned debts did not exist. Furthermore, Rothwells financed the purchase of the debts. The purpose of removing the debts was to obviate the need to disclose the large and increasing indebtedness of Connell to Rothwells (p35, 2.20). In summary, McCusker concluded

... the essential cause of the failure was an unsound asset base, resulting from mismanagement and misconduct with respect to its loans portfolio over several years, and apparently unbridled borrowing from Rothwells by Connell and his company Oakhill on an unsecured basis, leaving a "hole" in the Rothwells receivables of over $300m (pp27-28, 2.4).

The following sections will detail the manner in which the $300 million "hole" in Rothwells' receivables was made over a period of three years and how it was effectively concealed.

**Concealment of Connell-related debts at 31 July 1985**

The investigation into Rothwells revealed a close monetary relationship between it and L. R. Connell & Partners (hereafter referred to as LRCP) for the six months to 31 July 1985 with money passing from one to the other. However, the aggregate direction of the flow was to LRCP which received approximately $160 million from
Rothwells during this time (p44, 3.1). Rothwells' books showed a debt by LRCP of $60,366,153 as at 30 July 1985. The next day, the closing balance was nil (p45, 3.5). This was achieved by a series of adjusting entries variously described as routine journals (net), cashbook transactions (net), transfers between accounts (net) and corrections, which reduced the debt to $35,087,677 (Annexure to Chapter 3, Rothwells Inquiry - Balance Date Adjustments - 31 July 1985, p1). This amount was eliminated by a journal entry dated 31 July 1985 which purportedly represented the purchase by Rothwells of loans and advances from LRCP (Australia, undated, pp45-46, 3.5). As subsequent investigation demonstrated, the transaction was a sham (p49, 3.10).

The only documentation to support the alleged transfer of debts was an unstamped Deed of Assignment. The Deed was dated 31 July 1985 but showed Connell's company, Oakhill Pty Ltd, as assignor of the debts rather than LRCP as recorded in the notation to the journal entry eliminating LRCP's indebtedness to Rothwells (p46, 3.6). Such an assignment could not have occurred as the balance sheet as at 30 June 1985 disclosed total assets of $14.6 million including debtors of less than $1 million. An examination of LRCP's accounts showed that a number of the debtors appearing in the Deed of Assignment were, in fact, debtors of LRCP but the total indebtedness as at 31 July 1985 was approximately $8.4 million. However, those particular debts were not included in the Deed of Assignment (p47, 3.7). The debtors named in the Deed of Assignment did not receive any notice of assignment (p47-48, 3.8). Finally, on 1 August 1985, the first day of the Rothwells 1986 financial year, a journal entry reversed the transaction except that Cudull Pty Ltd now appeared as a debtor to Rothwells instead of LRCP (p48, 3.9). As McCusker noted, this method of removing Connell-related debts from Rothwells' accounts "... by a spurious "sale" of assets to Rothwells, reversed after balance date ..." was not an isolated incident. Similar "transactions" occurred in 1984 and were repeated in 1986 and 1987 (pp49-50, 3.10).
Concealment of Connell-related debts at 31 July 1986

During the 1985-1986 financial year, Connell and his company, Oakhill, continued to borrow substantial sums. In McCusker's terms, it was as though Rothwells was Connell's private bank (p79, 4.1). By 30 June 1986, the extent of indebtedness of LRCP and Oakhill to Rothwells was $145,760,356 (p79, 4.3). The following month, Rothwells was repaid almost $80 million (net). However, various "correcting" entries, similar to those used in the 1985 accounts (Annexures to Chapter 4, Balance Date Adjustments to the accounts of LRCP, pp1-7, Balance Date Adjustments to the accounts of Oakhill Pty Ltd, pp1-5) brought the balance of the recorded indebtedness of LRCP and Oakhill to $138,490,422 at 31 July 1986 (Australia, undated, p80, 4.3). This amount included an unreconciled imbalance of $26,121,839 between the Depositors Control Account and the Depositors Ledger and a further unspecified error in the accounting records of $4,982,422 (pp79-80, 4.2-4.3).

The "removal" of the Connell-related debt from the accounts was achieved by transferring it to an account titled "Loans and Advances - Others" which was then included in the 1986 balance sheet of the bank (p80, 4.3, p83, 4.7). Support for this account was a "list of debtors" which subsequent investigation showed to be fictitious. Most of the "debtors" included on the list denied owing any debt to Rothwells. Others did owe debts to Rothwells but not to the extent indicated on the list. An examination by Deloitte's showed that the list of so-called debtors was overstated by $130,814,069 (Annexure to Chapter 4, Rothwells Limited - $138 million List at 31 July 1986). Furthermore, the debts actually owed to Rothwells, amounting to $54,441,145, were effectively included in the balance sheet twice because they were reflected in both the Loans and Advances - Others account and the Commercial Bills and Advances account (Australia, undated, p83, 4.8, 4.9). In other instances, the debts included in the list were debtors to LRCP but these debts had not been assigned to Rothwells (p84, 4.10). Further evidence that the $138 million list was a sham was
the fact that the balance of the Loans and Advances - Other account remained unchanged throughout the following financial year. No repayments of principal were made and no charges nor payments of interest were recorded (p84, 4.11). On the following balance day, 31 July 1987, interest of $75,885 was added to the account. This represented one day's interest which was recognised as revenue in the 1986-1987 financial statements. The balance of the Loans and Advances - Other account was then transferred to the account of LRCP and back dated to 1 August 1986.

**Concealment of Connell-related debts at 31 July 1987**

The pattern of removing Connell-related debt which had been established in the 1984, 1985 and 1986 accounts was repeated in 1987. The total Connell-related debt removed from the accounts at 31 July 1987 was $324 million. The size of the Connell-related debt appears to have made the method of removal more complex than in previous years. In fact a number of methods involving transactions with other parties was used. The methods employed included the transfer of deposits, the assignment of debts and the transfer of other forms of property including listed and unlisted shares (Annexure to Chapter 5, L. R. Connell and Partners Loan Account Rothwells Limited). These transactions were invariably financed by Rothwells with the amount of these loans being used to reduce the Connell-related debt. Due to the complex nature of these transactions and the number of parties involved, only a summary account of them will be provided.

From the report, approximately $59 million of Connell-related debt was extinguished from Rothwells' accounts by the purported sale of debts by LRCP to four companies. Three of the 'purchasers' were $2 shelf companies with no capacity to repay the loans to Rothwells used to finance the purchases. The directors of the fourth company were purportedly unaware of a loan of $15,808,700, including interest, and the assignment of debts of $15,172,692 from LRCP until a confirmation letter was
received from the auditors in August 1987 (Australia, undated, p151, 5.34). Following discussion with executives of Rothwells, the directors belatedly agreed to the assignment (p152, 5.34). In all four cases, there was no effective assignment of debts and none of the loans to finance the purchases was ever repaid (p146, 5.29; p158, 5.40; p163, 5.45; p164, 5.49).

Another $2 company was used to reduce the Connell-related debt by $12 million but in this case, no purported sale of assets was involved. Again, the directors of the company concerned claimed they were unaware of any transaction taking place between the $2 company and Rothwells. The directors, who were effectively nominees of a Rothwells' executive, signed 28 Rothwells' commercial bills with a face value of $12,397,435. The debt to Rothwells thereby incurred, was substituted for the debt of LRCP (pp173-174, 5.59).

The Connell-related debt was further reduced by the substitution of loans amounting to almost $61 million to two companies for the purchase of listed shares. Of the total loans, $2 million was genuine but the transaction had not been agreed to, much less completed, at balance date (p175, 5.62). The $59 million balance represented a purported sale of shares by Connell, Oakhill and related entities (p167, 5.51). The validity of this transaction was doubtful for a number of reasons. Firstly, the commercial bills securing the loan from Rothwells were signed on 2 August 1987 and backdated to 31 July 1987. Secondly, at the time of the signing of the bills, there was no documentation concerning the purchase of the shares or, indeed, any share scrip evidencing the existence of the shares purchased (p168, 5.53). It was subsequently discovered, that the shares either did not exist or that the price had fallen (p170, 5.54). In some cases the shares included in the transaction had been sold up to three times previously (p172, 5.57). Subsequent investigation by the purchaser showed that shares representing some $31 million of the purchased portfolio were not recoverable. Thirdly, the transaction was undertaken hurriedly (p171, 5.56).
A further purported sale of unlisted shares reduced the Connell-related debt by $21.45 million. However, the transaction was not completed at balance date and was subsequently reversed (pp177-178, 5.66). A similar scenario applies to a purported loan of $57 million to another company for the purpose of purchasing property. Connell-related debt was reduced by the amount of the loan despite the fact that no sale of property took place and the directors of the company in question were unaware of either the purported loan or property sale (p177, 5.65).

Another transaction examined by McCusker related to a "round-robin" whereby a Rothwells' executive approached another company asking it to lend $50 million to Oakhill. Rothwells then directly repaid the company $30 million and indirectly, through yet another company, repaid the remaining $20 million. The "debts" of the two companies involved were substituted for $50 million of Connell-related debt (p176, 5.63).

_Dubious Accounting Practices 1985 to 1987_

In addition to the removal of Connell-related debt at balance date in each of the years 1985, 1986 and 1987, the investigation uncovered other examples of dubious accounting practices which contributed to the falsification of the financial statements for those years. Four major examples were the inadequacy of the provision for doubtful debts, the recognition of fee and interest income and the imbalance of $26 million in the 1986 accounts referred to previously as being included in Connell-related debt for that year.

As noted previously, Rothwells was a lender at the high risk end of the market. Its total receivables at 31 July 1985 stood at $162,884,985. Most of these debts were unsecured. Other banks, such as the National Australia Bank and Westpac, which had
more conservative lending practices, provided for doubtful debts at approximately 1.5 per cent and 1.4 per cent respectively (p74, 3.31). It is unusual, therefore, that for the year ended 31 July 1985, no provision for doubtful debts was made and no debts were written off for this period (p62, 3.18). Subsequent investigation revealed that many of the debts were "non-performing" in that principal was not repaid on the due date while interest was accumulated and brought to account as income even though it was not paid (p65, 3.24). The Deloitte's team appointed by McCusker to assist with the investigation concluded, after examining the receivables at 31 July 1985, that a minimum provision for doubtful debts at that time would have been $17 million (p64, 3.22). The pre-tax profit of Rothwells for the year was reportedly $7.25 million. Obviously, if such a provision had been made, Rothwells would have reported a loss rather than a profit for the year (p64, 3.23).

The investigation revealed that Rothwells' profit for the year had been further overstated by $4 million. This amount represented a settlement fee. However, the fee was due to LRCP not Rothwells. Given the circumstances of the transaction, McCusker suggested the inclusion of the $4 million fee in the accounts of Rothwells was a deliberate attempt to overstate profits for the year (p76, 3.32).

At 31 July 1986, Rothwells' reported a pre-tax profit of $13,780,728. The Annual Report boasted of a 150 per cent increase in profits and growth in shareholders funds and total assets since 1982. According to McCusker, these claims were incorrect and misleading (p82, 4.6). In reality, the position of Rothwells had deteriorated since Connell had assumed control in 1982 and had continued to do so during 1986. In fact, based on a reconstruction of the accounts, McCusker considered that by 31 July 1986, the entire consolidated capital and reserves of Rothwells of $54 million had been wiped out (p90, 4.20). This interpretation of the accounts was based on recognition of the irrecoverable status of the Connell-related debt and the inclusion in the accounts as expenses of the $26 million "imbalance" and $4 million "sundry minor
amounts" which were effectively capitalised by inclusion in the receivables accounts (p90, 4.20). The position of Rothwells was worse still because the accounts also should have reflected an appropriate provision for doubtful debts and interest income was invalidly recognised in the accounts (p91, 4.21, 4.22). The accounts were further distorted by the inclusion of fee income of $5 million which had not been earned at year end and which was never paid (p182, 5.73).

By 31 July 1986, Connell-related debt, which was unsecured, represented one third of Rothwells' receivables portfolio. An examination of the books of LRCP and Oakhill showed a deficiency of shareholders funds of $70,101,653 and $31,437,385 respectively. The implication which flows from this is that neither LRCP nor Oakhill could have repaid the $138 million debt to Rothwells and, accordingly, it should have been written off or, at the very least, a specific provision for doubtful debts for the amount should have been raised (p89, 4.19).

As noted previously, the $138 million Connell-related debt included an unreconciled imbalance of $26,121,839. On further analysis, it was found that this imbalance between the Depositors Control Account and the Depositors Ledger should have been taken into the accounts as an interest expense (p80, 4.4). During both 1985 and 1986, Rothwells' interest expense had been understated by $12,432,243 and $13,689,596 respectively. The $26 million imbalance in the 1986 accounts was the cumulative effect of this (p82, 4.5). The effective capitalisation of this amount by including it in receivables meant that Rothwells' reported profits for both 1985 and 1986 were overstated (p82, 4.6).

This overstatement was compounded by a failure to adequately provide for doubtful debts. As in 1985, no debts were written off as bad and no provision for doubtful debts was made in 1986. The only provision raised during 1986 was a "provision for contingencies" of $1 million. Given the non-performance of many of the debtors and
the lack of security for them, Deloittes advised the investigation that in addition to the provision for contingencies, a provision for doubtful debts of at least $16 million should have been raised (p91, 4.21). The calculation of this provision did not take into account the Connell-related debt.

While Rothwells did not bring interest expense to account or adequately provide for bad and doubtful debts, it readily recognised interest payable in its financial reports. From the Deloittes examination of the accounts it was ascertained that interest was accrued on almost all receivables accounts including those that were non-performing and apparently irrecoverable (pp91-92, 4.22). In many instances, interest was rolled-over and capitalised as part of the principal balances. Deloittes further pointed out that this was not standard practice according to generally accepted accounting principles or banking practice. Under generally accepted accounting principles, revenue should only be recognised when reasonable certainty exists that it will be received. Given that Rothwells was a bank, normal banking practice would appear to be the appropriate bench mark for determining reasonable certainty of the receipt of interest revenue. According to Deloittes, ninety days from the due payment date is the appropriate reasonable certainty time frame. After that, unpaid interest revenue should be recognised only if an acceptable explanation for non-payment has been received from the debtor. In Rothwells' case, the poor state of the records made it impossible to determine whether acceptable explanations had been received or even sought (p92, 4.22).

Finally, fee income of $5 million was incorrectly included in the calculation of profits. This fee was supposedly for corporate advice provided by Rothwells concerning a sale of assets between two other companies. The recognition of this revenue was suspect in various ways. To begin, the sale had not been completed at 31 July 1986. Furthermore, directors of the purported debtor company refused to confirm the fee was payable and the fee was never paid (p182, 5.73). Deloittes classified the
recognition as income of this fee as "unacceptably "aggressive" accounting" on the grounds that there was no justification for its inclusion in income. It was success-based and at balance date, no enforceable contract existed either for payment of the fee or the sale that gave rise to it (Annexure to Chapter 5, Summary of Adjustments to Reported Financial Statements - Annual Effect, p6).

From the foregoing, it is clear that the 1986 financial statements were distorted by the recognition of revenue which did not pass the reasonable certainty test and an understatement of expenses such as the write off of bad debts, adequate provision for doubtful debts and interest expenses. According to McCusker, the profits were inflated which meant that dividends were paid out of capital and that Rothwells paid income tax on non-existent profits (Australia, undated, p92, 4.23).

The distortion of Rothwells' accounts continued into 1987. In addition to the habitual removal of Connell-related debt from the accounts, a further pattern had emerged whereby debts, including interest, were rolled over even though no payments were received, unpaid interest on debts owing to Rothwells was recognised as income and an adequate provision for doubtful debts was not raised (p134, 5.12; p137-138, 5.18).

Rothwells' reported consolidated operating profit before tax for the year ended 31 July 1987 was in excess of $28 million. This included a provision for doubtful debts and contingencies of $4 million (p133, 5.12). During the course of the investigation, it was found that Connell had engaged Price Waterhouse to undertake an independent review of Rothwells' receivables (p129, 5.3). Evidence given to the investigation by a member of the review team was to the effect that the $4 million provision for doubtful debts was grossly inadequate. In fact, a member of the review team stated that had they been free to raise a provision for doubtful debts or write off bad debts, the amount would have been in excess of the existing equity of Rothwells (p134, 5.13). This view was supported by the Deloitte's team. On their calculations, an
additional provision for doubtful debts of $64,674,873 should have been included in the accounts (Annexure to Chapter 5, Summary of Provisions Required Against "Other Debtors" as at 31 July - 1986 and 1987, p2). Shareholders' Funds as reported in the accounts was $65,634,000 (Annexure to Chapter 5, Summary of Adjustments to Reported Financial Statements - Annual Effect, p1).

As noted with regard to the 1986 financial statements, a fee for corporate advice was taken into account even though the directors of the debtor company refused to acknowledge the fee was payable. At 31 July 1987, this fee was still outstanding. Nonetheless, no provision for doubtful debts was raised with regard to the debt. Furthermore, a similar fee for corporate advice was charged to a subsidiary of the original company in the 1987 accounts. Once again, the fee was not paid and directors refused to acknowledge that it was payable (Australia, undated, pp182-183, 5.73). According to Deloittes, an examination of the company's financial statements indicates it was not able to pay the fee (Annexure to Chapter 5, Summary of Adjustments to Reported Financial Statements - Annual Effect, p6). A further fee of $5.5 million was accounted for in the 1987 financial statements. This fee was also of dubious validity. It was described by McCusker as a "front-end" fee in connection with a June 1987 loan of $11 million. However, as McCusker pointed out, the fee would only be paid if the advance totalling $16.5 million was repaid. Given that the borrower was desperate enough to pay a $5.5 million fee for an $11 million loan over six months, recovery of the fee was doubtful and should not have been recognised as income (Australia, undated, p183, 5.74).

In a bid to establish the "true" financial position of Rothwells for the years under review, McCusker directed Deloittes to prepare a number of analyses including balance day adjustments, summary of provisions required for "other debtors" and adjustments to financial statements including the write back of fee income where necessary and provisions for doubtful debts in regard to both Connell-related debts
and other debtors (p184, 5.75). The calculations were simplified by making adjustments on an individual year basis. However, the analyses clearly show an overstatement of profits and, thereby, an overstatement of shareholders' funds from 1984 onwards:

<table>
<thead>
<tr>
<th>Year</th>
<th>Reported Shareholders' Funds ($'000)</th>
<th>Less Reported Pre-Tax Profits</th>
<th>Add back Tax Charges</th>
<th>Adjusted Profits/(Losses)</th>
<th>Adjusted Shareholders' Funds/(Deficit) ($'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>6,040</td>
<td>NA</td>
<td>NA</td>
<td>$6,040</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>7,770</td>
<td>(3,061)</td>
<td>851</td>
<td>(4,575)</td>
<td>$985</td>
</tr>
<tr>
<td>1985</td>
<td>21,257</td>
<td>(7,249)</td>
<td>2,810</td>
<td>(9,884)</td>
<td>$6,934</td>
</tr>
<tr>
<td>1986</td>
<td>54,259</td>
<td>(18,582)</td>
<td>7,491</td>
<td>(81,111)</td>
<td>(37,943)</td>
</tr>
<tr>
<td>1987</td>
<td>65,634</td>
<td>(28,690)</td>
<td>12,684</td>
<td>(107,979)</td>
<td>($58,351)</td>
</tr>
</tbody>
</table>

(Annexure to Chapter 5, Summary of Adjustments to Reported Financial Statements - Annual Reports, p6)

McCusker further pointed out that adjustments for provisions for doubtful debts were conservative and did not include any "general provision". If "general provisions" had been made in addition to specific provisions, profits and shareholders' funds would have been further reduced (Australia, undated, p185, 5.75). In each of the relevant years, Rothwells' audit report was unqualified. This raises questions as to the quality of the audit in those years particularly when the audit was conducted by KMG Hungerfords, one of the then "big six" chartered accounting firms, which, on evidence given to the investigation, lulled investors into a false sense of security (pp28-30, 2.7-2.8).

**Rothwells Audit 1985, 1986 & 1987**

As an overall impression, McCusker branded the manner in which the audits were conducted for the above years as "perfunctory and tolerant" and implied that this was the rationale behind the selection of an audit team from KMG Hungerford's Brisbane
office. At Connell's insistence, members of Hungerfords Perth office were precluded from participating in the audit in any way on the basis that they were too entrepreneurial. As McCusker noted, members of the Perth office would have had local knowledge which may have provided them with a better understanding of Rothwells' debtors and lending policies than members of the Brisbane team (p54, 3.14).

The auditors of Rothwells were extensively criticised throughout the investigator's report not only for the "perfunctory and tolerant" manner in which the audits were conducted but also failing to approach the audit task with an enquiring mind (p58, 3.16). These criticisms were based essentially on the perceived failure of the audit team to give large and unusual balance day adjustments, that is, transactions removing Connell-related debts from the accounts, the close scrutiny required particularly when the relevant transactions involved the chief executive of Rothwells (p59, 3.17; p118, 4.44; p122, 4.46; 5.71). In particular, the auditor in charge was accused of engaging

. . . in a course of deliberate blindness, to avoid being told what in fact was the truth and which would have been readily discoverable from reasonable enquiry . . . (p125, 4.49).

Evidence to support this allegation included the fact that Connell-related debts had been removed from the 1984 accounts when KMG Hungerfords not only audited the accounts but also " . . . played a major part in their preparation" (p78, 3.35). In addition, a member of the 1985 audit team admitted to being aware of the interlocking nature of activities between Rothwells and LRCP including the extensive borrowings of Connell and that evidence of this indebtedness was being removed from the accounts, "by design", at balance date (pp59-61, 3.17). The accountant in charge of the audits for the years 1985, 1986 and 1987 also admitted knowing that the purpose of the balance day adjustments at 31 July 1987 was to remove Connell-related debt from the balance sheet (p181, 5.71). This perhaps explains why normal audit
procedures, such as circularisation of debtors, was either not conducted or conducted in a questionable manner.

In 1985, a list of purportedly assigned debts was provided to the auditors. Thirteen of these were selected for the forwarding of audit confirmation letters. However, no letters were actually sent (p54, 3.14). The auditor claimed that reliance was placed instead on discussions with company officers who were familiar with the accounts. These "discussions" were not documented in the audit working papers (p55, 3.15).

This scenario was repeated in the 1986 audit when Connell-related debt was in excess of $138 million. On the admission of the auditor, no supporting evidence of debtors, in terms of ledger cards or computer print-outs, was examined during the course of the audit (p118, 4.44). Of the $138 million "assigned" debts, thirteen were selected for audit confirmation letters. In this instance, the letters were sent. However, confirmation letters sent to debtors appearing on the $138 million list were different to those issued to debtors drawn from the investment ledger.

Confirmation letters sent to investment ledger debtors were quite detailed referring to the term, rate and amount advanced under the facility. In contrast, letters sent to debtors on the assignment list asked for confirmation only of the existence of the facility. No details as to term, rate or amount owing were included (pp119-120, 4.44). This suggests that the sending of confirmation letters to those on the $138 million list were part of a deliberate ploy to conceal the falsity of the assignment but at the same time, appear to follow standard audit procedures (p122, 4.46).

The auditor was also questioned regarding the movements in the Connell and Oakhill loan accounts which gave rise to the $138 million balance in the Loans and Advances - Other account. One month before balance date, this account had a nil balance so the whole of the movement in the account to $138 million occurred in the space of one
month. The auditor claimed that this rapid increase had not been noticed at the time of audit. A list of debtors was asked for but was unsupported by further documentation. On further questioning, the auditor stated that the rapid increase in the account and the lack of supporting documentation would not have indicated a need for further audit enquiry because the amount could have resulted from a series of computer entries correcting errors which had occurred throughout the financial year. This would have given the impression of a lot of activity around balance date (pp112-118, 4.43). However, no audit investigation was undertaken to support this conclusion. This led McCusker to question the independence of the auditor "... it shows ... a notable willingness, on the part of a supposedly independent auditor, to allow to pass without checking or verification a large and unusual transaction occurring at balance date" (p118, 4.44).

In 1987, when Connell-related debt had reached some $324 million, no attempt was made by the auditor to confirm the debts assigned to various companies, including four $2 shelf companies or the loans of almost $100 million to Beltech (p181, 5.71).

In McCusker's view, the auditors' lack of independence and compliance with the wishes of Rothwells' management were essential to the concealment of Connell's indebtedness to the bank. This concealment was a breach of the Companies Code (pp77-78, 3.34-3.35). For example, the Companies Regulations at that time required disclosure of outstanding loans by a company to a director, spouse of a director or to another company in which a beneficial interest of not less than 10 per cent was held by the director (p45. 3.3). The purpose of the balance day adjustments to remove Connell-related debt from the accounts was to obviate the necessity of compliance with this provision. However, as McCusker pointed out, the transactions were a sham and, therefore, Connell and his companies remained debtors of Rothwells. Non-disclosure of this indebtedness was, thereby, a breach of the Companies Code (pp87-89, 4.17-4.19).
Furthermore, the failure to disclose Connell's indebtedness was also a breach of the Stock Exchange listing rules. Even if the balance day adjustments had represented legitimate transactions, the need to disclose Connell's borrowings throughout the year was mandated by the Stock Exchange requirements. The Stock Exchange listing rules required disclosure of all director-related loans taking place throughout the financial year including the name of the borrower, the terms and amount of the loan and interest to be paid and security for the loan (p45, 3.4). Hence, the balance day adjustments did not avoid the disclosure obligations imposed by the Stock Exchange. Furthermore, the Stock Exchange Rules required the disclosure of any material director-related contracts and the shareholders' approval for dealings in the securities of the company. The assignment of debts represented both material director-related contracts and dealings in company securities. The assignment of debts was not disclosed in the accounts as a material director-related contract nor was shareholder approval obtained (pp51-53, 3.12).

As McCusker noted, shareholders, potential investors and depositors and brokers and investment advisers were effectively deceived by the accounts as no indication of Connell's excessive borrowings was disclosed (p53, 3.13). Connell debts had been systematically replaced by, inter alia, the invalid assignment of substantially fictitious debts. In all cases, the substitution of Connell-related debt with other "assets" was financed by Rothwells. Given that a substantial proportion of the debts were "assigned" to $2 shelf companies with no assets, questions must be raised about the ability of assignees to repay their debt to Rothwells (p163, 5.46). This gave rise to additional criticism of the auditors and contributed to further breaches of the Companies Code.

As the details of Rothwells' accounts given above suggest, adequate provisions for doubtful debts were not made in the years 1985, 1986 and 1987. As McCusker notes,
an explanation for the lack of or inadequacy of a provision for doubtful debts was not to be found in the quality of the receivables portfolio. Many of the debts were non-performing and were unsecured (p65, 3.24). The debtors' files and records were variously described in the report as "inadequate" (p63, 3.20), "scant and unsatisfactory" (p71, 3.28), "in a state of considerable confusion" (p106, 4.39) "incomplete" and "downright vague" (p276, 11.3) and "an absolute shambles" and "a great portfolio of nonsense" (p278, 11.4).

According to Deloittes, the poor state of the debtors' files was such that it would have been impossible for an auditor to form an opinion as to the adequacy of a provision for doubtful debts had one been made in the 1985 audited accounts (p64, 3.21). From evidence given regarding subsequent years, it appears this also applies to the 1986 and 1987 years. In response to questions concerning the audit of the receivables portfolio in 1985, 1986 and 1987, the auditor in charge admitted placing greater reliance on discussions with a director and officer of Rothwells rather than on the files (pp70-71, 3.28; p105, 4.38; p181, 5.71). The persons upon whom the auditor relied were the director in charge of the receivables portfolio while the officer's own company was a substantial borrower of Rothwells (p107, 4.39). These particular persons also were responsible for the balance day adjustments removing Connell-related debt and preparation of the various "assignment" lists (p36, 2.21). Such reliance was not indicative of the level of auditor independence that shareholders and the public should have been entitled to expect (p107, 4.39).

This position was exacerbated by the auditor's claim that he derived "a level of comfort" (p68, 3.26) from an assertion that Rothwells would not suffer any loss due to doubtful debts because Connell "stood behind the debts of Rothwells" (p65, 3.24). Therefore, a provision for doubtful debts was not necessary in spite of the fact that many debts were non-performing and/or were unsecured (p65, 3.24). The auditor further admitted that no clarification was sought of what Connell's standing behind the
debts of Rothwells actually meant (p68, 3.26), the legal enforceability of the undertaking nor, indeed, Connell's financial ability to take up the debts should the necessity arise (pp72-73, 3.30). The folly of these omissions was clearly evident to the investigation. First, Connell denied making such an undertaking (p68, 3.26) which clearly suggests there was no written agreement. Second, Connell's "wealth" upon which the auditor relied in accepting the undertaking to stand behind the debts of Rothwells, had itself been financed by Rothwells (p73, 3.30). Finally, and perhaps most importantly, Connell's companies, LRCP and Oakhill, had, by 31 July 1986, deficiencies of shareholders' funds of $70,101,653 and $31,437,385 respectively. It is doubtful, therefore, that Connell, or his companies, would be able to repay their own debts (p89, 4.19) much less those of other outstanding debtors.

The further breaches of the Companies Code alluded to above were committed by both the directors of Rothwells and the auditor. Section 269(7) of the then Companies Code required directors to ensure the making of an adequate provision for doubtful debts. Evidence produced during the course of the investigation and detailed above, makes it clear that an adequate provision for doubtful debts was not made. This, in turn, would suggest the accounts did not show a true and fair view as was then required by section 269 (8B) of the Code. Section 285 (4)(b) required auditors to form an opinion as to the truth and fairness of the accounts. Given the inadequacy of the receivables accounts and supporting documentation, McCusker questioned how the auditors were able to form such an opinion (pp63-64, 3.20).

McCusker criticised both the lack of audit independence and the audit as

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\text{... a total failure to take any steps, independently of the executive directors, to determine the true state of the receivables, and an awareness that for several years the accounts and records relating to receivables had been and still were quite unsatisfactory (pp108-109, 4.40).}
\]
The auditors were also criticised with regard to the recognition in the accounts of fee income which was either not payable to Rothwells or had not yet been earned. As outlined previously, Rothwells' pre-tax profit at 31 July 1985 included $4 million fee income. This amount was actually due and payable to LRCP. McCusker argued that, given the auditors' knowledge of the intertwining nature of Rothwells and LRCP, the possibility of error in the accounts should have been recognised. Also, the $4 million fee represented a significant proportion of total fee income. This also should have alerted the audit team to the need for examination of the amount. However, the auditors failed to undertake any examination to determine the validity of the inclusion of the fee in the accounts of Rothwells (pp74-76, 3.32).

Similarly, fee income was included in the 1986 and 1987 accounts. As discussed previously, in 1986, a $5 million fee for corporate advice was raised at 31 July 1986 and included in income for the year. The 1986 fee had not been paid at 31 July 1987 and directors of the company concerned denied liability for the fee. While these facts were known to the auditors, the debt was not written-off and no provision against the account was raised. Furthermore, yet another $5 million fee for the same reason was charged to a related company in the 1987 accounts. Directors once again denied the fee was payable. The auditor in charge was also aware of this at the time of the 1987 audit but failed to seek independent verification of the validity of the fee (pp182-183, 5.73). A further amount of $5.5 million was included as fee income in 1987. Payment of the fee was contingent upon repayment within six months of a loan of $11 million. The auditor did not question managements' contentions that the fee had been earned in spite of the questionable recoverability of the loan (p183, 5.74).

The implication of the foregoing is that there was not an efficient allocation of resources. This was due in the first instance to the over-statement of Rothwells' profits from 1984 onwards and, in the second instance, by the failure of the auditor to qualify the accounts. As McCusker pointed out, had confirmation letters been sent in
1985 to the debtors on the $35 million assignment list, that transaction would have been revealed as a sham. The auditors would then have been forced to qualify their report and report the matter to Corporate Affairs (p56, 3.15). McCusker further argued that if this course of events had occurred, it is unlikely that Rothwells would have continued to receive increasing deposits from the public which were then used by Connell for the acquisition of personal assets (p77, 3.34). In other words, Connell would not have been able to continue to use Rothwells as his own private bank (p79, 4.1).

**Rothwells October 1987 to November 1988**

The deception of investors and the resultant inefficient allocation of resources accelerated in the wake of the share market crash of October 1987. According to evidence provided to McCusker

> ... the only thing keeping Rothwells going was that more people wanted to put money into it than wanted to take it out ... if that ever changed [Rothwells] would have a problem (p131, 5.7).

The share market crash precipitated the change which ultimately saw Rothwells placed in liquidation in November 1988.

As discussed earlier in this chapter, a collapse of investor confidence can have adverse effects on perfectly sound financial institutions. While Rothwells appeared to be quite sound in October 1987, many investors apparently believed the bank to be vulnerable having lent substantially to finance investment in the share market. This collapse of investor confidence precipitated a "run" on Rothwells (p28, 2.5). A very public rescue operation was launched to raise some $300 million to ease Rothwells through the resulting liquidity crisis and avert a further erosion of investor confidence which may impact adversely on other financial institutions (p242, 10.11).
The package involved the issue to "prominent business people" of $150 million in share capital and a $150 million overdraft facility from the National Australia Bank. The West Australian Government was persuaded to provide an indemnity against Rothwells' possible default on the repayment of the overdraft (p28-29, 2.6). According to evidence taken during the course of the investigation, the West Australian Government's involvement in the rescue was motivated, in part, by a view that if Rothwells failed, the Government would be required to fund the operations of some local Government Authorities and other organisations which had substantial deposits with Rothwells. It was further considered that if the Government and prominent business people were prepared to assist Rothwells, this would restore investor confidence and put an end to the run (p30, 2.9; pp232-233, 10.2).

The speed with which the rescue was executed precluded an in depth review of Rothwells' financial position. However, this situation was alleviated by the issue one month earlier of the 1987 accounts which depicted Rothwells as a profitable and well managed organisation. Furthermore, the accounts were not qualified and had been audited by one of the "big six" accounting firms (pp29-30, 2.7-2.8; p234, 10.4; p238, 10.7; p239, 10.8). Evidence to McCusker suggests that the rescuers relied on the 1987 accounts in making the decision to participate in the rescue package (p234, 10.4; p238, 10.7; p239, 10.8) and would not have participated had they known the true position (p235, 10.5). Obviously, if the "true" position, in particular, Connell's extensive borrowings and the non-performance and lack of security of the loans portfolio, had been disclosed, the "rescue" would not have been undertaken. Rothwells would have been put into liquidation a year earlier and the overall loss would have been less (p240, 10.9). Furthermore, the "rescue" of Rothwells allowed Connell to increase his indebtedness to around $500 million by June 1988 (p42, 2.29).

As noted previously, in both Reid Murray and Cambridge Credit, the directors held steadfastly to the view that the respective companies would survive what were seen as
temporary liquidity problems. McCusker expressed doubt that, of the Rothwells' directors, Connell at the very least, would not have been unaware of Rothwells precarious financial position at the time of the rescue (p240, 10.9). The bases of McCusker's contention included a Price Waterhouse review of Rothwells' receivables and evidence from former senior employees of Rothwells.

The Price Waterhouse review of receivables was instigated by Connell in February 1987 (p129, 5.3). The result of this review was that Rothwells was apparently insolvent (p132, 5.7) having external liabilities in excess of assets (p133, 5.11). Rothwells' largest asset was its receivables portfolio and most of the debts were bad or doubtful (p132, 5.7) to the extent that a write-off or adequate provision would effectively wipe out Rothwells' share capital and reserves (p132, 5.9). The significance of the conclusion is magnified when it is considered that the review did not include Connell-related debts (p132, 5.8; p133, 5.9). Connell was apparently the sole recipient of the results of the review (p131, 5.6, 5.7; p134, 5.13; p135, 5.14). The Price Waterhouse team had signed a confidentiality agreement that the results of the review would be made available only to Connell (p134, 5.13).

Connell was also well aware of the poor state of Rothwells' debtors' records and files and its liquidity problems. In 1986, a senior Rothwells' staff member was directed to review Rothwell's records and balance the debtors' ledger (pp93-94, 4.25). The results of this review were reported to Connell and made it clear the accounts were "in a mess" (p94, 4.26) due to breakdowns in the accounting system and poor corporate supervision (pp94-95, 4.27) which resulted in a failure to collect interest and principal repayments (p94, 4.27). In turn, these deficiencies led to a lack of cash flow and, consequently, liquidity problems (p94, 4.27).

Further evidence of Connell's awareness of Rothwell's precarious liquidity position was supplied by a former Treasurer of Rothwells. In evidence to McCusker, the
former Treasurer described the pressure placed on Rothwells' cash flow by Connell's incessant and unplanned spending (p101-102, 4.33). Connell's level of spending on a daily basis necessitated regular overnight borrowings at "huge fees" to "balance the books each night" (p102, 4.34). The difficulties imposed on Rothwells through Connell's expenditures were made known to him but to no avail. Most of the transactions were made through LRCP which then received fees for arranging loans for friends and companies associated with Rothwells' management (pp102-103, 4.33, 4.34). Connell was also aware that the cost of money to Rothwells was higher than the returns (p104, 4.36).

The results of the Price Waterhouse review and opinions expressed by the Rothwells' employees were not made available to the would-be rescuers. Furthermore, rescuers were told that the extent of Connell, and Connell-related, debt was less than $20 million (p237, 10.6). As already discussed, the financial statements indicated this was so. While the reality of Rothwells' position was progressively revealed over the following twelve months, a half year audit in January 1988 continued to mislead not only investors but those involved in the rescue.

The run on Rothwells in the wake of the October share market crash was not the only problem facing Connell and the bank at that time. An NCSC investigation into allegations of share market manipulation and warehousing of shares by Connell and Rothwells had commenced (p286, 11.11). This investigation was terminated on much the same grounds upon which the rescue was undertaken. If Rothwells collapsed, it would further shake investor confidence and adversely impact on other financial institutions (p286-287, 11.11). The termination of the NCSC investigation was on the condition, inter alia, that a management plan be implemented (p287, 11.11). This management plan included a requirement that outstanding loans be reviewed. The review was to cover the security given for loans and recoverability. The results of the review were to be conveyed to the NCSC by 28 February 1988 (p288, 11.13).
While it is not clear that this was the review prescribed by the NCSC, a further independent review of Rothwells' receivables was undertaken between December 1987 and February 1988 (p274, 11.1, 11.2). The exact purpose of the review is not evident from the investigator's report but it appears to have been in connection with both the NCSC's management plan requirements (p290, 11.15) and the West Australian Government's guarantee of the $150 million overdraft facility granted to Rothwells by the National Australia Bank (p274, 11.1; p283-284, 11.8).

As with the Price Waterhouse review, it was found that records and files were inadequate. In approximately 60 per cent of the files, no documentation was available as to terms of repayment or security for loans or even formal application and approval (pp276-277, 11.3). The conclusion was reached by one member of the review team that up to 70 per cent of the debts were uncollectable (p276, 11.3). The other member expressed the view that, with hindsight, the entire portfolio was doubtful (p277, 11.3). This review was apparently dismissed by Connell and other directors of Rothwells on the basis that it was undertaken by "traditional bankers" (p282, 11.7). Rothwells was a merchant bank. According to the directors of Rothwells, merchant banks had a different lending philosophy in that a "loan" effectively may not be a repayable debt but an equity investment (p278, 11.4, p283, 11.7) "a shareholding or part ownership" (p276, 11.3). In spite of this defence of Rothwells' policies, the results of the review were destroyed (p280, 11.5). The NCSC accepted audited half yearly accounts instead of the review of the loans prescribed in the management plan. This course of action was proposed by Connell on the basis that publication of audited half yearly accounts would help restore the financial markets confidence in Rothwells (p290, 11.5).

The audit, of course, was conducted by the same team that had undertaken the 1985, 1986 and 1987 audits and with similar results (p291, 11.15). Once again, reliance
was placed on directors for information on receivables rather than on documents and files which were of limited value anyway (p294-295, 11.18; p96, 11.20). In this instance, a provision for doubtful debts of $100 million was raised even though the auditors considered $127 million was more appropriate (p295, 11.19). On the basis of the Price Waterhouse review and the independent review undertaken between December 1987 and February 1988, it is obvious that this provision was grossly inadequate. Nonetheless, the accounts were unqualified (p301, 11.24). Rothwells issued a press release stating, inter alia, "[t]he directors took the unusual step of having the accounts for the period fully audited, confirming their validity" (p302, 11.25).

According to McCusker, both the NCSC and the public were effectively misled by the publication of the audited results. It appeared Rothwells was recovering financial stability when, in fact, it had almost no income as most of its receivable were non-performing. Rothwells continued to operate by the grace of deposits from government authorities and agencies (p302, 11.26; p307, 11.32).

Evidence to McCusker suggests the deception was maintained until around June 1988 when members of the West Australian Government became aware of the extent of Rothwells' bad debts which by this time were estimated to be around $300 million (p304, 11.28). Rothwells was continuing to have liquidity problems. There was not a "run" on the bank as such, but depositors were withdrawing funds reportedly because of the extent of Rothwells' bad debts (p304, 11.28). Rothwells was having difficulty borrowing funds because of the poor state of its files and records (p303, 11.27). This situation gave rise to what could be termed the second Rothwells' rescue in June/July 1988. The full details of the various transactions undertaken as part of this rescue plan are provided in the investigator's report (pp307-33) and will only be briefly dealt with here.
The "rescue" this time was aimed at financing the purchase by Connell of $350 million of Rothwells' uncollectable debts (p305, 11.28). Financing was provided through an agreement whereby the West Australian Government and businessman, Alan Bond, purchased Connell's interest in a petrochemical project for $350 million (p307, 11.30). In this instance, the sale of the debts was approved by shareholders at a general meeting held on 29 July 1988 (p319, 11.44). Settlement took place on 17 October 1988 (p330, 11.61). The overall effect of this transaction was to improve Rothwells' liquidity by $16.2 million and reduce liabilities by $333.80 million (Annexure to Chapter 11, Disbursement of "PICL" Payment of $350m, pp1-2).

This, however, was not sufficient to allow Rothwells to continue operations. Two days later, a government representative and others involved in the management of Rothwells since the time of the first rescue in October 1987, came to the conclusion that Rothwells was "technically insolvent" (p330, 11.61). A further rescue package of some $75 million was proposed on 21 October 1988 (p333, 11.62). To ease an immediate liquidity crisis, $15 million was provided indirectly by the West Australian Government through a pre-payment for coal to a Rothwells' subsidiary (p333-338, 11.62-11.68). However, it appears no further financial support was forthcoming and provisional liquidators were appointed in November 1988.

The Rothwells' saga has definite parallels with both the Reid Murray and Cambridge Credit cases. A major feature of all three companies for the years immediately prior to collapse was a lack of liquidity compounded by unprofitable operations. Yet the published accounts provided no inkling of this. Both Reid Murray and Cambridge Credit relied on a steady inflow of debenture funds for survival while Rothwells' continued existence was contingent upon deposits of funds exceeding out flows. To this end, the published financial statements of each company needed to portray well-run and profitable concerns. This was achieved by various methods including the use of different accounting methods to account for similar transactions, the recognition of
profits on transactions not completed at balance date, the back dating of transactions, capitalisation of development and interest expenses and a failure to provide for bad and doubtful debts. The deception was further facilitated by all three companies by the use of a network of related companies and organisations to engineer profits such as on land sales, nominal interest charges and other fees. Rothwells carried this even further by using related companies and firms to conceal director-related debts.

The investigators' reports in each case stated that the published financial statements were misleading. In each case, investigators contended the auditors had aided and abetted management in this deception by failing to approach the audit task with an enquiring mind and demonstrating a willingness to accept management's assurances as to the validity of transactions in spite of evidence to the contrary. The auditors concerned had the benefit of professional guidelines to help them. In the Cambridge Credit and Rothwells cases, the auditors also had the benefit of the experiences of the auditor in Reid Murray and the ASA Report issued in 1966 to guide them. It appears, however, that the experiences of the past and the guidance which had been provided by the profession since at least 1946 were effectively ignored.

In each of the cases examined above, the ultimate collapse of the company concerned led to the discovery of the misleading nature of the financial statements and failure of the audit process. A final case will be examined briefly to demonstrate that such failures of the regulatory system can occur without the company concerned going into liquidation.

AWA Ltd v Daniels [1992] 7 ACSR 759

This was a case dealing with auditor negligence and contributory negligence on the part of company management. During 1986, AWA Ltd entered the world of speculation on foreign exchange (p778). As will be discussed in detail in a subsequent
chapter, foreign exchange management is characterised by high risk and requires a great deal of skill and experience to minimise the inherent risks. The management of AWA Ltd and, more importantly, those involved in the foreign exchange dealings had neither experience nor skill in this area (pp778-779).

Initially, the company appeared to be making profits on its foreign exchange dealings (Peers, 1986, p30) reaching a peak of $26 million for the month of March 1987 (AWA Ltd v Daniels [1992] 7 ACSR 759, p824). The directors were uneasy about the company's entering into the foreign exchange market, particularly when informed of the March 1987 foreign exchange profits which some described as "almost unreal" as this was not consistent with previous foreign exchange profit patterns (p823). Nonetheless, the directors accepted the figure on the basis that the external auditor would surely pick up any accounting errors and notify them. This did not happen.

As subsequent investigation revealed, the foreign currency accounting records were substantially incomplete and unauthorised foreign exchange loans had been used to pay out and thus conceal some of the losses incurred on speculative foreign exchange transactions. In addition, foreign exchange losses which were not concealed by the use of unauthorised loans were rolled over. This practice was acceptable under the then newly released AAS 20 *Accounting for Foreign Currency Translation* (hereafter referred to as AAS 20) paragraphs 3 (p), 10, 11 and 53. The provisions of AAS 20 meant that losses incurred on this type of transaction could be deferred and amortised almost indefinitely. However, a different treatment was accorded foreign exchange profits which were recognised as incurred. The auditor was aware that the foreign exchange accounting records were incomplete and that there was a lack of adequate internal controls to safeguard the foreign exchange operations. The board of directors was not informed of this state of affairs. By the time the short comings of the foreign exchange department were made known to the directors, foreign exchange losses totalled $49.8 million.
In terms of the failure of standard setting participants, regulators and parliamentary and government bodies, AAS 20 had taken some 13 years to develop and did not take effect until 31 October 1986. Up until this time, companies were free to select the foreign currency translation accounting method of their choice. The long gestation period for the foreign currency standard will be shown later to have been the result of political influences rather than any technical difficulties. The standard, when finally issued, was flexible in that it permitted, inter alia, the rollover of realised gains and losses on long term monetary items rather than prescribing immediate recognition. This, in itself, was a political decision made after submissions to the AARF (Miles, 1986, p31). It would seem that political expediency overshadowed the need for relevant and reliable information.

The NCSC had been expressing concern at the lack of uniformity in accounting for foreign currency transactions for some time (Bushnel, 1985, p1; Uren, 1985, p13; Wilson, 1985, p40). In 1985, seemingly impatient with the professional accountancy associations' standard setting process dealing with foreign currency, issued a practice note dealing with disclosure of foreign currency methods and amounts (Bushnel, p1; Prosser, 1985, p15; Uren, p13). This practice note subsequently became approved accounting standard AASB 1003 *Foreign Currency Translation - Disclosure* (hereafter referred to as AASB 1003). For some reason, which the NCSC did not disclose, the prescription of accounting methods was left to the AASB (Commentary, AASB 1003).

In addition, much of AWA Ltd's foreign currency dealings were highly speculative and evidence will be produced in a later chapter to show that speculation in the foreign currency market was widespread among Australian companies. Despite this, neither the NCSC nor AAS 20 addressed this issue. In fact, the original AAS 20 specifically excluded speculative foreign currency dealings from its scope (AAS 20
The current AAS 20 and its counterpart AASB 1012 Foreign Currency Translation (hereafter referred to as AASB 1012) deal with disclosure of speculative foreign currency dealings but do not prescribe accounting methods for such transactions. As with the immediate recognition versus defer and amortise options, the failure of the two professional bodies and the AASB to address the issue of accounting for speculative foreign currency dealings raises questions about their commitment to ensuring the achievement of the economic and social consequences that SAC 2 and 3 argue will flow from the provision of relevant and reliable information. The situation that AWA Ltd found itself in was, admittedly, more than a matter of selective application of accounting practices. Nonetheless, AWA Ltd and the foreign currency losses incurred by other companies (to be discussed in detail in Chapter 6) serve to demonstrate the failure of accounting standards to provide relevant and reliable information.

Clarke and Dean provide similar examples of companies that reported profits in 1989, 1990 and 1991 and have subsequently reported losses through the write-off of asset values (1992, p186). Both the profits reported in previous years and their subsequent reversal were calculated according to “conventional accounting” (p186). As noted by Clarke and Dean, it is unlikely that the entire decline in asset values occurred in the year prior to their recognition in the financial statements. This, in turn, casts doubt on the appropriateness of conventional accounting rules used in prior periods (p187).

The failures of Reid Murray, Cambridge Credit and Rothwells demonstrate that not only has the public interest been foreseen in the flexibility of accounting practices but also by an attitude on the part of some auditors, that the wishes of management take precedence over the information needs of those who deal with corporations. While it is true that the financial reports of companies are the responsibility of management, can accountants morally hide behind the wording of a statute? Accountants are supposed to have expertise that non-accountants, including management, do not
possess and these special skills are supposed to raise them above the purely technical occupations. Accountants are supposed to be able to use their "professional judgment" to determine the appropriate accounting treatment for transactions in given circumstances. The choice of method is supposed to be neutral, in other words, it is not supposed to benefit one group at the expense of another. If management is to take the entire blame for the preparation of false and misleading statements such as those in the cases detailed in this chapter, then it would appear that management is exercising "professional judgment" and the accountant has been relegated to the role of bookkeeper doing what management has directed. Also accountants, if members of a professional body, are supposed to be bound by a code of ethics that requires them to comply with accounting standards. These standards are meant to represent best accounting practice - but, best for whom? It appears not necessarily what is best for shareholders and creditors or those affected by the activities of corporations.

The ethics of the auditors must also be questioned. Auditors have a duty to certify that accounts show a true and fair view and comply with approved accounting standards. If management, by clever ploys and undetectable dishonest means has hidden the true facts from diligent and competent auditors, then auditors cannot bear responsibility for accounts that are misleading. However, evidence to investigators in the cases of Reid Murray, Cambridge Credit and Rothwells suggest that the auditors were well aware of what management was trying to achieve with regard to the published financial statements. The failure by the auditors concerned to report clearly, honestly and professionally on the accounts has discredited the profession.

It could, of course, be argued that the instances discussed in this chapter are isolated and are not representative of the integrity of either directors or accountants in general. There is, however, evidence to suggest that this is not the case. Justice Rogers of the New South Wales Supreme Court recently made reference to a "recurring cycle of
booms and collapses” and the fact that even though changes are made, the same problems recur (1991, p1). Similarly, Chambers alleges that

. . . corporate accounting does not do violence to the truth occasionally and trivially, but comprehensively, systematically and universally, annually and perennially (1991, p16).

Clarke and Dean also make reference to the recurring problems of “. . . bad management, immoral behaviour in corporate life, greed and avarice . . .” (1992, p178). These problems were as evident in the corporate failures of the 1960’s as they are in the more recent collapses and this is so in spite of actions supposedly taken to ensure that such activities were not repeated.

The first part of the next chapter will provide some of the traditional arguments put forward as explanations for the failures of the regulatory system identified in this chapter. The second half of the chapter will seek to provide an alternative explanation based on the concepts of circuits of power, dissidence and autopoiesis.
CHAPTER 5

IN SEARCH OF AN EXPLANATION OF

REGULATORY FAILURE

The corporate failures detailed in Chapter 4 demonstrate that unexpected corporate failures have continued despite the existence of company legislation incorporating account and audit provisions aimed, in part, at providing protection for those who deal with corporations. Unexpected corporate failures have also continued in spite of the emergence of an accounting profession which claims to be committed to ensuring that general purpose financial reports provide a means by which management and governing bodies will be accountable for their actions and which will facilitate an economic allocation of resources. As the inspectors' reports discussed in the previous chapter suggest, much of the blame for misleading financial statements has been laid at the door of accountants, in particular, auditors. However, as Chambers has noted, others should also wear some of the criticism:

The practices that companies have adopted have generally been permissible under the statutes, regulations and technical rules of accounting of their time. The trouble has been that the laws, regulations and rules have been vague, toothless and often self-contradictory.
The financial information on company affairs which flows to the securities market is the product, principally, of accounting rules. But we do not hold that accountants or their professional associations are alone responsible for the state of the rules. Managers, directors, stock-brokers, financiers, lawyers and others have also played a part, consciously or unwittingly, in bending and stretching the rules (1973, Preface, Securities and Obscurities, unpaginated).

The reasons for this are not clear but McCraw sheds some light on the purpose of regulation and, thereby, on the difficulties involved in enforcing it: "... regulation is best understood as an institution capable of serving diverse, even contradictory, ends, some economic, some political, some cultural" (1975, p180).

Because regulation serves such diverse interests, the potential for conflict is obviously going to be quite great. The outcome of such conflict will be governed by weaknesses within the regulatory structure. Hence, as was suggested in Chapter 1, there are actually layers of failure within the regulatory system and unexpected corporate failures are the outcome of a series of weaknesses within the system. The first part of this chapter will attempt to identify specific weaknesses in the regulatory framework governing financial disclosure which have contributed to regulatory failures such as those discussed in Chapter 4. The second part of the chapter will attempt to demonstrate that these weaknesses are themselves the result of underlying socio-political influences. It is the contention of this study that these influences are the cause of regulatory failure and can be explained within the circuits of power and autopoiesis frameworks developed and elaborated on in chapters 2 and 3.

AREAS OF REGULATORY WEAKNESS

Legislation is one of the most obvious sources of regulatory weakness. The fact that company legislation has been in existence for well over 100 years makes one wonder how the examples of grossly misleading financial statements discussed in the previous
chapter could have occurred. One contributory factor may be the motives behind the legislation. As discussed in the previous chapter, the dominant force behind the original companies legislation in the UK was to facilitate incorporation. Hence, it was clearly in the interests of business. In return for the privileges of incorporation, companies were required to adhere to certain rules or guidelines including the disclosure of financial information. Australian corporate legislation was adapted from the UK model and was expanded upon in the wake of the Victorian land boom of the late nineteenth century to provide further protection to investors and creditors (Victoria, 1895, p3338). However, given that fraud and misrepresentation still prevail in spite of legislation, it could be asked if the disclosure requirements of company legislation are little more than a sham or a symbolic gesture to quell the fear engendered by previous corporate collapses and fraud. As Cranston states:

> Often it is fallacious to assume that the forces dominant in formulating business regulation really intended to make any dent on commercial practices. Business regulation may be characterised as symbolic, since from the outset the purpose may simply have been to assuage public opinion or to divert its attention (1982, p3).

Legislative initiatives can be both intentionally and unintentionally weakened in a number of ways with the result that those who wish to avoid the consequences of the legislation may do so with relative impunity. Legislative failure could be said, therefore, to be a result of weakness in other layers of the regulatory framework. For present purposes, the major source of weakness in company legislation is uncertainty. The areas of uncertainty to be examined here are: Australian federalism, frequent changes in legislation/legislators, lack of authority vested in regulatory agencies, lack of funding and ambiguous or flexible statutes and standards.
1. Australian Federalism

Grabosky and Braithwaite discovered in their study of enforcement strategies of business regulatory agencies in Australia that business regulation in Australia is "... a fragmented, unco-ordinated melange of overlapping Commonwealth, state, and local government agencies ..." (1986a, p2).

The fragmentation of regulation in Australia is a result of our federal system. This weakness in the regulatory system was recognisable very early in the life of federated Australia. For example, the difficulties imposed by the Australian constitution were raised in Chapter 3 with regard to obtaining legislative registration of professional accountants. In addition, in 1906, *The Public Accountant*, suggested each of the six States refer to the Federal Parliament their powers to legislate for companies (Editorial, 1906c, p18; 1906d, p35). The following year, a conference was instigated by the Federal Government to consider and seek recommendations on the formulation of uniform company and bankruptcy law throughout Australia (Editorial, 1907c, pp138-139). No progress was made in either the referral of State powers to the Federal Parliament or in achieving uniform legislation throughout the Commonwealth. In an address reproduced in *The Public Accountant* in 1912, a call for Federal legislation was made on the basis that the individual Australian States made up a Commonwealth with a common destiny. Hence

[it] is absurd ... that a "limited Company" should imply one set of statutory conditions in New South Wales and another in Victoria or South Australia. Throughout the Commonwealth "limited liability" should mean one thing, under one comprehensive statute ... (Braddon, 1912, p145).

Half a century later, the problem still existed:

It is regretted that it appears impracticable to have a Federal Companies Act which would apply to all states. ...
At present anyone who has to deal with company matters which extend beyond one State is faced with six companies acts and also Federal ordinances for Territories. While there is general similarity in these Acts, they vary considerably in detail and arrangement (Chancellor, 1957, p200).

Despite a recognised need for Federal company legislation, this was not achieved for ninety years. A major reason for this has been judicial interpretation of the Australian Constitution which has effectively supported the reluctance of the various State Governments to delegate their corporate powers to the Commonwealth. The decision in Huddart, Parker, Co Pty Ltd v Moorehead (1908) 8 CLR 330 gave a very narrow reading to section 51(xx) of the Constitution which deals with the Commonwealth's powers to make laws with regard to corporations. As a result, the Commonwealth was forced to seek co-operation from the States in passing uniform legislation. Alternatively, as suggested as early as 1906, the States could have referred their powers to the Commonwealth which could then have enacted legislation to regulate companies on a national level. The States had no desire to take such action. The compromise was uniform legislation but this was not achieved on a national scale until 1963.

Uniform legislation, however, was not a complete solution. In the wake of the minerals boom of the 1960's, early 1970's, two Parliamentary Committees were appointed: The Company Law Advisory Committee, 1967, and the Senate Select Committee on Securities and Exchange (Rae Committee) 1974. In 1968, the Interim Report of the Company Law Advisory Committee recommended the establishment of a Companies Commission to oversee the securities industry including the preparation and presentation of financial statements (Australia, 1970, pp14-16). Six years later, the Rae Committee made a similar recommendation. The Rae Committee stated clearly that a joint regulatory scheme involving individual States and the Commonwealth Government was not a viable solution.
... in advocating the establishment of a national regulatory body we are not in favour of such a joint commission, particularly not one which involves the concept of continuing responsibility to all the governments. Such an arrangement would seriously endanger the ability of the system of regulation to adapt speedily to ever-changing circumstances and standards (1974, p16.14).

However, bringing these recommendations to fruition took another ten years. The delay appears to have been largely due to the threat of a constitutional challenge to the Federal Government's powers in this area.

In 1972, the possibility of Federal corporate regulation began to gain ground. The Huddart, Parker decision was specifically overturned in Strickland v Rocla Concrete Pipes Ltd [1972] ALR3. This turn of events appears to have given the then newly elected Federal Labor Government the incentive to initiate legislation to regulate corporations. However, the proposed legislation lapsed when the Labor Party lost power in 1975.

Rather than risk a constitutional challenge to any attempt to institute national company legislation, the newly elected Federal Liberal Government began negotiations with the States for the introduction of a Co-operative Scheme under which companies legislation dealing with the Australian Capital Territory and Territories would be adopted by the States. A National Companies and Securities Commission (NCSC) was to be established which would be independent of direct parliamentary control either by the Federal Government or by the States. A Ministerial Council comprising a minister from each State Government and the Federal Government was also to be established to oversee the activities of the NCSC and recommend appropriate legislation or amendments to existing legislation. The Formal Agreement, which brought the Scheme into effect was signed on 22 December, 1978. The aims of the national scheme were summarised by the Campbell Committee as being
to achieve greater uniformity in the law and its administration;
to promote commercial certainty;
to reduce business costs and increase the efficiency of capital markets; and
to enhance the confidence of investors in securities markets (Australia, 1981, p364, 21.4).

The NCSC was established in March 1980 to oversee administration of the uniform legislation.

For reasons to be discussed in the next two sections, the co-operative scheme and the NCSC were not as successful as was originally hoped. In February 1980, it was described in an editorial in the Australian Business Law Review as "the fruition of one of the "dreams" for the 1970's" (Editorial, 1980, p1). Two years later it was seen as

... a compromise between the most efficient means of regulating the market to the standards now required by the community and the political realities that must be faced under the Australian Federal System (Samuel, 1982, p33).

Dissatisfaction with the Scheme continued and culminated in an unanimous recommendation by the Senate Standing Committee on Constitutional and Legal Affairs that it be replaced with comprehensive Commonwealth company and securities legislation (Australia, 1987, 6.8). The Committee described the Co-operative Scheme as "an exceptional constitutional creature" (paragraph 6.1) and criticised it on a number of grounds including:

administrative and general inefficiency due to the duplication of functions arising from the delegation of duties by the NCSC to State and Territory Corporate Affairs Commissions (paragraph 3.8)
On the basis of these criticisms and recommendations, the Federal Government attempted to introduce Commonwealth company legislation. However, this bid has been thwarted by a successful, if limited, Constitutional challenge in New South Wales v Commonwealth of Australia (1990) 1 ACSR 137. The decision in this case was handed down by the High Court in February 1990. It was held that Constitution Section 51 (xx) did not confer on the Commonwealth power to legislate for incorporation of companies but, once a company was duly incorporated, it could then come within any relevant Commonwealth legislation. In itself, the decision did not directly affect the proposed Commonwealth legislation to any great extent. Incorporation was only a small part of the legislation. However, it left the way open for further constitutional challenges. The fact that the case was brought in the first place highlights the political nature of the regulatory process and indicates the degree of uncertainty that our federal system is capable of generating in terms of effective government and control of regulation.

In the wake of the High Court decision, negotiations again began between the Federal, State and Northern Territory governments in a bid to overcome the constitutional difficulties. Agreement was reached in June 1990 with the States and the Northern Territory agreeing to enact legislation adopting the Commonwealth Corporations Act 1989 and the Australian Securities Commission 1989. A national corporations scheme, based on Commonwealth, State and Territory legislation, finally became effective in December 1990 (Australia, 1991c, 1.3.17-1.3.21, pp14-14).

2. Frequent Changes in Legislation/Legislators

According to Doyle, frequent changes in legislation can have an adverse impact on compliance with laws:
Where laws relating to a subject-matter are frequently altered . . .
it becomes difficult to persuade those who are ruled that "regulation" ie. technical, neutral implementation of a law, is possible . . . the law is in "disrepute" because parties know that the values are not settled and the "law" is as temporary as the present configuration of law-makers (1981, p98).

Parliamentary debates of both the Senate and House of Representatives indicate that frequent changes to company legislation under the Co-operative Scheme were indeed a problem. For example, in November 1983, Senator Durack commented on the number of amendments to the legislation before the Senate at that time:

The Senate is about to debate the Companies and Securities Legislation (Miscellaneous Amendments) Bill. This involves amendments to the whole co-operative companies and securities scheme . . . This may be somewhat surprising in view of the relative recency of the co-operative scheme and the codes under it, particularly as the Companies Act itself came into existence only a short time ago . . .

It may seem surprising that one would have about 100 amendments proposed to a package of such recent origin. The Senate should be aware that we are faced with the prospect of legislation of this magnitude and complexity virtually on an annual basis (Australia, 1983, p2680).

Parliamentary debates some nine years later reveal that nothing has changed. The need for lengthy and complex amendments to the 1989 corporations legislation is indicative of the political nature of the national scheme in that the States would have been aware of problems of this nature but persisted in launching a constitutional challenge to Federal legislation. In discussing the report of the Joint Committee on Corporations and Securities presented to the Senate in June 1992, reference was made to evidence given to the Committee by the business and professional communities. This evidence maintained that further amendment to the corporations law was not necessary and that company directors were having a difficult time coming to grips with changes to the law brought about by the newly introduced national
regulatory scheme and the creation of the ASC. Further amendments, therefore, should be delayed (Australia, 1992b, p4109).

The extensiveness of changes to the corporations law since 1989 was raised in the Senate in the following December. The Corporations Bill 1989 contained almost 1,000 pages. Amendments required in the aftermath of the constitutional challenge contained some 300 pages. A series of other amendments followed. These included the Corporations Legislation Amendment Act 1991, the Corporations Legislation Amendment Bill (No 2) 1991, the Corporations (Unlisted Property Trusts) Amendment Bill 1991, the Corporations Legislation (Evidence) Amendment Bill 1992 and the Corporate Law Reform Bill (No 2) 1992 (Australia, 1992e, p5296). These amendments were described in the Senate as complex and directed towards achieving a national regulatory scheme (p4109).

It appears the business and professional communities had valid grounds for complaint. Such frequent amendments also raise doubts about the purpose of the legislation. The business and professional communities' claims to be having difficulty in coming to grips with existing legislation would tend to give them an excuse not to apply it particularly when it is likely to be changed at any time. In turn, frequent and complex changes in legislation can make enforcement difficult. This point was also raised in the Senate (p4109). As will be discussed below, difficulties of enforcement may result because the regulators themselves lack expertise. With an ever changing set of rules, gaining expertise is unlikely to be an easy task. This point was raised in evidence before the Joint Committee on Corporations and Securities in August 1992. Tony Hartnell, then chairman of the ASC, stated that problems were encountered by the ASC in training staff because the complexities of the corporations law made training a very long, slow process (Australia, 1992c, p13). Inexperience was also suggested as a reason for the ASC's preference for civil remedies as opposed to criminal proceedings during the years that Tony Hartnell was chairman. It was claimed in the financial
press that Hartnell had a commercial background and had both a distaste for and lack of familiarity with criminal law (Gray, 1992, p12).

The question of enforcement was also raised in the Senate with regard to the progress of the ASC and prosecutions arising out of the corporate failures of the 1980's. Early in its existence, the ASC identified 16 "big" cases which were to be investigated. By June 1992, some $4.7 million had been spent on these investigations but only two convictions had resulted. Even though there were a number of matters pending, progress cannot be said to be apparent. The Commonwealth Director of Public Prosecutions (DPP) complained that the ASC was not referring matters to it for prosecution and, as a result, it had underspent its corporate prosecutions budget by $1.5 million (Australia, 1992d, p5289).

Dissension between the DPP and the ASC became very public during 1992 with a series of articles appearing in the press (eg. Gray, 1992, p12; Pheasant, 1992, p4; Spiers, 1992a, p1-2; 1992b, p1-2). As a result of the dispute becoming public, hearings were held with both parties before the Joint Statutory Committee on Corporations and Securities in October 1992. The report of this committee dealt with apparent conflicts between the ASC and the DPP. In defence of the ASC's failure to conclude investigations into alleged serious criminal corporate activity and initiate prosecutions, the report made reference to the backlog of complex investigations - "an inherited mess not of its own making" - and the inexperience of the newly created ASC's investigators - "many of whom were new to the task" (Australia, 1992d, pp3-4).

The investigation into the collapse of the Bond group in 1989 provides an example of the difficulties inherent in Australian corporate regulation. A Ministerial Council appointed enquiry was established in March 1990. In 1991, the enquiry was taken over by the ASC and a management committee comprising members drawn from the
ASC, the Federal Police and the DPP. As of July 1994, the investigation is still incomplete. In the intervening years, there have been a number of changes in the membership of the management committee including the ASC's chairman and national co-ordinator of enforcement and the representative from the Federal Police. These changes in the membership team were cited as one reason for the delay in bringing the investigation to a conclusion (Williams, 1994b, p15).

In an accounting context, Walker also lends support to Doyle's view. In an evaluation of the ASRB and accounting regulation policies that affected its progress, Walker stated that between 1978 and 1985, the formative years of the Co-operative Scheme, the NCSC and the ASRB, the Ministerial Council had undergone some thirty changes in composition (1987, p281). Furthermore, there had been changes in a number of "key players" since the establishment of the ASRB. The "key players" identified by Walker included NSW Attorney-General, Frank Walker, Commonwealth Attorney-General, Gareth Evans, NCSC foundation chairman, Leigh Masel and senior public servants. Changes in the positions held by these individuals and the introduction of new "players" influenced the policies affecting company regulation. According to Walker these changes in players worked to the profession's advantage which, in contrast to the regulators, had a relatively stable leadership:

The reshuffling of portfolios in both State and Commonwealth arenas, the retirement of Masel, and the reassignment of public servants led to a lack of continuity of involvement by leading participants in the government sector, and accordingly some volatility in policies. On the other hand, there was a high level of continuity in the leadership and staffing of the two accountancy bodies. In this environment, the profession found that when lobbying about the ASRB or the future of Schedule 7, it did not need to take 'no' for an answer (1987, pp284-285).

As will be demonstrated in the following chapter, the inability of the profession to come to a firm decision regarding the translation methods to be used for translating
the financial statements of foreign subsidiaries and the treatment of gains and loss arising on translation and the treatment of gains and losses on foreign borrowings allowed companies to select the method most suited to their purposes. The result being that there was inconsistency not only from company to company but in the accounting methods adopted by individual companies. Some companies were inconsistent in the application of accounting methods on a year by year basis and also from transaction to transaction.

3. Lack of Authority

Legislation may also be deficient in that it fails to provide a regulatory body with sufficient powers to effectively carry out its duties. Alternatively, the powers and duties may not be clearly defined leaving the regulatory body open to challenge on its right to undertake certain activities. There are at least three areas in the Australian regulatory system where this weakness is either still evident or has been until recent times.

a. The Co-operative Scheme

As already noted, the Co-operative Scheme and the NCSC were criticised by the Senate Standing Committee on Constitutional and Legal Affairs for administrative and general inefficiency (Australia, 1987, paragraph 3.8). The Co-operative Scheme was also criticised on the ground that responsibility for the Scheme was vested in the Ministerial Council, composed of members from each State Government and the Federal Government rather than a Federal Minister who would then be answerable to Parliament (paragraph 3.8). This had two consequences. From the point of view of the Committee it led to "lowest common denominator decision-making" which cast doubt on the quality of administration of the Scheme (paragraph 3.8). It also took control of company legislation away from Parliament and vested it in a small group which was subject to frequent change and had diverse political ideologies. This in
turn led to delay in enacting amendments to the legislation and additional administrative costs:

... the Ministerial Council virtually puts us, as the National Parliament, in a position of legislating in accordance with its wishes.

... we have to sit back and wait for six State Attorneys ... to come to some agreement, with all the delay, the excess administration and the burden that imposes ... (Australia, 1985, pp385, 386)

The adoption of Federal corporate legislation may have removed this particular barrier to a certain extent in that the Corporations Law is administered by specified Ministers appointed by and answerable to the Parliament. However, as already indicated, the necessity to frequently amend the legislation makes it clear that the national scheme has not removed all of the problems within the regulatory system.

b. The NCSC/ASC

Under the Co-operative Scheme, the role of the NCSC was to administer company legislation in Australia. The State and Australian Capital Territory Corporate Affairs Commissions were to act as delegates of the NCSC. However, as Grabosky and Braithwaite have noted, the NCSC was to "have regard to the principle of maximum development of a decentralized capacity to interpret and promulgate the uniform policy and administration of the scheme" (1986a, p12). As a consequence, the NCSC had no control over the allocation of resources within the scheme and while it was able to provide guidelines and refer cases to its delegates, it could not initiate prosecutions or interfere in enforcement policies at State level (1986a, p12). Grabosky and Braithwaite describe the relationship between the NCSC and its State delegates as poor and co-operative in name only:
We send what we think are good cases to the states because we don't have the resources to do them ourselves. In fact, most time is spent on sending good stuff we've picked up and two or three years later we're still writing letters begging them to reply as to what they've done.

In very few cases we have resources to go in and say look... give us a report on that. We want a report. The report then comes over and they say there is no case to answer... and you could go through this report and their interviews and there was a *prima facie* case there. You could go in and prosecute them on the documents (1986a, p13, interview with senior NCSC official. Emphasis in original).

The administration and functions of both the Co-operative Scheme and the NCSC are characterised by what Grabosky and Braithwaite term "layering", that is, the delegation of enforcement of regulation to various administrative layers (1986b, p88). The purpose being that the more layers a prosecution must transit, the less likelihood of it ever being completed. While the extension of this process to legislation under the Co-operative Scheme may be beyond the scope that Grabosky and Braithwaite saw for the term "layering", it clearly has the same impact as indicated in the parliamentary debates previously cited.

Further evidence of layering within the area of corporate regulation is the relationship between the NCSC's successor, the ASC, and the DPP. The ASC has authority under section 49 of the Australian Securities Commission Act 1989 to initiate prosecutions for offences against the Corporations Law. Given the experience of the NCSC in terms of the delegation of prosecutions to State Corporate Affairs Commissions, the decision to delegate prosecutions to the DPP appears at first to be somewhat puzzling. However, a review of the evidence given by Tony Hartnell to the Joint Committee on Corporations and Securities in 1992 provides the answer to this riddle. Apparently, the legislation which created the DPP contains a provision stating that the DPP can undertake corporate prosecutions. According to Hartnell, the DPP informed the ASC that if it did not willingly send prosecutions to the DPP, the
legislation would be invoked and the DPP would undertake the prosecutions whether the ASC liked it or not (Australia, 1992c, p18). On the basis that the difficulties inherent in the splitting of the regulatory function in this way were known, the inclusion of such a provision in the DPP legislation is questionable.

Grabosky and Braithwaite found that regulatory agencies that used the State Crown Law Offices or the DPP in the case of Commonwealth agencies, often experienced delay and other problems in the conduct of prosecutions:

The most common complaints were the failure of prosecutors to understand technical problems, according low priority to regulatory work compared to 'cops and robbers' cases, entering into plea bargains without consulting the agency, delays, and failure to come to grips with the regulatory strategy of the agency (1986a, p200).

The long delay in the Bond investigation briefly referred to above suggests the same problems still exist. In addition, as already noted, there has been open conflict between the two bodies giving rise to a series of hearings before the Joint Statutory Committee on Corporations and Securities in 1992. Both sides to the conflict attributed blame to the other for delays in the conclusion of investigations.

The DPP criticised the ASC's preference for seeking civil remedies instead of criminal prosecutions even in instances of serious corporate wrongdoing (Australia, 1992d, p6-7, 1.17-1.20). This, of course, could be the ASC's backlash to the DPP's demand to undertake criminal prosecutions rather than allowing the ASC to follow through on its investigations. However, there is no evidence to support this. In response to the DPP's criticisms, the ASC argued that evidence arising from civil proceedings may give rise to criminal charges (p5, 1.14, 1.15). Even if such evidence emerges, it may prejudice subsequent criminal prosecutions. The prejudice problem was identified by Rogers J in one of the many Cambridge Credit hearings.
... it is an affront to the usual concepts of justice that, 13 years after the events in question, factual material should be denied to the Court and to the parties because the possibility remains of criminal charges being laid at some future date. . . . I have . . . attempted to refrain from expressing any view on the propriety of the conduct of the directors in order to ensure that, if they should be brought to trial on some criminal charge, nothing I say should hinder them from getting a fair trial (Cambridge Credit Corp Ltd & Another v Hutcheson & Others (1985) 3 ACLC 263 at 268).

The question of prejudice was also extensively dealt with in a Cambridge-related case, Cooke v Purcell; Cooke v Whitbread and Others; Attorney-General v Purcell and Others (1988) 14 NSWLR 51. This was an appeal against an earlier decision that criminal charges which had been laid against the auditor and directors of Cambridge be permanently dropped. The appeal was disallowed on the grounds, inter alia, that the possibility of a fair trial was in doubt due to prejudice arising from the time which had elapsed since the relevant transactions had taken place and the laying of charges some ten years after the collapse of Cambridge. Relevant considerations identified by the court included fading memories of the respondents and witnesses, the deaths of one co-accused and some potential witnesses and the fact that some of the respondents had given evidence in civil proceedings which was now to be used against them in criminal proceedings.

The ASC further argued that the DPP wasted resources by pursuing only a small number of charges arising from ASC investigations and/or requiring additional evidence before proceeding with prosecutions (1992d, pp10-11, 1.29-1.34). The Committee recognised that the problem here was the separation of investigators and prosecutors particularly when there was no liaison between the two until the investigation was completed (p12, 1.35-1.36). The desirability of both investigators and prosecutors working together from the outset of an investigation was recognised. However, the separation of the two bodies, in effect, layering, provided "a check on
over-enthusiastic investigators and prosecutors and protected the rights of the individual . . ." (pp12-13, 1.36). The stalemate in the Bond investigation highlights the difficulties of separating investigators and prosecutors even if there is liaison between the two.

As noted previously, the investigation into the Bond collapse is now in its fifth year with no apparent end in sight. The investigation is being managed by a committee comprising representatives from the ASC, the Federal Police and the Commonwealth Director of Public Prosecutions. Members of the legal community are also working with the committee in a consultative capacity. The investigation team has been described as "bureaucratic and top heavy" (Williams, 1994b, p15). The major problem flowing from this is lack of agreement as to the scope of the investigation, charges to be laid and the amount of evidence required to instigate prosecutions (Williams, 1994a, pp1, 10; 1994b, p15).

The Federal Attorney-General's solution to problems of this nature was the establishment of yet another layer in the regulatory process. A National Steering Committee on Corporate Wrongdoing was established to, inter alia, resolve disputes between the ASC and the DPP (1992d, Appendix II). The problem with this is that it will add to the time taken to complete investigations which now has legislative and judicial complications.

Under section 1316 of the Corporations Law, prosecutions for criminal offences identified within the Act must be undertaken within five years of the relevant event taking place. At the current rate of progress, it appears unlikely that prosecutions will eventuate regardless of the findings of the investigation unless the consent of the Minister responsible for administration of the Act (section 80A(2) provides this definition of "the Minister") is obtained. In other words, even if sufficient evidence is gathered to support a prosecution, this must be achieved within five years or yet
another layer of the regulatory system must be negotiated to even bring the matter to court.

Even if the five year statute of limitations is waived, the courts may not be prepared to accept prosecution on the basis of natural justice. As already indicated, the Cambridge Credit case provides evidence of this. Criminal charges involving common law conspiracy to cheat and defraud investors and potential investors, were laid against three company officers and the auditor of Cambridge in March 1985, some ten years after the collapse of Cambridge. A permanent stay of proceedings was granted on appeal to the New South Wales Supreme Court (Whitbread & Others v Cooke & Others; Purcell v Cooke & Others (No 2) (1987) 5 ACLA 305). In coming to its decision, the court stated that the guilt or innocence of the directors and auditor were not at issue. The only point to be decided by the court was whether or not the delay in bringing charges was an abuse of process (p313). Almost two years later, the case was effectively thrown out of court on the basis that to bring charges after such a length of time was "harsh and oppressive and an abuse of process" (p327).

c. The ASRB

The ASRB, while perhaps not technically a regulatory authority, was also impeded in its work by lack of statutory mandate. The ASRB was not created by statute but by a resolution of the Ministerial Council. Its powers and duties were also conferred upon it by resolution of the Ministerial Council. As noted previously, frequent changes in the composition of the Ministerial Council and others involved in policy decisions regarding the workings and function of the ASRB led to a lack of continuity in these areas. The profession was also able to use the ASRB's lack of statutory powers to impede its activities. As indicated in Chapter 3, the original intention of the Ministerial Council was that the ASRB was to have the power to determine priorities and commission the development of high priority standards for review by the Board.
The profession questioned the Board's power to commission the development of accounting standards:

... the questions of whether the Board had these powers became the source of conflict between the Board and representatives of the profession, and the question of whether the 'commissioning' power should be exercised became the subject of some disagreement within the Board itself (Walker, 1987, p272).

The Australian Securities Commission Act appears to have been designed to eliminate problems of this nature. Section 224 of the Act establishes the Australian Accounting Standards Board (replacing the ASRB) and section 226 confers certain functions and powers on the Board. These powers include the review of proposed accounting standards and the sponsorship and development of proposed accounting standards. The Board may also change the form and content of proposed accounting standards. As will be discussed in a subsequent section, the success of these provisions will, to a certain extent, depend upon the membership of the Board and its commitment to the promulgation of impartial and effective accounting standards. This, in turn, will depend on the ability of Board members to withstand pressure from interest groups. The Act specifies that members must have knowledge of, or experience in, the fields of accounting, law or business (section 225(3) but says nothing of any affiliations members may have with interest groups such as the accounting profession or business. The discussion in Chapter 3 indicates that the AASB may be independent in form alone as it relies on the AARF for all research and only accounting standards emanating from the AARF have been approved.

4. Lack of Funding

While not directly related to legislation, funding is also an example where the government may, either intentionally or inadvertently, circumvent its own legislation. If insufficient funds are provided to monitor compliance with or enforcement of legislation, it becomes little more than an exercise in public relations or deception.
The government can point to the legislation and claim that it has provided the necessary measures to protect the public. As has been pointed out by Charles Williams, as deputy chairman of the NCSC, legislation is cheap but enforcing it is another matter (cited by Bowerman, 1990, p1). The question of resources available to enforce legislation was raised in the 1991 report of the House of Representatives Standing Committee on Legal and Constitutional Affairs (Australia, 1991c, pp32-33). During the course of hearings giving rise to the report, evidence of a lack of resources for the administration and enforcement of corporate legislation was presented to the Committee by the Attorney-General's Department and the former chairman of the NCSC, Henry Bosch (pp32-33). Details of the evidence was not provided in the report. However, the financial press published part of Bosch's evidence in August 1990 (Sculley, 1990, p25). Bosch told the Committee that during 1987 the NCSC received a constant stream of complaints from shareholders about the activities of certain companies. The media and the Commission itself also detected a number of matters worthy of attention by the NCSC. However, due to a lack of resources, the Commission had only been able to consider about one-tenth of the matters brought to its attention (p25). The lack of activity by the NCSC was also raised by Tony Hartnell before the Joint Committee on Corporations and Securities in 1992. Hartnell claims that when the ASC took over from the NCSC, the press and Australians, in general, thought the NCSC were actually pursuing a number of "notorious" matters. According to Hartnell, virtually nothing, in fact, was being done and in some cases, files had not even been opened (Australia, 1992c p7).

As was evident in some of the quotes from the previous section, funding was also a problem for the State Corporate Affairs Commissions. In addition, it has been disclosed that lack of resources meant that only one third of 1,168 cases referred to the New South Wales Corporate Affairs Commission in 1975 were pursued. Many of these cases were subsequently dropped. Corporate Affairs Commissions in Victoria, South Australia, Western Australia and the Australian Capital Territory have
also complained that lack of resources had forced them to either drop cases or accumulate substantial backlogs of cases with little prospect of catching up (Grabosky & Braithwaite, 1986a, pp24-25). The issue of funding was also raised before the Joint Statutory Committee on Corporations and Securities in the dispute between the ASC and the DPP. The ASC is required to fund both the cost of investigation and prosecution. This situation was described by the Committee as "almost designed to produce hostility" (Australia, 1992d, p1, 1.31). This is evident in the complaints by the ASC that the DPP often rejects the evidence gathered or requires more extensive investigations. On the other hand, the DPP complained that it was hampered in its prosecution function by decisions made by the ASC as to the amount of resources to commit to a particular investigation and prosecution (pp10-11, 1.29-1.32).

Lack of resources was identified as an element in the long delay between the collapse of Cambridge Credit Corporation and the laying of criminal charges against the auditor and three directors of the company (Whitbread & Others Cooke & Others; Purcell v Cooke & Others (No 2) (1987) 5 ACLC 305 p318). Maxwell J provided explicit details of the resources required but not supplied to facilitate completion of the investigation (pp318-321). These included lack of supervision by senior legal staff of the Corporate Affairs Commission, lack of legal officers, investigators and clerical staff to conduct the investigation and equipment such as computer and photocopying facilities. Maxwell J concluded that the delay in commencing criminal proceedings was unjustified and further stated

... the relevant evidence of the team's activities is ... that of an ill-equipped, rudderless ship sailing without a competent master. . . . The team's problems were compounded by the lack of adequate facilities and the failure of the Commission and the Government to provide the means by which the preparation of the Commission's prosecution could have proceeded with due expedition (p323).
It would appear that funding is a political tool. Research by Grabosky and Braithwaite supports this view. As evidence, they cite comments from Ministers to requests by Corporate Affairs Commissions for additional resources such as "[t]he more resources you have, the more matters you will find to investigate" (1986a, p25) and refusals of State treasuries to provide additional funding to support new staff appointments (p13).

Revelations such as these support the assertion by Parker, Peirson and Ramsay that lack of funding was one of the factors which could prevent the NCSC from successfully enforcing compliance with approved accounting standards (1987, p243). However, they considered that the provisions of section 285 of the Companies Act (Code) would mitigate this problem in so far as it required auditors to report non-compliance with the Code, including applicable approved accounting standards, to the ASRB and the NCSC or State Corporate Affairs Offices (1987, p244). The NCSC would then be able to investigate the matter and if necessary, prosecute offending parties.

There is evidence, however, to suggest that auditors are not necessarily reporting breaches of the company law including compliance with approved accounting standards. In the NCSC's eighth Annual Report, concern was expressed about the number of both reported and unreported instances of non-compliance with accounting standards. The NCSC indicated its intention to pursue this matter by, in particular, reminding auditors of the responsibility to shareholders imposed on them by company law (NCSC, 1987, p23). Part of this process was a policy statement issued jointly by the NCSC and ASRB, reminding auditors of their duty to report instances of non-compliance and warning them of the possible consequences of failure to do so. The policy statement was issued in the wake of an investigation which revealed that auditors were neither reporting departures from accounting standards nor providing an opinion on departures (Cooper, 1987, p38). A similar policy statement was issued
in 1990 after the revelations of the Rothwells' investigation and the failure of the National Safety Council of Australia. On issuing this policy statement, the executive director of the NCSC, Dr Arthur McHugh, stated that he would be surprised if there had not been instances of failure to report corporate misdemeanours connected with some of the large corporate collapses (cited by Pheasant, 1990, p1). As indicated in the previous chapter, this appears to be the case with Rothwells and the failure of the auditor to report Connell's extensive borrowings from Rothwells to Corporate Affairs. Prosecutions, however, require funding so that even if auditors do report instances of non-compliance with the law or fraud, it may make little difference if the regulatory agencies are unable, or unwilling, to take any action. In addition, the matter would still require investigation by the ASC and the agreement of the DPP to initiate a prosecution. The best that can be hoped is that an investigation may be instituted before the relevant company fails.

In 1990, the Federal Budget provided for an increase in regulatory funding of $210 million over the next four years. This represented a 50 per cent increase in funding (Boyd, 1990, p3). The new Australian Securities Commission was to receive $107 million for the first 6 months of operations and $123 million and $137 million respectively for the following two years. In contrast, Government funding of the NCSC and State Corporate Affairs Commissions amounted to some $70 million per annum. These bodies, of course, also generated revenue but this was not necessarily available for regulatory activities (Shanahan, 1990, p86). Given that the collapse of a single company, Cambridge Credit in 1974, resulted in the loss of between $75 million and $100 million of investors funds, one wonders whether the increase in funding, which is supposedly aimed at protecting shareholders, is little more than a "drop in the bucket". This question becomes very pertinent given the statement made by Gavin Campbell, group managing director of the Australian Stock Exchange:
The financial difficulties of some well-known individuals and their associated companies have caused the loss of at least $5 billion of shareholders' funds during the past year (1990, p20).

Consideration also needs to be given to the plight of creditors. The collapse of the National Safety Council of Australia (NSCA) is a case in point. It was recently announced that unsecured creditors of the NSCA were told that they could expect minimal return on the $276 million owed to them (Porter, 1990, p25).

As Bosch has also pointed out, the amount of regulatory funding available from the government should be compared with the cost of special investigations into companies activities. For example, the investigations into the Bond Group and Rothwells have to date cost approximately $1 million and $2 million respectively (Skulley, 1990, p25). These investigations are still in process and the costs mentioned do not include the cost of any subsequent legal action.

Following the announcement of the increase in funding to the ASC, its chairman, Tony Hartnell, stated that enforcement of the law and litigation arising from investigations into recent instances of contravention of company law would be the first items on the agenda for the ASC. However, as was indicated above, progress on these investigations has been slow due to the inexperience of some members of the ASC and the conflicts with the DPP. A further problem has been the wording of relevant statutes and accounting standards which may be so ambiguous or flexible that prosecutions may not be initiated or proceeded with due to fear of losing them anyway.

5. Ambiguous & Flexible Legislation & Standards

Legislation and accounting standards may be specifically designed to permit non-compliance by making provisions ambiguous or flexible. Of course it is also possible
that the drafters of the legislation were not able to foresee difficulties with the provisions or lengths to which the regulated might go to avoid the legislation.

### 1. Legislation

Prime examples of ambiguous and flexible statutory provisions are the accounts, audit and related provisions in the former Companies Act (Codes) and the Corporate Law. The provisions of the Companies Act (Codes) required, inter alia, directors to have prepared for each financial year a profit and loss account and balance sheet giving a true and fair view of the company's profit or loss and state of affairs (section 269(1), (2) & (3)) and for auditors to express an opinion as to the truth and fairness of the accounts and other matters covered by section 269 (section 285(3)). The Act required compliance with the provisions of the Act, Schedule 7 (now replaced by Schedule 5) and applicable approved accounting standards (section 269(8),(8A)) unless compliance would not show a true and fair view (section 269(8B)). In other words, true and fair was a statutory over-ride in that non-compliance with both standards and the provisions of the Act was permitted if this meant the accounts provided a true and fair view.

The term "true and fair view" or similar versions such as "true and correct" and "full and fair", have a long history in terms of application to financial reports. The origin of these terms is usually taken to be the UK Joint Stock Companies Acts of 1844 and 1856. However, Chambers (1989) has traced the history to the beginning of the 18th century where similar terminology was employed in Acts governing both publicly and privately owned ventures (1989, pp2-3).

In spite of its relatively long history, the term has never been given a statutory definition. The profession's position, in general, has been that compliance with accounting standards provided evidence that accounts show a true and fair view. APS 1, Conformity with Statements of Accounting Standards, paragraph 1 states:
The National Councils believe that, if there is to be a fair presentation of an entity's financial position and performance, then accounting standards must be consistently applied in preparing financial statements. The National Councils also believe that application of the Statements of Accounting Standards is necessary for those entities whose financial statements are required by Statute or otherwise to give a "true and fair view".

A New South Wales Corporate Affairs Commission (CAC) Report in 1978 supports this interpretation by stating that non-compliance with accounting standards is prima facie evidence that accounts may not show a true and fair view. The courts, however, while declining to define true and fair have not freely accepted the profession's or the CAC's interpretation. For example, in CAC v A & T Barton (1977) ACLC 40-343, Berman SM stated:

... each case must be considered on its own merits. Proper attention must be paid to the opinions of auditors and accountants but their views are not binding. Pre-determined principles must bow to the requirements of the particular case (p29,471).

On the other hand, Berman SM cited with apparent approval another view expressed by F J O Ryan, then New South Wales Commissioner for Corporate Affairs "... there are as many 'true and fair' views as there are viewers" (p29,471).

A similar interpretation of the meaning of true and fair in UK legislation was put forward in 1983 by Hoffman and Arden. As was the case in Australia, the true and fair view concept in the UK is a statutory override (Hoffman & Arden, 1983, p154). According to Hoffman and Arden, however, non-compliance with accounting standards suggested accounts did not show a true and fair view because what was true and fair depended upon the expectations of users of financial reports. These expectations were influenced by past experience "... because by and large they will
expect to get what they ordinarily get and that in turn will depend upon the normal practices of accountants" and accounting standards "crystallise professional opinion" (1983, p155).

Earlier, Flint offered an interpretation of true and fair based on society's perceptions which in turn were influenced by perceptions of social morality and ethics (Flint, 1979, p490). True and fair was contextual in that what was useful to one group of users, for example, historical cost, may not be useful to another (p489).

These interpretations of "true and fair" are indicative of the uncertainty the term engenders. This uncertainty can be seen as a fundamental weakness in the enforcement of the accounts and audit provision of company legislation. As Bosch has observed "[t]he trouble with true and fair is that not only can we not define it but we do not always know when we are looking at an example" (1987a, p3).

Bosch and at least one other member of the NCSC have alluded to the difficulties "true and fair" presents when regulators contemplate a prosecution for non-compliance with company legislation and/or accounting standards. Henry Bosch, as chairman of the NCSC, publicly announced the Commission's intention of finding a suitable case of creative accounting and bringing legal action against the perpetrators (Bartholomeusz, 1987, p25). Such a case was found. Bosch described the company's accounts as being so creative as to be outrageous. However, on seeking legal advice, the response was very negative and the case was not pursued. Part of the problem was apparently the fact that the company auditors were one of the then Big Eight accounting firms. True and fair comes down to a matter of professional judgment and advisers indicated that it would be very difficult to first find expert witnesses who would be prepared to testify that accounts signed as "true and fair" by a member of the Big Eight did not, in fact, show a "true and fair view". Second, even if such witnesses were forthcoming, it may be difficult to prove to the court that the opinion
expressed by the NCSC witnesses were superior to those of the auditor of the accounts (Bosch, 1987a, pp18-19). The nature of this problem was identified by Salmon LJ in Odeon Associated Theatres Ltd v Jones (1971) 2 WLR 331:

... sometimes there is evidence of two parallel but conflicting principles of commercial accounting. In such cases the courts must do the best they can without evidence, or choose between the conflicting evidence, or decide which is the most appropriate principle of commercial accounting to adopt (pp336, 337).

A former member of the NCSC research staff, Ian Langfield-Smith, has also suggested that the uncertainty surrounding the interpretation of "true and fair" has led regulators, on legal advice, to institute prosecutions under the general criminal law rather than the companies legislation because of the relatively greater certainty of the outcome (1990, p25). On the other hand, as Bosch has indicated, the standard of proof under the criminal law is "beyond reasonable doubt" and when the outcome of a prosecution is likely to turn on the conflicting evidence of expert witnesses, this standard may be difficult to achieve (Bosch, 1987a, pp18-19).

This point of view is not new. In 1977, F J O Ryan used an example which had come before the New South Wales Commission for Corporate Affairs earlier that year to demonstrate the inadequacies of "true and fair". The matter concerned a company which had reported a half yearly profit of $81,247. The auditors, however, considered the appropriate accounting principles to be applied in the circumstances would have shown a loss of $1.6 million. Nonetheless, they were unable to prove to the Commission's satisfaction that the profit of $81,247 was not an honest or reasonable result (1977, p560). As noted by Ryan:
The principal point of concern is not the disparity of $1.7m between the two figures. Rather it is the fact that it arose from the absence of enforceable and universally accepted standards, so that in any given case the difference can be open-ended. This leads to the result that where a contest as to the truth and fairness of accounts can be made to turn upon a difference of opinion between directors and auditors as to the appropriate principle to be applied, a prosecution will only succeed in those cases where no reasonable man could possibly have arrived at the same figure as the directors (1977, p560).

In a bid to overcome the problems outlined above, the Corporations Legislation Amendment Bill 1991 amended the "true and fair view" requirement. In essence, the amendment requires the preparers of financial statements to comply with requirements of the Corporations Law and approved accounting standards and if it is considered that a true and fair view will not result, additional information is to be provided in the notes to the accounts (section 297(1), section 298(1) and section 299(1) respectively). The purpose of this amendment is to reduce

... the scope for some companies to use some dubious accounting treatments in reliance on the more general, and vaguer, true and fair test, rather than comply with a relevant appropriate accounting standard (Australia, 1991b, pp4214-4215).

In the inevitable debate over this amendment, it was not surprising to find that the director of the AARF, Warren McGregor, was in favour of the amendment. As the research arm of the AASB, and therefore an integral part of the standard setting machinery, the AARF would have much to gain from what amounts to the legislation of accounting standards. The corporate failures discussed in Chapter 4 indicate that practising accountants and auditors have varying viewpoints as to what are acceptable accounting methods. Some of the methods used were clearly questionable but others were supported by the ASA report on corporate failures in the 1960's (ASA, 1966). Therefore, an argument against the elimination of the true and fair view statutory override is that accountants may see part of their function being downgraded to
mechanical application of technical rules with little or at least reduced scope for the 
exercise of "professional judgment". Auditors, on the other hand, could perhaps, be 
seen to welcome the amendment as it would provide them with a defence in a legal 
action. Previously, mere compliance with accepted accounting practices was not 
sufficient to constitute a true and fair view. As Craig and Clarke have observed 
"[p]rofessionalism was traded for protection" (1993, p56, emphasis in original).

However, the true and fair concept is not the only culprit in this area of regulation as 
is clearly evident from the decision in CAC v A and T Barton (1977) ACLC 40.343. 
This case dealt with charges brought under the Securities Industry Act 1970 and 
section 176 of the Crimes Act which, inter alia, makes it an offence for any person to 
knowingly make a statement which is false or misleading in a material particular. The 
court held that a prima facie case had not been made out under section 176 because

... the difficulties and the honest differences of opinion inherent 
in the concepts of 'profit', 'true and fair', and 'ordinarily accepted 
accountancy principles'

meant

... there was not sufficient cogent evidence to establish that the profit statement was false (p129.466)

Clearly, any flexibility inherent in both accounting standards set by the profession and 
approved accounting standards promulgated by the AASB will only serve to diminish 
any gains made by the legislative attempts to overcome the difficulties posed by the 
lack of definition of true and fair. In this regard, Flint's comments regarding 
accounting standards and statutory requirements are particularly pertinent
Compliance with statutory requirements of disclosure and presentation and with accounting principles or accounting standards will not of itself ensure achievement of a true and fair view unless these requirements, principles or standards have been well conceived within the context of what are understood to be the criteria of a true and fair view.

[These requirements, principles or standards] are the means to the end and not the end itself (1978, p488).

Similar observations apply to the profession's claims to serve the public interest by developing accounting standards which will facilitate an efficient allocation of resources. Unless standards are consciously formulated to achieve this, it is unlikely they will do so except by coincidence. As the following will endeavour to show, accounting standards are flexible and have the potential to be manipulated to achieve the view desired by management.

2. Accounting Standards

The majority of accounting standards contain what Henderson calls "weasel words" which allow "accountants to wriggle out of compliance with a standard" (1988, p9). Weasel words such as "should", "beyond reasonable doubt" and "reasonable assessment" are justified by the profession on the grounds that not all companies are the same and therefore accountants must be able to use their "professional judgment" (1988, p9). Further support for this view is available from Henry Bosch. In an article in the May 1987 edition of The Chartered Accountant in Australia, Bosch is reported to have stated:

... there are too few (accounting standards) and those that there are, have too many loopholes and ... these loopholes are capitalised upon by the personal interpretation of the accountant (The Chartered Accountant in Australia, 1987, p46).

Unfortunately, the evidence provided to investigators into the collapse of Reid Murray Holdings, Cambridge Credit Corporation and Rothwells suggests some
accountants appear to use their professional judgment somewhat capriciously. While this obviously brings the profession into disrepute and creates an aura of uncertainty, it also makes it difficult for regulators to "mount a successful prosecution" (Langfield-Smith, 1990, p25).

Flexibility in accounting standards can also lead to what has been termed "creative accounting". Creative accounting allows a variety of treatments of substantially the same transaction and thereby allows management to manipulate results to suit particular purposes. It follows that creative accounting extends not only to failure to comply with accounting standards but also in their application (Clarke, 1988, p64; English, 1989, p15; Clarke and Dean, 1992, p186). The practice is clearly evident in Australia as indicated in Chapter 4. This is supported by a research report issued in 1990 by the Australian Bankers Association which sets forth the proposition that among the factors contributing to corporate failures, inadequate accounting standards and low corporate morality figured prominently (1990, p15).

As indicated above, Henry Bosch, while chairman of the NCSC, launched a campaign for eradication of creative accounting but with variable success due to the difficulties inherent in the true and fair view concept. The potential for this difficulty to arise is still present due to the scope for professional judgment in accounting standards. While it is not possible to cover the inadequacies of each and every standard, a few examples of some of the problems which flexible accounting standards can create will be given.

A prime consideration for the application of a standard to a particular item is materiality. AAS 5 Materiality in Financial Statements, provides both qualitative and quantitative guidelines to assist preparers of financial reports to determine whether or not an item is material and therefore to be included in the financial reports (paragraphs 8-12). However, it is clear that the overall criterion is professional judgment in each
circumstance. There is no approved accounting standard dealing with materiality. Instead, each AASB standard contains its own materiality provision. The potential for conflict arises because of the scope for differences of opinion as to what constitutes a material item. Secondly, and perhaps, more importantly, many standards allow for choices of accounting methods. As already indicated, this flexibility and scope for professional judgment has the potential to make it difficult for regulators to successfully argue that published accounts are misleading.

The previous AAS 20 *Foreign Currency Translation*, provides a good example. A detailed history of the foreign currency debate will be provided in the next chapter. Therefore, only a brief overview of the problems inherent in the standard will be provided here.

In its original form, AAS 20, allowed companies to either recognise foreign exchange losses immediately or to defer and amortise them possibly when the foreign currency translation rate was more favourable. This allowed for the possibility of manipulating profits and was described by Langfield-Smith as an "extremely creative" accounting technique (1987, p7). As the AWA case discussed in Chapter 4 shows, this allowed the company's foreign exchange dealer to hide losses on foreign currency transactions but report profits in the financial statements. Bosch also levelled criticism at the former AAS 20:

> Despite the existence of an accounting standard on the subject, there are considerable differences in the way in which companies are treating this matter and substantial sums are involved . . .

The effect of all this is to make the concept of profit elastic (1987a, pp5-6).

The following examples taken from actual financial reports were used to illustrate the point:
Company H . . . wrote off the bulk of its unrealized foreign currency losses of $170M. Company I appeared to ignore, for the purposes of comment, large unfavourable movements which occurred after the balance date but before the directors signed the accounts. Company J amortized both 'realized and unrealized gains and losses on long term borrowings'. Company K used the 'defer and amortize' approach recommended by the standard and proudly lists as assets deferred foreign currency losses. This is surely a perverse use of terminology (1987a, p6).

In September 1987, AASB 1012 (formerly ASRB 1012): *Foreign Currency Translation*, was introduced. AASB 1012 requires foreign exchange gains and losses to be accounted for as part of operating profit in the period in which the exchange rates change. The deferral option is no longer available except in the case of costs incurred on assets under construction (qualifying assets) and hedge transactions dealing with the purchase or sale of specific goods or services. AAS 20 was subsequently amended to conform with approved accounting standard AASB 1012. However, there is still flexibility within both standards which may allow holding companies to manipulate consolidated results. The standards prescribe two methods for the incorporation of foreign-based operations into the accounts of the holding company - the temporal method and the current rate method. Considerable differences in financial results can occur between these methods. The appropriate method depends on whether the subsidiary is a self-sustaining operation or an integrated operation. While guidelines are provided for purposes of identifying self-sustaining operations, there is scope for differences of opinion. As Langfield-Smith has stated

... the presence of foreign exchange gains and losses can only be determined once the benchmark question of integrated or self-sustaining has been answered, a test which seems to allow a considerable degree of latitude (1987, p12).
Furthermore, even if the distinction between self-sustaining and integrated operations is correctly applied, not all gains or losses resulting from foreign currency translation will be recognised in the accounts since "... the temporal method ... excludes the recognition of potentially significant foreign exchange gains and losses" (1987, p12).

Langfield-Smith identified three other areas of the standard which allows options which may provide scope for "creative" accounting or "abuse" of the relevant provisions. Briefly, these areas deal with

- **qualifying assets** whereby gains or losses associated with these assets may be used to adjust the cost of the assets;

- **hedging transactions** The standard permits the netting of gains or losses arising from 'hedging transactions'. To the extent that gains and losses on hedged transactions and hedging transactions cancel each other out, full disclosure of the impact and possible risk associated with foreign trade are not made;

- **branch or subsidiary operations** The definition of "foreign operations" implies that only those reporting entities required to prepare accounts or groups accounts would be classified as "foreign operations". Furthermore, the accounts or group accounts must be prepared in a foreign currency. If these criteria are not met, it could be argued that translation differences need not be accounted for (1987, pp12-15).

Another problem area is provided by AAS 1/AASB 1018 *Profit and Loss or Other Operating Statements* which calls for a distinction to be made between operating profit or loss including abnormal items and extraordinary gains or losses. The NCSC has found that some companies adopt a selective approach where income from the sale of capital items is included in operating profit but losses on similar items are disclosed as extraordinary (Bosch, 1987a, p4).

Given the lack of certainty surrounding the meaning of true and fair view and the flexibility inherent in accounting standards, it is not unusual to find a lack of judicial
precedent on these matters or on the accounts provisions of the Companies Act (Codes). A search of company law cases found no entries dealing with the accounts provisions, including true and fair view, of the Companies Act (Codes) 1981 and very few with the legislation's predecessor, the Uniform Companies Act 1961/62. Some eight cases between 1967 and 1982 made mention of true and fair but not necessarily within the context of the relevant accounts provisions of the legislation. One such case was the previously cited CAC v A and T Barton in which it was stated that the accepted differences of opinion within the accountancy profession made it impossible to establish whether or not a particular profit statement was misleading ((1977) ACLC 40.343 at p29,466).

In light of this decision, even from a Magistrates Court, it is not surprising that advice to members of the NCSC was to pursue prosecutions under the general criminal law rather than the Companies Legislation which relies upon the true and fair view concept. Similarly, given the evidence arising from the special investigations into Reid Murray Holdings, Cambridge Credit Corporation and Rothwells Ltd and the conclusions of the investigations that the accounts of these companies were misleading and did not give a true and fair view, it is surprising that no charges were laid under the accounts and audit provisions of the company law. On the other hand, the lack of criminal prosecutions in such cases provides evidence of the difficulties inherent in such prosecutions.

Further evidence is provided by Craig and Clarke who argue that the variations permitted in approved accounting standards give rise to a staggering number of "acceptable" permutations (1993, p59). In support of this contention, Craig and Clarke use as an example, a company which must apply twenty approved accounting standards. The example further assumes, conservatively, that each standard permits two alternative treatments of particular accounting items. On this basis, the number of acceptable accounting outcomes is 1,048,576 (pp59-60). This result is patently
inconsistent with the sentiments expressed by Vic Prosser as executive director of the Institute of Chartered Accountants in Australia:

The Accounting Standards Board of the AARF is aware of and committed to the need for a base of consistent logical and effective accounting standards to aid the standard and uniformity of financial reporting and the public understanding and use of financial statements (1983, p91).

The foregoing has attempted to identify some of the problems inherent in company regulation in Australia. The question that must now be addressed is why, after almost 100 years of company regulation of some sort, do these problems still exist? For example, "true and fair" has had an even longer life-span than company legislation but its meaning is no closer to being clarified than it was 100 years ago. Flexible accounting standards or practices have been used to distort or manipulate profits and other accounting numbers with the result that the accounting profession in Australia has been discredited since the turn of the century. Why is there flexibility and ambiguity in corporate regulation? Answers to questions such as these are difficult to find because it essentially requires knowing what the individuals involved think. The best that can be achieved is to draw inferences from actual events and try to analyse them for cause and effect relationships.

This will be the task of the balance of this chapter. In particular, an analysis of the power relationships between the regulators and the regulated will be undertaken. This analysis will draw on experiences of the accountancy profession in Australia, the UK and the USA in an effort to demonstrate how elements of dissidence and resistance can threaten hegemonic domination of the regulation of corporate reporting. Where possible, the profession's responses to such threats and the activities undertaken to maintain domination will be outlined. It will be argued that the desire to maintain domination helps explain weaknesses in regulation.
RESISTANCE, DISSIDENCE AND SYSTEM CLOSURE

Chapter 2 developed a power framework which was used in Chapter 3 to explain how the accountancy profession achieved hegemonic domination of the regulation of disclosure in external financial reports. In particular, it was suggested in Chapter 2 that the setting of accounting standards which are binding on members of the professional accounting associations and preparers of financial reports is an example of the exercise of power at the episodic agency level of the power framework. It was further stated that the episodic agency level of the power framework was characterised by resistance or dissidence which may challenge the profession's exercise of power or control of the obligatory passage points. This resistance or dissidence will be reflected in both the dispositional and facilitative power levels of the framework.

Achieving dispositional power at the level of social integration is contingent upon the formation of alliances and agency relationships. The formation of professional associations organised on the altruistic premise of ensuring that practitioners are highly educated, skilled and ethical has facilitated the profession's achievement of dispositional power. The promulgation of accounting standards that are proclaimed to be aimed at achieving an efficient allocation of resources has also been part of this process in that the profession has effectively set itself up as an agent of the public. Chapter 4 was aimed at demonstrating the profession's attempted agency relationship with the public and showing instances where members of the profession had clearly failed in serving the public interest by the publication of financial reports which did not result in an economic allocation of resources. It will be argued in this section of the study that the underlying causes of the unexpectedness of corporate failures and losses is in part attributable to dissidence and resistance to the profession's domination of the determination of appropriate accounting standards and practices.
Dissidence and resistance may arise from both endogenous and exogenous sources and can weaken alliances and agency relationships established at the level of social integration because it may result in the creation of conflict between the various elements within a system. Therefore, as the accountancy profession represents only one element within the regulatory system, it must be mindful of the possibility that the standards and practices it advocates may have an adverse impact on other elements of the system, in particular, business interests. This adverse impact may exist in fact or be simply perceived. Conflict may also arise from within the profession itself. The long drawn out battle for a Royal Charter detailed in Chapter 3 is an example of dissidence and resistance within the profession itself. This conflict may be resolved within either the social integration level of the power framework or at the level of systems integration.

The level of systems integration is the level at which facilitative power or domination is achieved or, possibly, lost because activities at this level create an institutional order or change an existing institutional order. For example, if the accountancy profession fails to "fit in" with the other elements in the regulatory system, it may be replaced by another element such as a government sponsored and controlled standard setting organisation. This is consistent with the concept of autopoiesis also developed in Chapter 2.

As discussed in Chapter 2, an autopoietic system is autonomous and is organisationally closed in that it produces its own boundaries, processes and structures and determines its own rules and laws. It is, however, cognitively open because an autopoietic system must be compatible with its environment. In addition to the need for congruence or structural coupling with its environment, there must also be compatibility between the structures within the autopoietic system. Therefore, the environment can trigger changes in it but change is determined by the system itself and is directed only towards the survival of the autopoietic system. It was argued in
Chapter 2 that accountancy is, at the very least, a virtual autopoietic system because it provides a unique function in the determination of accounting practices but there are mutual feedback loops between accountancy and other elements in the environment in which it exists.

This section of the study will identify some instances of resistance and dissidence which have challenged the profession's position in the institutional order it helped to create during the course of this century. Dissidence or resistance may be both reactive and proactive. It also may be manifested in a variety of ways such as attempts by another element in the regulatory system to encroach upon the exercise of power by an already dominant group by gaining control of obligatory passage points or threatening to do so unless the dominant group modifies the regulation it is seeking to impose. To demonstrate the forms dissidence or resistance has taken and the responses the profession has made in order to maintain its position, examples will be drawn from the experiences of the accountancy profession in Australia, the USA and the UK.

It is acknowledged that there are differences in the regulatory systems in Australia, the USA and the UK and in the relative position of the accountancy profession within each. Furthermore, some of the examples used and the outcomes of them suggest that the profession in Australia has been more successful at avoiding or combating dissidence and resistance than its USA and UK counterparts. However, it could be that as an autopoietic system, accountancy in Australia has learned how to survive. Hence, what happens in other environments may be communicated to the accountancy profession in Australia which then reacts in order to avoid or minimise conflict between itself and other elements within its own environment. Evidence was provided in Chapter 3 to support the contention that the profession in Australia was influenced by the activities of accounting professional bodies in the UK. The following chapter will provide further evidence of this and also that the experiences of
the USA profession, in particular, are relevant to the decisions of the Australian profession.

This study maintains that the profession's responses to dissidence and resistance are aimed at the survival of the accountancy profession and its dominance in the standard setting area of corporate regulation. As noted by Horngren with regard to the standard setting bodies in the USA

Survival is mankind's primary motivation. Standard-setting bodies in the private sector have had various useful lives . . . The useful life of the FASB is not going to rest on issues of technical competence. The pivotal issue will be the ability of the board to resolve conflicts among the various constituencies in a manner perceived to be acceptable to the ultimate constituent, the 800-pound gorilla in the form of the federal government, particularly the SEC . . . (1981, pp88-90).

The same comment is applicable to Australian standard setting organisations.

1. Government Interference - the formation of the ASRB

Chapter 3 traced the origins of the accountancy profession in Australia including a brief history of the standard setting process. A major barrier to the exercise by the profession of episodic agency power in the form of enforceable accounting standards was the lack of a statutory mandate. This was achieved with the establishment in 1984 of the ASRB but at the apparent expense of the profession's autonomy. As discussed in Chapter 3, the profession's preferred option was that statutory backing be given to standards developed by its research arm, the AARF. However, under pressure from the New South Wales Corporate Affairs Commission and the NCSC, the ASRB was intended to be independent of the accountancy profession. The establishment of the ASRB could be seen, therefore, as a prime example of government interference in the standard setting arena. Craig and Clarke consider that the basis of this interference was the Federal Government's desire to ensure its own
political survival. The accountancy profession was effectively made the scapegoat for corporate failures on the grounds that it was unable to develop effective self-regulatory standards (1993, p56).

As noted in Chapter 3 and earlier in this chapter, the two major professional accountancy bodies, the ASCPA and the ICAA, embarked on a series of approaches to undermine and thwart the activities of the ASRB in order to regain domination of the standard setting process. These included using the ASRB’s lack of statutory authority to determine priorities and commission the development of high priority standards for review by the Board (Walker, 1987, p272). It appears that what the profession was attempting to do was control the standard setting agenda. Controlling the agenda could be seen as almost the ability to control the standard setting process itself. As Horngren observed with regard to the FASB:

... With social choice being conducted in a multi-period setting, the agenda is important ... the power to control the agenda may be far more critical to the status and life of the FASB than the nature of the technical framework (1981, p90).

The two professional bodies also effectively delayed the approval of accounting standards by the ASRB. In June 1985, the president of the ICAA, Bruce Edwards, lamented the lack of progress of the ASRB stating

Regrettably, due to the complexity and difficulty of the issues involved, no accounting standards have been approved to date and indications are that none will be approved in time to be applicable to financial accounts for the year ending June 30, 1985 (1985, p6).

What Edwards did not do was make it clear that the complex and difficult issues were created by the two professional bodies. One of the difficult issues was copyright of accounting standards promulgated by the AARF prior to the establishment of the ASRB. The profession argued for the rights to copyright and, thereby, royalties on
sales of accounting standards approved by the ASRB (Journalist, 1985, p84; Durie, 1985, p 6; Walker, 1987, p274; 1988, p18). The Ministerial Council eventually bowed to pressure from the professional bodies. Copyright to approved standards remained the property of the ASRB but the professional bodies were given a licence to the copyright allowing them to benefit from arrangements with publishers to reproduce the standards (Durie, 1985, p6; Walker, 1987, p275; 1988, p18).

Even with this issue resolved, the ASRB's problems did not end. The professional bodies effectively prevented the ASRB approving standards by failing to offer any for consideration. The final settlement of this issue saw the introduction of what was termed "fast track" procedures which effectively meant the ASRB rubber-stamped the standards which had already been issued by the two professional bodies (Walker, 1987, p280; 1988, p18).

As noted in Chapter 3, the AARF provides the AASB's research base. In addition, in 1988, the professional associations successfully negotiated the merger of the then ASRB and the Accounting Standards Board of the AARF on the grounds that such a merger would facilitate the setting of accounting standards by having only one standard setting body instead of two (ASA & ICAA, 1993, p43). As a result, the membership of the ASRB was increased from seven to nine. The additional members were to be nominees of the professional associations. Under these arrangements, the profession nominated four out of nine members of the ASRB. The AARF would continue to provide assistance, including research, to the ASRB (p43). The profession had successfully negotiated the translation process and had regained the initiative for determining accounting standards. As Walker has claimed:

... the accounting bodies have won a victory of sorts, after a dogged (and somewhat devious) campaign to reduce government involvement in standard setting.
It seems a fair guess that the board will be dominated by the profession (1988, pp18-19).

In 1991, membership of the ASRB was increased to eleven members and renamed the Australian Accounting Standards Board (AASB). The extended membership was premised on the need to provide greater representation from user groups. Craig and Clarke argue, however, the standard setting process in Australia is still "a joint venture between the accounting bodies and the Commonwealth Government" (1993, p58).

It should be noted, however, that the threat of government interference still exists. The Australian Securities Commission Act, section 224, established the AASB and section 226 conferred certain functions and powers on it. These powers include the review of proposed accounting standards and the sponsoring and development of proposed accounting standards. The Board may also change the form and content of accounting standards. The composition of membership of the Board and its research base remains as outlined above. However, even though the accountancy profession may be seen to dominate the standard setting process, the Federal Parliament may disallow standards approved by the AASB. One example of this was AASB 1024 Consolidated Accounts that will be discussed in the next section. There is also the possibility that subsequent legislation may alter the present institutional order. Even if the Government does not make visible inroads into the standard setting process, there is evidence that it can effectively intrude into determining the content of accounting standards.

2. Government Interference - Content of Accounting Standards

(i) Inflation Accounting - The UK Experience

The inflation accounting debate in the UK is a prime example of government intervention in the standard setting process. In 1968, the ICAEW published
Accounting for Stewardship in a Period of Inflation which advocated supplementary financial statements prepared using current purchasing power (CPP) accounting. This was followed by ED 8 issued in January 1973 by the Accounting Standards Steering Committee (ASSC) also recommending CPP supplementary statements. ED 8 formed the basis of what was to have been SSAP 7. However, in July 1973, the government effectively "pulled the rug out from under the profession" by announcing its intention to appoint a committee to study the question of inflation accounting. This move was apparently totally unexpected by the profession:

... the government, which had been fully consulted about the CPP proposals whilst they were being formulated, suddenly decided to pull the rug out from under the feet of the Accounting Standards Steering Committee ... (Stamp, 1975, p411)

It is also unclear why this step was taken. According to Stamp it was because the Government had

... become alarmed at the prospect of accountants throughout the country making detailed measurements of the impact of inflation. The Government feared that this would upset their deliberately balanced prices and incomes policy ... (1977, D12)

Similarly, Whittington considers "... there was a fear of the possibly explosive consequences of indexation ... CPP can be regarded as a form of indexation" (1981, p71).

Whittington also provides evidence of "representations from industry":

... of the companies who commented on ED 8, only one-third supported CPP and the remaining two-thirds were divided between replacement cost accounting and other methods and there were indications that the Government had been lobbied by a number of companies against the introduction of a CPP standard ... (1981, p71, fn 8, cited from personal correspondence with Douglas Morpeth).
As a consequence of the announcement of what was to become known as the Sandilands Committee, SSAP 7 was issued as a "provisional" standard in May 1974 pending the report of the Government sponsored committee.

The Sandilands Committee issued its report in 1975 and rejected CPP in favour of current cost accounting (CCA) based on Bonbright's concept of value to the owner. The report also recommended the establishment, by the Accounting Standards Committee (ASC, formerly the ASSC), of a Steering Group to implement the findings of the Sandilands Committee by 24 December 1977 (Morpeth, 1981, p46). The Inflation Accounting Steering Group, under the chairmanship of Douglas Morpeth, was subsequently formed and began work in January 1976. The profession was thereby effectively forced to abandon its preferred CPP accounting and develop an inflation accounting standard based on CCA. As Morpeth notes:

The Steering Group and the ASC were thus being asked to implement a government-sponsored committee report for the introduction of a new method of accounting to replace historical cost accounting within an extremely short time span and in the context that the ASC had few teeth with which to enforce standards. The initiative had been returned to the profession with a vengeance, but with express limitations on the choice of method (1981, p48).

The profession accepted the situation because in Slimming's view it was keen to introduce some form of inflation accounting and therefore: "[w]e were prepared to accept less than the whole loaf in order to get something" (1981, p22).

In other words, the profession was prepared to compromise in order to maintain its position in the standard setting area.
This compromise led to the issue of SSAP 16 in March 1980, some 2 years later than envisaged by the Sandilands Committee. However, it appears that the Committee did not envisage the extent of the profession's resistance to CCA.

SSAP 16 was preceded by two exposure drafts, ED 18 and ED 24. ED 18 was issued in December 1976 but was rejected on the grounds, inter alia, that it was too permissive and

... bringing with it considerable subjectivity and discretion to directors of a company in the calculation and assessment of what should be distributable profit and what should be set aside to reserve for the maintenance of the business (Morpeth, 1981, p51).

It was also criticised because it was "... too complicated, too quick and too costly to implement" (Morpeth, 1981, p52).

The death knell of ED 18 was a special meeting of the ICAEW which, by vote of the membership, rejected the introduction of any form of compulsory current cost accounting (Myddleton, 1981, p91).

ED 24 was issued in April 1979. It was apparently considered more acceptable than ED 18 to all parties concerned and was subsequently re-issued with little alteration as SSAP 16 in March 1980 (Morpeth, 1981, pp57-59).

This, however, was not the end of the story. SSAP 16 was, in Whittington's terms, "an awkward compromise" between two extreme views of inflation accounting, CCA and CPP. Nonetheless, Whittington, and no doubt others including the ASC, thought that inflation accounting was permanently ensconced in UK accounting standards. The Inflation Accounting Steering Group was disbanded following the issue of SSAP 16 (Morpeth, 1981, p59). Whittington considered that
The introduction of current value into accounting statements represents a considerable revolution in accounting practice, and, once this is accomplished, it seems unlikely that it will be reversed (1981, p80).

This prophecy proved to be invalid. SSAP 16 was originally introduced on a trial basis for three years. During this time, there was substantial non-compliance with it. The fact that the ASC had no powers of enforcement and that the Stock Exchange failed to impose sanctions on those who failed to comply with SSAP 16, would appear to have facilitated its demise. Auditors eventually declined to qualify their reports for non-compliance. In the face of resistance of this nature, work on improving SSAP 16 was dropped. SSAP 16 remained in force until March 1985 when it was made non-mandatory (Taylor and Turley, 1986, p87).

(ii) The Profession, The Government & Business - The USA Experience

In the USA, the Accounting Principles Board (APB), had similar experiences with the investment tax credit and accounting for business combinations and goodwill. These experiences provide prime examples of proactive resistance and of the influence of lobby groups on the government which, in turn, can prevent the exercise of episodic power.

In 1962, legislation was passed in the USA which allowed companies purchasing new depreciable assets, other than buildings, to reduce their income tax liability by up to 7 per cent of the purchase price of the asset in the year the asset was commissioned. The objective of the investment tax credit was to provide an incentive to business to purchase assets other than buildings. Three methods of accounting for the tax savings were identified. Firstly, it could be taken into account in the year the benefit was received. This was known as the "flow through" method. Alternatively, the "deferral" method whereby the credit was spread over the useful life of the asset could
be used. A third alternative was the "cost reduction" method whereby the cost of the asset was reduced by an amount equal to the amount of the tax saving. The APB opted for a combination of the "cost reduction" and "deferral" methods which was consistent with the practice of spreading benefits over the useful life of assets and issued an exposure draft to this effect in November 1962. The Board's position attracted considerable debate and in Zeff's view was probably the first time that "... a controversial issue was coloured by public-policy" (1971, p179). By the time of its meeting to make a final decision in December, the Board had received some 594 letters more or less equally divided on the issue (1971, p179). Corporate management, four of the Big Eight and the SEC were either directly opposed to the cost reduction and deferral method or considered the "flowthrough" method to be equally acceptable. In a letter to the APB, the SEC stated:

that any release published at this time should recognize the propriety of the [flow-through] method of accounting for the credit. This Commission would prefer this method but would not, in appropriate circumstances, take exception to the position taken in the Board's exposure draft as it relates to the determination of income (cited by Zeff, 1971, p179)

In spite of this, the Board maintained its stand and issued APB Opinion No 2 which prescribed the "deferral method". Three of the Big Eight firms, Price Waterhouse, Haskins & Sells and Ernst & Ernst promptly made it clear that they would not require their clients to adopt the deferral method (1971, p180). Business also successfully lobbied the SEC which in 1963 issued ASR 96 allowing either the deferral method or the flow through method of accounting for the investment tax credit on the grounds that both had "substantial authoritative support" (1971, p180). This was an attempt by the Board to exercise episodic agency power by narrowing areas of difference and take the lead in thinking on unsettled and controversial issues. The actions of the SEC in releasing ASR 96 effectively thwarted the APB in its endeavours and forced it
to abandon its position. In 1965, the APB issued APB Opinion No 4 which allowed all three accounting methods.

When the investment tax credit was again introduced in the 1970's, the APB was effectively precluded from issuing a standard dealing with accounting for the tax savings by Congress. Under the 1971 Revenue Act, a particular method of accounting for the tax saving on the investment tax credit could not be enforced. According to Miller and Redding this action by Congress was the result of lobbying by business interests (1988, p98). Even though the investment tax credit has lapsed, the provisions of the Revenue Act will continue to prevent the issue of an effective accounting standard dealing with the tax saving.

The long drawn out debate over the appropriate accounting treatment of business combinations provides another example of resistance to the power of the profession to determine appropriate accounting treatment of specific issues. This has been described as "the most time-consuming and extensively discussed problem the APB faced" (Wolk, Francis and Tearney, 1989, p64). The controversy spanned some eight years, from 1963 to 1971, and resulted in a less than satisfactory compromise and was significant in the decision to institute a review of the process of setting accounting principles and the subsequent demise of the APB.

Briloff describes the 1960's as the "Decade of the Twin Congs". The Viet Cong being one and conglomerates the other. The handling of both causing dissension among different factions in the community (1972, p59). The debate on accounting for business combinations centred on pooling of interests as opposed to treating the transaction as a purchase and amortising any goodwill arising. Pooling of interests was apparently preferred by many companies because it allowed them to artificially inflate their earnings (p65).
The controversy began in 1963 with the publication of ARS 5, *A Critical Study of Accounting for Business Combinations* in which the author concluded that the pooling of interest method should not be followed. Furthermore, goodwill could be divided into two parts, one to be amortised and the other to be carried forward indefinitely. This conclusion was contrary to existing accounting practice. In 1968, to add to the confusion, ARS 10 *Accounting for Goodwill* was published which contended that goodwill was not an asset and should be deducted from shareholders' equity. These particular accounting problems generated considerable interest not only from members of the profession and affected corporations but also the financial press, the SEC, the Federal Trade Commission and the Federal Government as evidenced by the interest of "at least three Congressional committees" (Zeff, 1971, p213). The debate highlights the very political nature of determining accounting principles and serves to emphasise the impact of this on the eventual survival of bodies formed for this purpose. This point was readily apparent in an address by AICPA Vice President, Leonard Savoie in 1969:

> The Accounting Principles Board was born in crisis and has been continually beset by crises . . . the prospects for Board progress in the 1970s will be greatly influenced by its response to a current crisis. This one involves accounting for business combinations and goodwill (cited by Briloff, 1972, p89).

Savoie let it be known that the Board was considering the issue and expected a draft to be issued which would abolish the pooling of interests method and prescribe the amortisation of goodwill. He further stated:

> . . . Anything less than this solution will mean simply a "repositioning" of the abuses which have become so rampant in recent years.

> . . . If this solution is not reached, then I predict little progress for the profession in the development of accounting principles in the 1970s (cited by Briloff, 1972, p89).
As subsequent events showed, Savoie's prophecy about the future progress of the profession was correct in so far as the APB was concerned. As indicated by Savoie, the APB issued its first draft Opinion under which the pooling of interests method was to be eliminated and goodwill amortised over a maximum of 40 years. Two of the Big Eight voiced their opposition to the draft outright. The Federal Trade Commission agreed with the elimination of the pooling of interests method but not the amortisation of goodwill. In its view, "... the establishment of goodwill accounts should be discouraged" (Zeff, 1971, p214). In 1970, the APB issued yet another draft Opinion allowing the pooling of interests method to be used in some circumstances but still requiring the amortisation of goodwill over not longer than 40 years. The Board was still unable to get the required two-thirds majority to issue a final Opinion. Eventually, the APB came up with a compromise solution. Two separate Opinions were issued. Opinion No 16 dealt with Business Combinations and Opinion No 17 dealing with Intangible Assets. This politicised solution was required because, according to Briloff, the Board needed the vote of one of the larger firms which was prepared to accept the Business Combination Opinion but not the goodwill issue (1972, p89).

These examples indicate that in order to maintain episodic agency power it is necessary to repeat some of the stages of translation so that it is clearly an on-going process. It also demonstrates that the profession may be forced to accept a situation that it does not consider optimal accounting practice in order to maintain its position of dominance in the standard setting process. As Gerboth has noted:

The defeats [of the APB] arose ... from conflicts with other powerful interests, who acted to ensure that they had strong voices in formulating accounting rules of consequence to them (1973, p284).
The APB did not survive the 1970's. Following the debacles of the investment tax credit and business combinations and the criticism it attracted over its research studies, the Board avoided controversial issues and, during its last five years, did not undertake any new research studies (Moonitz, 1974, pp27-28). It was replaced by the FASB as the profession again instituted the phases of the translation process in a bid to maintain its position. The replacement of the APB with the FASB is an example of bifurcation. Accountancy could not resolve or overcome the elements of resistance and dissidence that were threatening its domination so a new organisation was created.

(iii) The Australian Experience

The profession in Australia has not, to date, suffered affronts of this significance to its domination of the standard setting process. The closest it has come would be the furore surrounding the issue of SAC 4: Definition and Recognition of the Elements of Financial Statements. This matter will be discussed in more detail in the context of conceptual framework projects. Another example which demonstrates the potential for government interference in the standard setting process is AASB 1024 Consolidated Accounts.

AASB 1024 was the first Australian accounting standard dealing with consolidation. When it was issued in December 1990, it was not gazetted. In other words, it did not have statutory backing. The reason for this being that the definitions of subsidiary, group of companies and group accounts in the corporations legislation of the time were inconsistent with the thrust of AASB 1024. For example, section 266 of the Companies Code permitted a choice in the form of group accounts which could be a set of consolidated accounts for the entire group, two or more sets of consolidated accounts for particular members of the group, separate accounts for each company within the group or a combination of consolidated accounts and individual accounts. In addition, there were two approaches to the determination of a holding
company/subsidiary relationship  These were based on either ownership or control. Control was premised on the ability of the holding company to control the board of directors or more than half of the voting power of the subsidiary. Ownership was determined by reference to the issued capital. One company was considered to be the subsidiary of another where more than half of the issued share capital was held except where ownership rights did not extend to a right to participate in a distribution of capital or profits beyond a specified amount.

The solution was determined in favour of the profession's preferred position. The Corporations Law was amended so that definitions in relevant accounting standards apply also to provisions of the Act dealing with consolidated accounts (section 294A (3)). The provisions of accounting standards in terms of one entity's ability to control another also apply for purposes of the Act (section 294B(3)). Finally, the Act has been further amended to be consistent with the standard in terms of what constitutes an entity. Section 294 A (4) specifies that an entity is

(a) a company
(b) a recognised company
(c) any other corporation
(d) a partnership
(e) an unincorporated body
(f) a person in a capacity as trustee that has only one trustee

The logic of changing the law to be consistent with the standard is readily apparent from cases such as Cambridge Credit where, as discussed in Chapter 4, the accounts were successfully manipulated for years by the failure to recognise the relationship between the parties to transactions. Hence, even though many of the companies within the Hutcheson Conglomerate were controlled by and financially dependent on Cambridge, their accounts were not consolidated with those of Cambridge because the view taken by management was that consolidation was only necessary where more than 50 per cent of voting shares were held. In addition, share ownership was
manipulated by the use of nominee rather than beneficial ownership and the back-dating of joint-ownership agreements (New South Wales, 1979, p22, 2.10).

The amendments to the legislation were clearly based on a recognition that some companies were using the flexibility in the corporations law to manipulate accounts by not including trusts and partnerships in the preparation of group accounts. Group accounts, even if prepared for all related parties, did not reveal the extent of intra-group transactions (Australia, 1991a, p2414; b, p3509). Hartnell claimed before the Joint Committee on Corporations and Securities in 1992, that intracorporate transactions were a major factor in the corporate failures of the 1980's (1992c, pp15-16). It could be argued, therefore, that the government's response was not so much because the profession possessed superior knowledge or skill but because the evidence arising from investigation into corporate failures indicated the validity of the profession's stance.

The subject of equity accounting, however, was not resolved in the profession's favour. AAS 14 *Equity Method of Accounting*, was originally issued by the two professional bodies in July 1983. In its original form, it required equity accounting to be applied in the preparation of the consolidated accounts of holding companies or the financial statements of other companies. However, the NCSC ruled that equity accounting did not comply with the provisions of the Companies legislation and that it was not to be included in group accounts other than as supplementary information (NCSC, 1987, pp23-24). AAS 14 was subsequently amended to require supplementary disclosure as prescribed by the NCSC (AAS 14, paragraph 4; Appendix 1). AASB 1016 *Disclosure of Information about Investments in Associated Companies* similarly requires the disclosure, in the notes to the accounts, of financial information about investments in associated companies. This information is to be prepared using the equity method of accounting (AASB 1016, paragraph .03, Statement of Purpose).
3. Conceptual Framework Projects

The above provide examples of government interference in the setting of accounting standards often at the behest of business interests. These examples also demonstrate dissidence and resistance within the profession. In the face of interference, dissidence and resistance or its threat, the profession has endeavoured to develop a theoretical core or conceptual framework. Such endeavours can be seen as serving two related purposes. The first of these purposes is as a defence against interference:

... a coherent theoretical base on which to erect accounting standards is an essential weapon in the armoury that can defend accounting from political interference. It may not give complete protection; but it may ward off some attacks and lessen the damage done by others (Solomons, 1983, p112).

The second purpose can be seen as an effort to legitimise the profession's dominance of the standard setting process. For example, in December 1976, the FASB released a Discussion Memorandum Conceptual Framework for Financial Accounting and Reporting Elements of Financial Statements and Their Measurement in which the need for a conceptual framework and its purpose were stated:

Perhaps because accounting in general and financial statements in particular exude an aura of precision and exactitude, many persons are astonished to learn that a conceptual framework for financial accounting and reporting has not been articulated authoritatively...
. . . (FASB, 1976, Preface to Discussion Memorandum)

The purpose of a conceptual framework as indicated in the two preceding quotes is similar to Goldstein's perception of a profession referred to in Chapter 2. Professionalism implies the existence of an "intellectual core" which facilitates the monopolisation of a particular area of knowledge as well as the maintenance of the
"prestigious social niche" a professional group has created for itself (Goldstein, 1984, p175).

While perhaps not so explicit, the Australian profession have also recognised the defensive and legitimising benefits of a conceptual framework. For example, ASRB Release 100 states, inter alia:

The Board is of the view that its decision-making during the development of Approved Accounting Standards would be enhanced by the application of an agreed framework of broad accounting concepts, and that the promulgation of such a conceptual framework would be of assistance to preparers and auditors in accounting for those transactions and events which are not the subject of particular Standards.

The conceptual framework will comprise a series of Statements of Accounting Concepts... The Concepts Statements will set out the general concepts which should be followed in the preparation and presentation of general purpose financial reports. They will define the nature, subject, purpose and broad content of general purpose financial reporting. The Concepts Statements will assist constituents in understanding the broad concepts which govern the decisions of the Board reflected in proposed Approved Accounting Standards (ASRB Release 100, paragraphs 8 and 9).

(i) The USA Experience

The need for a conceptual framework, a theory of accounting or a set of agreed accounting practices has been recognised from as early as the 1930's. As noted in Chapter 3, the first efforts were those of the accountancy profession in the USA and included principles studies by American Accountancy Association (AAA) in 1936 and by the American Institute of Certified Public Accountants (AICPA) in 1938 and a study of accounting standards by Paton and Littleton in 1940. The major purpose of these studies was to describe existing practice rather than prescribe accounting practice. An attempt to formulate a prescriptive framework was not made until the efforts of the APB in the 1960's.
During its lifetime, the APB sponsored a number of research projects but priority was given to studies of basic postulates and broad principles of accounting. Most of them did not gain wide acceptance and four attracted substantial criticism.

The first of these studies, *The Basic Postulates of Accounting*, was undertaken in 1961 by Maurice Moonitz, the then Director of Accounting Research. It was divided into three sections: the postulates, the field of accounting and the imperatives. There was little response to the study at all which could be construed as indirect support. However, as the author has stated, the APB and the profession in general "were clearly waiting for the research study on 'principles' which appeared in 1962" (Moonitz, 1974, p18). In addition, as Zeff explains:

... a study of this sort had few precedents in the accounting literature ... many readers, not to exclude the Board, did not know quite what to make of it. Seldom had accountants formalized their conceptual schemata in terms of postulates, whether or not rigorously derived (1971, p174).

The "principles" study, Accounting Research Study No 3, received a somewhat different reception. It apparently was too far ahead of its time in that it implied that merchandise inventories, plant and equipment should be disclosed in financial statements at current values and accounts payable and receivable should be disclosed at present values. At this point in time, the profession obviously was not prepared to accept change even though the Special Committee responsible for the formation of the APB had implied the need for such change by specifying that the written expression of generally accepted accounting principles should be "more than a survey of existing practices" (cited by Moonitz, 1974, p17). The study was rejected by the APB even before it was circulated. APB Statement No 1, which appeared as part of ARS 3 made the APB's view quite clear:
The Board believes, however, that while these studies [ie., the first and third research studies] are a valuable contribution to accounting thinking, they are too radically different from present generally accepted accounting principles for acceptance at this time (cited by Moonitz, 1974, p18).

Moonitz, who was co-author of the third study, expressed the view some years later that the Board had, by its action, made it impossible for its members to use the studies even in those areas which were in line with accounting practice (1974, p18). While recognising that it was difficult to be objective about Studies 1 and 3, Moonitz felt the APB should not have rejected them out of hand. Rather [t]he studies should have been left to circulate for a time, such as a year, to see if they floated or sank (1974, p19).

Chambers provided a detailed critique of technical aspects of both the postulates and principles studies (1964). With regard to the Postulates Study, Chambers considered the number of postulates too small with the result that there were a number of "unspecified" postulates underlying the 14 statements presented as postulates:

> The things which are represented in accounting statements and the ways in which they are represented are varied and complex. Measurement, communication and interpretation, preliminary to action, are all complex, and not self-evident or self-descriptive operations. The technical names given to events and objects are numerous and require to be defined within the system they are to serve. For all these reasons it seems improbable that the number of postulates (including definitional postulates) will be small.

> . . . It will be apparent that the "postulates" are really complex statements presuming a series of more fundamental statements which are not given (1964, p42).

The "postulates" were also shown not to meet the criteria of the nature of postulates:
... we are given no indication of the implications of the postulates presented in the Study. The postulates singly or in various combinations may be expected to yield a variety of conclusions...

There is no comparable demonstration in the Postulates or Principles Studies (1964, p43).

The Principles Study was criticised on various grounds including the failure to provide an analysis of the needs of users of accounting statements even though the principles were said to be designed to address these needs. The Study was also criticised for its vagueness and lack of relationship with the Postulates Study:

The study purports to rest on the Basic Postulates... However the references to the Basic Postulates are so few as to be negligible, and there is no demonstration of the manner in which the principles are derived from the postulates (1964, p44).

At a more general level, Chambers saw the studies as a compromise (1964, p53). This is consistent with the view that in order to achieve agreement, it is often necessary to accept "second best" solutions. However, as Chambers has stated, this should not have been the purpose of the studies:

Compromise is essentially a political action, by which conflicting views are sought to be reconciled. The pursuit of knowledge is an entirely different operation. At the level of inquiry one does not want to reconcile conflicting views; one wants to find a way of understanding things. Conflicting and contradictory views may be held by others about those things, but this should not cloud or divert the attention of the searcher. The end of inquiry is explanation, not compromise (1964, p53).

The next attempt to formulate a statement of generally accepted principles was that by Paul Grady in 1965. Accounting Research Study No 7, Inventory of Generally Accepted Accounting Principles for Business Enterprises was one of the longest and most highly demanded studies undertaken. It does not appear, however, to be what the APB was looking for. In fact, it was more like what they said was not wanted, "a survey of existing practice". More than half of it was made up of "reproductions of

A subsequent Special Committee on Opinions of the Accounting Principles Board called it "... a giant step forward ... a comprehensive statement of the accounting principles which appear to be generally accepted" (cited by Moonitz, 1974, p21).

Although Study No 7 did not attract the same storm of protest as Studies 1 and 3, it was, nonetheless, accorded the same treatment by the APB - it was not adopted.

The next, and final, attempt by the APB to fulfil its charge to develop a statement of generally accepted principles underlying financial statements was APB Statement No 4. This statement was the result of a recommendation of the Special Committee of the AICPA. The Special Committee on Opinions of the Accounting Principles was appointed in 1964 to determine the authority of Board pronouncements and a means of ensuring compliance with them. Its recommendations included

At the earliest possible time, the Board should:

(a) Set forth its view as to the purpose and limitations of published financial statements and of the independent auditor's attest function.

(b) Enumerate and describe the basic concepts to which accounting principles should be oriented.

(c) State the accounting principles to which practices and procedures should conform (Report to the Council of the American Institute of CPA's, as cited by Moonitz, 1974, p21).
The Committee on the Fundamentals of Financial Accounting was appointed and, largely using Paul Grady's 'Inventory' as a base, produced APB Statement No 4 five years later.

Moonitz described the statement as "...a reasonably good research study ..." (p22). Other members of the profession were not so complimentary:

This is a masterpiece in double talk on accounting. No document could be issued that would more aptly qualify for the recent title of a magazine article relating to the effort to improve accounting - "Words, Words, Words". This Statement is a 30,000 word document that can be read only with difficulty and determination. It is full of meaningless statements, obvious elementary observations, or plain misleading statements (Address delivered by Leonard Spacek to the Conference Institute, November 19, 1970, "The Significance of Recent and Pending Opinions of the Accounting Principles Board", p16 as cited by Briloff, 1972, p34).

Although indirect, the most telling criticism of all, from the APB's point of view, is the decision to issue the study as a Statement rather than an Opinion. As such "... it is binding on no one for any purpose whatsoever ..." (Moonitz, 1974, p22).

The failure of the APB to produce the profession's long sought after theoretical core and its experiences with the investment tax credit and business combinations saw it replaced by the FASB in 1973.

The FASB continued the search for a theoretical core which it dubbed a "conceptual framework" and described as

A conceptual framework is a constitution, a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function, and limits of financial accounting . . . (FASB 1976, Preface to Discussion Memorandum).
To date, six Statements of Financial Accounting Concepts (SFAC'S 1-6) have been issued:

SFAC 1: *Objectives of Financial Reporting by Business Enterprises*
SFAC 2: *Qualitative Characteristics of Accounting Information*
SFAC 3: *Elements of Financial Statements of Business Enterprises*
SFAC 4: *Objectives of Reporting by Non-Business Organizations*
SFAC 5: *Recognition and Measurement in Financial Statements of Business Enterprises*
SFAC 6: *Elements of Financial Statements*

Unfortunately, it appears that the goal of developing a conceptual framework will not be achieved. The conceptual framework developed to date has been criticised on the grounds that it is internally inconsistent (Agrawal, 1987, p169), riddled with compromise and inconclusive (Miller, 1985, p51). A major problem appears to be an apparent lack of agreement or dissidence within the profession, particularly amongst the members of the FASB involved in the recognition and measurement phase of the conceptual framework project. The debate devolved to historical cost versus some form of inflation accounting (Miller & Redding, 1988, p117-119). As in the UK and Australia, no progress was made on the matter. SFAC 5 does no more than describe existing practice without providing any guidelines for which should be used or when alternatives might be adopted (Miller, 1985, p51; Agrawal, 1987, p168).

SFAC 5 was the last scheduled document in the FASB's conceptual framework (FASB Status Report, December 31, 1984, p2). SFAC 6 was essentially a modification and reissue of SFAC 3 and really did not cover any new ground. The Board has not officially closed the project so the door is still open for further work to be undertaken. It appears that, as in the UK, the question of measurement in financial statements of business enterprises, is a divisive issue not only within the profession but for government and the business community. As will be discussed later, the profession in Australia has yet to address this issue in its conceptual framework project. Its own experience in gaining acceptance of research and inflation accounting can be seen as a reason for avoiding the measurement issue.
In 1977, Taylor stated:

The profession identified the central financial accounting problem as "the need to narrow the areas of inconsistency in financial statement reporting practices" as early as the 1930's and the solution is still being sought today. Various approaches to accounting theory have emerged over the years, but none have gained deliberate widespread adoption because consensus within the profession as to the appropriate approach has never been reached (1977a, pp19-20).

Taylor then went on to examine some of the different approaches to the development of accounting theory including the inductive, deductive and objectives approaches. An extension of the objectives approach, the objectives-standards approach was used by Kenley and Staubus in a study of objectives of accounting undertaken on behalf of the Accounting Research Foundation. Taylor criticised the study on the ground that it appeared to be "two separate, unrelated studies" (1977a, p21). The primary objective of financial reporting was "disclosure of all information necessary to provide a true and fair view". However, the "true and fair view" concept was then rejected as "unrealistic" and "impracticable" and replaced with the objective to provide information useful in decision-making but no elaboration of the type of decision or for what purpose was made (1977a, p21). The study was never applied in the formulation of accounting standards.

(ii) The Australian Experience

(a) Measurement Models

A similar fate befell the Accounting Standards Review Committee under the chairmanship of Professor Ray Chambers. The Committee was appointed in November 1977 by the New South Wales Government to undertake a study of Australian accounting standards. The effect of its recommendations was to reject all
existing standards and those then under consideration and replace them with standards based on current cost accounting using exit prices. In other words, standards should be based on Chambers' inflation accounting model, Continuously Contemporary Accounting or CoCoA. In the introduction of an article highly critical of both the Report and of CoCoA, Booth and Lyons stated:

It is perhaps unique in the field of accounting, where procrastination is almost a revered principle, that this Committee was able to absorb, reflect upon and reject current accounting standards and exposure drafts; to carry out or examine the empirical research aimed at determining the needs of users of reports; to determine the function of accounting reports in relation to these users; to gain a succinct appreciation of the intention of the legislature as expressed in the Companies Act; to state a precise definition of "true and fair" and to suggest a general accounting standard in respect of both companies and groups of companies - all within a period of six months and without any differences in opinion (1979, p15).

Their conclusion was equally biting:

If the Attorney-General in New South Wales wishes to make a serious attempt to improve the standards of corporate reporting in the State, any committee entrusted with the responsibility of reviewing the current situation and of recommending changes in current legislative and professional requirements should at least represent the major parties with interests that are affected by corporate reports (1979, p21).

In response to such criticism, it is possible to say that there is also no evidence to suggest that a committee drawn from interested parties will achieve a workable solution. In fact, the evidence would contradict this. While not given in rebuttal of the above comments, Chambers' views regarding the work of committees is relevant:

A committee is unable, by its nature, freely to engage and disengage from its immediate attention particular clusters of ideas in the search for worthwhile conclusions. . .
... a committee has not one mind. It has many minds. . . each member will have his own set of ideas in the back of his mind, waiting to be drawn upon, and each will tend to value his own ideas differently from those of other members. . . Committees . . . tend to brush aside evidence; or, when evidence is adduced, each member can be depended upon to meet specific evidence with specific counter-evidence since each member is concerned more with the impact of his own specific experience on himself than with the general import of his experience and the experience of others (1976, pp5-6).

Chambers' committee comprised three people with similar backgrounds which may account for the speed with which it produced its report. Chambers also had vast accounting experience and knowledge of accounting theory. It could also be said that committees, the membership of which is intended to represent a cross-section of views, will face the obstacles to agreement outlined above and the following:

... there is no evidence to the effect that any of these gestures of co-operation for collaboration have brought the different groups closer to the clarification, rationalization or integration of accounting principles (p9)

As has been suggested already, the outcome of co-operation and collaboration has often been compromise which should not be the end result of enquiry (Chambers, 1964, p53).

Chambers' study was not Australia's only excursion into the inflation accounting debate. The editorial notes appearing in the Guidance Notes on Statement of Accounting Practice SAP 1 Current Cost Accounting provide a listing of investigations and studies which clearly indicates an extensive Australian interest in the area of accounting for changing price levels. Some six bulletins, papers or theory monographs issued by the Society or the AARF between 1968 and 1985 are listed. A series of exposure drafts is also listed beginning with "Preliminary Exposure Draft" ED 7 Accounting for Changes in the Purchasing Power of Money in 1974 and

It is apparent from the title of the 1974 ED 7 and that of SAP 1 that there was a change in the preferred method of accounting for inflation from current purchasing power to current cost accounting. According to the editorial note to SAP 1, this change in stance was as a result of responses to ED 7. In June 1975, ED 9 A *Method of Current Value Accounting* was issued. It may be coincidence, but the timing of the issue of ED 7 and its replacement with ED 9, is consistent with the release and subsequent withdrawal of the proposed UK statement prescribing current purchasing power.

Apart from amendments to pagination, page numbers and the introduction in 1989, there have been no significant changes to SAP 1. There has been no apparent move to give SAP 1 standard status and its application remains optional. An introductory note to SAP 1 states:

> To advance the adoption of improved accounting methods to cope with the effect of changing prices, the accounting bodies strongly recommend that, from the date of issuance of this Statement, all entities publish CCA financial statements on a basis supplementary to conventional financial statements (Institute of Chartered Accountants in Australia and Australian Society of Certified Practising Accountants, 1989).

The question of the acceptability of SAP 1 is clearly evident in that it has not been included in the Australian conceptual framework. In fact, the issue of measurement has, to date, been skirted. This is clearly evident in early statements by the ASRB dealing with the criteria for evaluating accounting standards and the assumptions underlying those criteria and the failure of the AARF to publish the research monograph dealing with measurement.
In 1985, the ASRB issued Release 100: *Criteria for the Evaluation of Accounting Standards*. This statement included nine assumptions underlying these criteria. A tenth assumption was added with the issue of ASRB Release 101: *Evaluation of Accounting Standards - Assumption 10: Application of Measurement Procedures*. In Release 101, the Board recognised the contentious nature of measurement and valuation procedures and stated that it did not intend attempting to deal with the issue at that time (paragraph 7). Instead, the Board expressed the view that the valuation process was not an end in itself but was directed towards providing useful information to users of financial statements. The appropriate method of valuation could vary depending on the particular organisation, its market setting at a given time and the decisions faced by users or potential users of the financial statements (paragraph 6). The tenth assumption set forth in Release 101 did not prescribe any particular measurement or valuation method. It simply stated that valuation methods should be applied to individual assets and liabilities as opposed to overall groupings of items and that such methods were not aimed at valuing the business (or businesses) carried on by the entity (paragraphs 10 and 11).

This result is not surprising given some of the submissions received by both the ASRB and the AARF. The conflicting views expressed make it clear that the issue of current cost or value accounting is as contentious here as in the USA and the UK. One submission to the ASRB considered the present modified historical cost based system to be inadequate for "informed decision making". Another expressed the view that current cost accounting had the potential to provide misinformation and confusion and should have a low priority unless it was to be adopted for taxation purposes. In a submission to the AARF on recognition criteria, opposition to accounting for assets based on "valuations" was expressed as it represented a "significant change". Therefore, the matter should be subjected to extensive discussion.
The approach adopted by the AARF in developing its concepts statements has been to initially sponsor the publication of a monograph on the topic of a proposed concept statement. This procedure was followed with the AARF's measurement project. However, it appears that there is some area of contention in the monograph, *Measurement in Accounting*. The author has stated that the AARF was so impressed with it, they failed to publish it (Warrell, 1989).

To date, no further progress on the measurement aspect of the conceptual framework has been reported by the AARF. This may be because the framework itself provides a further example of dissidence within the profession.

(a) The Australian Conceptual Framework

In February 1984, the newly created ASRB issued Release 400 which gave rise to the initial version of Release 100: *Criteria for the Evaluation of Accounting Standards*. Release 400 called for submissions, amongst other things, for suggestions in relation to the development of a conceptual framework.

The number of submissions received was not large but was in excess of 50 and ranged from the very brief to detailed opinions.

In general, support was expressed for the idea of a conceptual framework although, as in the USA in the 1930's and 40's, many considered that such a project would be time consuming and the review and approval of standards should not be delayed. Therefore, suggestions were also made that either the Board adopt the FASB's conceptual framework when completed or support the project then being undertaken by the AARF. Concern was also expressed about the cost and potential benefits of such a project in light of the lack of support the FASB's efforts were receiving.
Comments were also made about the appropriate basis of such a framework. For example, one submission suggested that a "decision-oriented" framework such as the FASB's was like chasing moonbeams because "it will never achieve a set of defensible boundaries within which operational definitions can be usefully framed". In retrospect, this view could well be valid given that the FASB has been unable to gain acceptance of its conceptual framework. If the basis of the conceptual framework is not accepted or is defective in some way, then this will flow through the rest of the project. As will be discussed shortly, it has also been suggested that the AARF's conceptual framework, which is also based on decision-usefulness, has been criticised for being based on too broad an objective.

The political nature of standard setting and the development of a conceptual framework were also identified. One submission agreed with the need for a conceptual framework to simplify standard setting and help ensure that standards were logical and consistent both within themselves and as a group. However, if an agreed conceptual framework could be developed, it would no longer be needed because "...the major arguments would be over, the battles would be won or lost".

This could well be the reason why agreement on a conceptual framework is so difficult to achieve because it could mean there may no longer be a need for an accountancy profession. An autopoietic system survives by conversation and communication. If agreement on a conceptual framework could be achieved, conversation and communication in accounting would no longer be necessary. Survival of accountancy could, therefore, be seen to be contingent on the balance of the above quote.

This may be acceptable if there were just two groups of contestants, each quite sure of the issues. Instead we have more like 22 ill-defined groups of contestants, many of whom do not understand full where the battle is, let alone what it is really about.
Apart from a partial conceptual framework issued as part of Release 100, the ASRB has not developed a conceptual framework. Part of the explanation for this could be that the ASRB was not given its own research facilities. The AARF provided its research base. Therefore, it is logical that the conceptual framework of the AARF has continued rather than an ASRB project.

To date the AARF's conceptual framework consists of a series of Statements of Accounting Concepts (SACs): SAC 1 *Definition of the Reporting Entity*, SAC 2 *Objective of General Purpose Financial Reporting*, SAC 3 *Qualitative Characteristics of Financial Information* and SAC 4 *Definition and Recognition of the Elements of Financial Statements*. These SACs originated from a series of exposure drafts dealing with the objectives of financial reporting (ED 42A), qualitative characteristics of financial information (ED 42 B), definition and recognition of assets (ED 42C), definition and recognition of liabilities (ED 42D), definition of equity, revenue and expenses (ED 46A & B reissued as ED 51A Definition of Equity and ED 51B Definition and Recognition of Expenses).

Each of these exposure drafts contained an invitation to interested parties to comment on them. As with the submissions the ASRB received with regard to the conceptual framework project, the comments received by the AARF contain some interesting insights into attitudes toward some potentially contentious issues and suggest that this conceptual framework may be as futile as the FASB's effort in terms of gaining acceptance. For example, one submission stated:
I accept that there is a need for clarification of fundamental concepts used in accounting standards. It would be risky, however, to believe that such concepts are so fundamental as to be independent of the standards to be based on them. Indeed, many of the concepts are preconceptions of a particular time, culture and political standpoint, based on some sweeping assertions.

Others considered that the objective was too broad:

Decisions that the owners make as a result of the information they receive will affect the allocation of scarce resources, but this does not mean that the objective of the financial report should be to provide information to all users that is useful for making and evaluating decisions on such allocations.

On a technical note, the NCSC submission considered that the definitions of assets and liabilities could lead to creative accounting:

We are concerned that the definition of "probable" in paragraph 34 in the Assets Statement and 24 in Liabilities could provide scope for "creative accounting" by permitting both the omission of items which should be included, and the inclusion of some items which are overvalued.

The most contentious of the concepts statements has been SAC 4 which was issued by the AASB and the PSASB in March 1992. The objectives of SAC 4 as outlined in paragraph 6 are:

... to establish definitions of the elements of financial statements and to specify criteria for their recognition in financial statements that are consistent with the objective of general purpose financial reporting.

Work on this Statement extended over at least five years with the issue of ED 42C and ED 42D in December 1987. In spite of this lengthy gestation period and the opportunity for public comment and debate on some five exposure drafts, SAC 4 was
greeted with a hail of protest from the business community. The derogatory comments directed at SAC 4 were reminiscent of those made about the FASB's SFAC 5. For example, the general manager corporate and director of one Australian company slated SAC 4 as

Confusing, internally inconsistent, lacking practicality and a threat to the public reputation of the accounting profession in Australia (cited by CPA News, April, 1993, p1).

Section 226 of the Australian Securities Commission Act specifies the functions of the AASB. These functions include the development of a conceptual framework. This framework is stated to be "... for the purpose of evaluating proposed AASB standards". As noted previously, while the AASB conceptual framework project has not proceeded, the AARF project has and, presumably, it is expected to be used for the purpose detailed in the Australian Securities Commission Act. This gives rise to one of the complaints regarding SAC 4 and that is that the definitions in SAC 4 conflict with some existing accounting standards and practices (Sims, 1992; Shanahan, 1992; Stevenson, 1992a, 1992b; CPA News, April, 1993; Lonergan, 1993).

Furthermore, APS 1 - *Conformity with Statements of Accounting Concepts and Accounting Standards* makes the application of the concepts set out in SACs mandatory for members of the two professional bodies except where there is a conflict with an accounting standard (paragraph 9). The mandatory status of SAC 4 was also criticised (CPA News, 1993, p1).

Whatever the merits of SAC 4 or the validity of the claims against it, the furore over it has been most effective. When first released, SAC 4 was to be effective from 1 January 1994 (SAC 4, Editorial Note, 1993, p123). In response to mounting criticism, the AASB has deferred the operative date to 30 June 1995 (SAC 4,
Editorial Note, 1994, p57). In addition, in July 1993, the two professional bodies announced the withdrawal of the mandatory status of SACs.

The backlash to SAC 4 could not be said to be the result of some haphazard thought processes on the part of the AARF. As indicated above, the development of the statement involved the issue for public comment of a number of exposure drafts and was at least five years in process. The explanation for the deferral of the operative date of the statement and the withdrawal of the mandatory status of SAC's generally can only be described as a defence measure on the part of the profession aimed at restoring compatibility between it and business interests within its environment. Persistence with criteria not acceptable to these interests could ultimately lead to destruction of the profession's hegemonic domination of accounting. Furthermore, sending SAC 4 back to the drawing board, so to speak, achieves two other purposes. First, it provides the profession with more scope for conversation and communication until the recognition criteria are established, if ever. Second, it means that tackling the measurement question has been delayed once again.

The extended gestation period for the development of SAC 4 and its temporary withdrawal for further consideration is not unusual and is attributable to what is termed, due process. Like the conceptual framework, due process can be seen to serve as both defence and legitimising strategies.

4. Due Process

In 1985, Henry Bosch criticised Australia's paucity of accounting standards stating

Under the present system and at the present rate of progress it may be reasonable to fear that we will not have a comprehensive set of enforceable Australian standards until early in the 21st century (1985, p20).
Bosch compared Australia's progress with that of the FASB which was established in 1973 and by 1985 had produced some 83 standards (1985, p19). Australia's standard setting history began just one year after that of the FASB but had only 18 standards to its credit by 1985. Bosch further added that it had taken the ASRB 19 months to approve two standards (1985, p20). In Bosch's view, the cause of much of Australia's delay in developing standards was a result of the due process procedures adopted by the AARF which meant that more than three years often elapsed before a proposed standard was submitted to the ASRB for detailed consideration (1985, p22). Bosch described the standards resulting from this process as "rather loose" and questioned the necessity for such extensive exposure when major legislation was sometimes passed on the basis of a single exposure (1985, p23). In making the comparison of the ASRB with the FASB, Bosch did not take into consideration the fact that the FASB had a full time staff to work on such matters. Nonetheless, the criticisms over the length of time taken to issue standards or concept statements are as relevant today as they were in 1985. SAC 4 is testament to the length of time taken by the AARF to produce a concepts statement only to have it rejected by the business community.

The due process procedures outlined by Bosch are essentially the same as those in place today. These procedures include the preparation of a discussion paper, draft exposure draft and general exposure draft. The exposure drafts are subjected to selective and general distribution for comment and are amended on the basis of submissions received before being circulated again for further comment. The existing procedures also allow for both public and private hearings at which interested parties may put their point of view. Even after the AASB considers the standard or concepts statement should be approved, the National Councils of the ASCPA and the ICAA, the Federal Attorney-General and the ASC have 30 days within which to make comment. The proposed standard or concepts statement may be amended again on the basis of such comment. Finally, approved accounting standards must be tabled in
Federal Parliament which may disallow the standard (PSASB & AASB, 1993, Policy Statement 1, paragraphs 21-34).

While due process may be seen as detracting from the profession's autonomy in determining accounting standards and practices, it is argued here that due process is essential to maintaining the profession's hegemonic domination of this aspect of regulation. Achieving hegemonic domination of the obligatory passage points requires the formation of alliances and agency relationships. Since accounting standards prescribe and, in some cases, proscribe, the accounting methods to be used in the preparation of financial statements, it is reasonable to expect that both preparers and users of financial statements will have an interest in the determination of those methods. If all parties are in agreement, the process is straight forward. However, such consensus is unlikely. Not only is there the possibility of conflict between groups but also within groups. As Gerboth puts it

In common with other essentially political activities, accounting rule-making must overcome as its chief obstacle not the inscrutability of nature, but rather the conflict between interest groups (1973, p479).

In addition, a standard setting body cannot be perceived as consistently serving the interests of one particular group. If this occurs, the legitimacy of its activities will be questioned and it may ultimately lose its position in the regulatory system. A perception that the APB was dominated by the audit section of the profession, and, thereby, their clients, was one of the reasons for its demise (Burns, 1974, p19, p84, pp90-94). Gibson argues that such a perception also existed in Australia prior to the joint establishment by the ICAA and the ASCPA of the AARF (1980, p150). Due process is a way in which standard setters may be seen to consider the views of all those with an interest in accounting standards. For example, Miller and Redding define due process as
... the steps used to assure that an administrative matter is given the careful consideration necessary to adequately protect the interests of those involved (1988, p56).

Similarly, Rahman considers due process to be an integral feature of a democracy (1991, p28). In addition to the need to be seen as considering all points of view, due process procedures also appear to have arisen as a result of the recognition that accounting standards can have economic consequences. Zeff describes economic consequences as

... the impact of accounting reports on the decision-making behavior of business, government, unions, investors and creditors. The resulting behavior of these individuals and groups could be detrimental to the interests of other affected parties. Accounting standard setters must take into consideration these allegedly detrimental consequences when deciding on accounting questions (1978, p56).

Benston and Krasney divide economic consequences into direct and indirect effects (1978, pp162-164). Direct effects arise from items such as taxes and accounting requirements which have a direct impact on the allocation of resources (1978, pp162-163). Indirect effects flow from the manner in which items are reported and do not directly affect cash flow but may have an impact on the way in which a particular company is perceived (1978, p163). As will be discussed in the chapters dealing with the foreign currency standard, one reason offered against the temporal method of accounting for the translation of the financial statements of foreign subsidiaries was the mandatory recognition in the profit and loss account of translation gains and losses. It was argued that recognition of gains and losses as incurred caused wide fluctuations in reported profits. Over time, these fluctuations were cancelled out, but companies were still concerned at the short term volatility of income patterns. The result being that accounting standards in the UK, USA and Australia all provide for a
choice between the current rate method, which allows translation gains and losses to be taken to reserves, and the temporal method.

This result is not surprising given that earlier experience showed that powerful interest groups could effectively use arguments that rules determined by the accountancy profession were contrary to government policy to thwart particular accounting standards. The experience of the APB with the investment tax credit is a case in point. It could well be argued that government interference in this issue was justified on the grounds of the public interest. As Savoie put it

Businessmen and professional accounts (sic) went directly to Congressmen with the story that the APB was trying to remove an economic incentive granted by Congress. No amount of accounting logic about matching costs and revenues could overcome this economic argument and legislative challenge (1974, p325).

Economic consequences were also implicit in the decision of the UK government to appoint the Sandilands Committee to study the question of inflation accounting on the eve of the issue of a profession-sponsored standard requiring the use of current purchasing power in the preparation of financial statements. According to Stamp, the government was fearful of the effects which detailed measurement of inflation in the accounts of companies might have on their prices and incomes policy (1977, D12).

**DISSIDENCE, RESISTANCE & SURVIVAL**

As discussed in Chapters 2 and 3 accountants have used their claim to specialised knowledge and skill which is to be used in the public interest to help them achieve hegemonic domination of the determination of accounting standards and practices. However, if it could be argued that the rules determined by them were not in the public interest, for example, where compliance with such rules could be perceived as
having adverse economic impacts on companies or the economy, then there would be
grounds to vest the standard setting process in another group. Therefore, it could be
argued that due process serves not only to legitimise the profession's domination but
to preserve it. In other words, due process is a survival strategy.

It was pointed out in Chapter 2 that an autopoietic system does not exist in a vacuum.
Its survival depends on its ability to be compatible with other elements within its
environment. In the regulatory environment, this means that ability, skill and
knowledge are necessary but not sufficient. There must also be acceptance by the
business community and other elements within the regulatory environment of the rules
imposed by accountancy. For example, it has been suggested that the replacement of
the APB with the FASB was not due to any "structural deficiencies" but to resistance
to its proposed rules:

Some of the APB's opponents were not satisfied with defeating the APB on business combinations. They precipitated meetings which resulted in formation of the Wheat Committee early in 1971. In so doing, their determination to bring down the structure rather than submit to a professional pronouncement was apparent (Savoie, 1974, p325).

Gerboth takes this further and suggests that the demise of the APB was attributable,
in part at least, to resistance, on the part of "powerful interest groups", to its control
of the standard setting process and that it was threatening to succeed in imposing
rules determined by it on those interest groups (1973, p481).

The role of due process as a survival strategy is obvious. Chambers is quite open
about the nature of such activities and describes them as "bargaining exercises":

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The whole business of receiving submissions, holding hearings, issuing exposure drafts and tentative statements is a process of polling opinions to see just how far it is possible to go, or just how little it is necessary to do, in any specific, critical setting. It is a means of getting the greatest satisfaction (the least disturbance of the accounting status quo - in technique or prestige) for a given sacrifice (1976, pp258-259).

Standard setting, and the development of accounting concepts upon which standards are based, is clearly both a technical and political process and while Bosch appeared to imply that due process procedures such as these should not be followed, they have effectively become institutionalised. Section 226(1)(d) of the Australian Securities Commission Act requires the AASB to engage in such public consultation as may be necessary to decide whether or not it should make a proposed accounting standard.

The Act does not prescribe the nature or extent of such public consultation. This has been left to the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation (PSASB) and the AASB which have further institutionalised the procedures outlined above in Policy Statement 1. The Development of Statements of Accounting Concepts and Accounting Standards which was issued in 1993. Policy Statement 1 has effectively extended the due process procedures outlined above by the inclusion in the standard and concept setting process of a "... broadly-constituted Consultative Group to increase the involvement of various interested groups in the standard-setting process" (PSASB and AASB, 1993, paragraph 16). The procedures prescribed in Policy Statement 1 are essentially the same as those adopted by overseas standard-setting organisations (1993, Preface).

The removal of the mandatory status of SAC's and the outcome of the APB's battles over the investment tax credit and business combinations appear to suggest that standard setters are more susceptible to the wishes of business than of others with an
apparent interest in accounting standards. As already noted, both the APB and the Australian profession prior to the formation of the AARF were considered to be dominated by the audit section of the profession. However, as will be discussed shortly, there is no evidence to support the contention that business interests consciously receive more consideration by standard setters. It is possible, however, that business interests carry more weight in due process procedures by default.

One explanation can be found in the idea of isomorphism discussed in Chapter 2. In discussing claims that the APB was not independent, Horngren agreed that this was possible but not in any conscious manner. Accountancy firms have many clients. Over the years members of these firms discuss accounting issues with clients and other members of the firm who also have spoken with clients. In this way, view points are influenced and should a member of an accountancy firm be appointed to a standard setting board, this view point, in turn, is likely to influence any resulting standard (Burns, 1974, pp94-95).

A second reason is that larger business firms have been found to be more likely to lodge submissions in response to exposure drafts of proposed accounting standards. This was verified by the results of Australian studies published in 1985 (Coombs & Stokes), 1986 (Morris) and 1989 (Gavens, Carnegie & Gibson). These studies also verified that standard setters are sensitive to views expressed in submissions as evidenced by those views being reflected in subsequent accounting standards. There was, however, no evidence to suggest that Australian standard setters issued standards which favoured any particular industry group (Coombs & Stokes, 1985, p44). As pointed out in the 1985 and 1986 studies, only formal, written submissions were included in the analyses. Other forms of lobbying such as public or private meetings or phone calls were not included (Coombs & Stokes, 1985, p44; Morris, 1986, p48). The implication of this is that standards may be biased in favour of those
companies which are sufficiently organised to lodge formal submissions dealing with proposed accounting standards.

Such results are consistent with the concepts of power and autopoiesis adopted for purposes of this study. A diffusion model of power would argue that the standard setters bow to pressure from big business because they have the power to ensure a particular viewpoint is adhered to. The circuits of power framework, however, argues that the exercise of power through the promulgation of accounting standards is the result of the formation of alliances and agency relationships. Maintaining control of the standard setting process, that is, survival, requires standard setters to consider the impact of rules on those who must comply with them. If only certain members of the regulatory system convey their views to the standard setters, then clearly, only those views are likely to be taken into consideration in the development of accounting standards.

In addition, due process, whether formal or informal, can be offered as reason for the flexibility inherent in accounting standards. In order to have accounting standards accepted by parties who feel they may be affected by them, it is often necessary for the standard setter to promulgate standards which represent a compromise position rather than one that is seen as being best accounting practice. The inflation accounting debate and the furore over SAC 4 are evidence of this. It will be shown in the next chapter that pressure from business resulted in the foreign currency accounting standard allowing two methods of translating the financial statements of foreign subsidiaries and the effective watering down of the ban of the deferral and amortisation of translation gains and losses on the financing of non-monetary assets.

The purpose of this chapter was to identify some of the weaknesses inherent in the Australian regulatory system and provide an underlying explanation for those weaknesses. These weaknesses included Australian federalism which prevented the
establishment of Federal corporate legislation for almost ninety years; frequent changes in legislation; lack of authority and funding of regulatory bodies and ambiguous and flexible legislation and standards. This study maintains that the weaknesses in the regulatory system identified in this chapter are the result of the desire of those who have achieved hegemonic domination of particular areas of that system to maintain their position. The experiences of the accountancy profession in the USA, the UK and Australia provide evidence to support this.

These experiences show that in some instances, there has been resistance to the profession's exercise of episodic agency power in the promulgation of accounting standards and concepts to be used in the preparation of external financial reports. There has also been dissidence both from within the profession and from external sources such as government. Dissidence from government sources appears to have been in response to lobby groups which suggests that the government also endeavours to use its available resources to form alliances and agency relationships in order to maintain its dominant position. The actions of the UK government with regard to the inflation accounting issue demonstrates its ability to protect itself from the possible consequences of public documents which show the impact of inflation on companies and, thereby, the economy. The inflation debates in the UK, the USA and Australia, the investment tax credit, accounting for business combinations fiascos in the USA and the conceptual framework projects in the USA and Australia also provide evidence of dissidence within the profession itself. Such endogenous dissidence is particularly damaging because achieving alliances and agency relationships requires effective organisation. Therefore, it is not only necessary for the profession to compromise in order to have its rules accepted, it must also compromise to achieve compatibility within its own structure.

The next chapter will undertake a detailed examination of the development of the foreign currency translation standard in order to provide a comprehensive example of
the political nature of standard setting and the impact this has on the resulting standards.
DOMINATION, AUTOPOIESIS AND REGULATORY FAILURE:
THE ACCOUNTANCY CONNECTION

VOLUME THREE
CHAPTER 6

ACCOUNTING FOR FOREIGN CURRENCY

TRANSLATION

This chapter will undertake a detailed examination of the accounting for foreign currency debate and the development of the accounting standard dealing with this issue. Increases in foreign trade and foreign investment coupled with the floating of many of the world's currencies provided the profession with an opportunity to justify its domination of the standard setting process. An opportunity was also provided for the profession to exercise episodic agency power by the promulgation of an accounting standard prescribing the translation methods to be used in accounting for foreign currency transactions, in the translation of the financial statements of foreign subsidiaries and the treatment of translation gains and losses. On the other hand, dissidence within the profession arising from disputes over appropriate accounting methods and treatments and resistance by business interests to the profession's proposed solutions to accounting for foreign currency translation and fluctuations, had the potential to put its domination in jeopardy. To safeguard domination, the profession was put in a position of compromising its principles and then finding a way to justify its actions. In terms of the circuits of power, the expansion of foreign trade and investment and activities in the foreign money market changed the environment in which many corporations operated. As evidence from the Australian financial press will demonstrate, the new environment and its impact provided scope for
manipulation of financial statements. This, in turn, attracted criticism of the accountancy profession (e.g. Peirpont, 1977; Staunton, 1978; Bosch, 1985).

The response of the profession, in general, was to attempt to establish the most appropriate method(s) of accounting for the effects of this new environment. In the USA, the FASB issued FASB 8 Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements (hereafter referred to as FASB 8), which effectively removed all flexibility in foreign currency accounting. Australia and Canada subsequently followed suit with exposure drafts that closely followed the FASB standard. However, there has been resistance to the profession's solution:

The former profusion of methods so useful to managements but so confusing to analysts, has given way to a single method which now infuriates many managements (Editorial Commentary, 1976, p9).

There was also dissidence within the profession on the issue. For example, in 1972 two profession-sponsored research projects dealing with accounting for foreign currency translation made totally different recommendations. Furthermore, accounting standards and exposure drafts issued between 1973 and 1988 showed marked differences of opinion and changes in opinion in relatively short spaces of time. The FASB, for example, issued two entirely different foreign currency standards in the space of five years. As discussion of the events leading to the issue of the second standard in 1981 will show, this was not surprising. At the same time, it shows the profession's willingness to compromise between what it sees as sound accounting practice and having its accounting standards accepted by those who are bound by them. This is particularly so given the stated objective of each statement was rejected in the other. The same situation prevailed with exposure drafts and standards issued in Australia between 1973 and 1987.
The question that must be asked and answered is was this about face due to the perception by the FASB that it had made an error in its first standard and the second standard corrected it or was it that the FASB bowed to pressure and permitted flexibility, albeit on a reduced scale. Accounting standard setters in other countries, including Australia, followed the lead of the FASB which raises the same question in regard to them. It is intended to show that pressure from the business community, in particular, was the primary cause for the FASB's change of stance and adoption of that same stance by other western accountancy bodies including the Australian. In this sense, the foreign currency issue is a classic example of the workings of the circuits of power and autopoiesis models. The profession rated survival higher than principle.

The purpose of this chapter initially is to outline:

1. the nature of the accounting problems arising from an increase in both foreign trade and investment in foreign corporations

2. alternative methods proposed for accounting for foreign currency translation including weaknesses in the various methods as identified in the media, professional journals, profession sponsored studies, exposure drafts and accounting standards

3. the profession's response to perceived weaknesses in accounting for foreign currency translation in the form of accounting practice notes, exposure drafts, accounting standards and revisions to them.

This section of the study demonstrates the political nature of accounting standard setting and explains why flexible methods of accounting for the translation of foreign
subsidiary accounts and for gains and losses on foreign currency loans has been advocated. For this purpose, much of the first part of the chapter will be essentially a review of profession-sponsored studies undertaken in the USA and Canada, journal articles and newspaper reports dealing with appropriate methods of accounting for foreign currency translation and the impact of foreign currency fluctuations and accounting methods on firms and their management. It is acknowledged that much of this review represents ground that has already been well covered in the literature. However, the use of this material is justified on the grounds that it shows the development of a discourse on accounting for foreign currency translation and the extremely contentious nature of the issue. The use of studies, newspaper reports and articles from not only Australia but from other countries is also justified on the basis that the approach to the foreign currency issue adopted by the Australian standard setters was influenced by what had occurred in other countries and in the USA in particular. One need only look at progress reports on Australian accounting standards in issues of Australian professional journals in the early 1980's (eg. Stevenson, 1980, p10; Pound, 1983, p 20; Stevenson, 1983b, p18) where it was repeatedly stated that work on the foreign currency standard had been suspended pending the outcome of deliberations on the matter in other countries.

For this reason, heavy reliance is placed in this chapter on the USA experience up to the issue of FASB 52. The USA has been selected in preference to the UK because the FASB was the first standard setting body to attempt to impose a single method of accounting for foreign currency translation. Furthermore, a broad focus is justified because accounting for foreign currency translation is, by its nature, a world-wide problem. The growth of multinationals has meant that it is very difficult for the standard setters in one country to totally ignore the views of standard setters in other countries. Accounting methods prescribed in a country may influence investment and financing decisions by companies in other countries. There has also been a move towards harmonisation of accounting standards throughout the world. Australian
accounting standards also include a section stating whether the standard is consistent with comparable International Accounting Standards. Australia's reliance on accounting standard setters in other parts of the world is exemplified in the following:

The Foundation has deferred the issuance of a standard subject to action being taken by the US, UK and Canada, as foreign currency is one area where it would be highly desirable to have international uniformity. Following the release in December last year of a standard by the FASB and an exposure draft released by the UK in October, the Foundation has proceeded to prepare a first draft of a proposed Statement of Accounting Standards (Stevenson, 1982, p11).

It is, therefore, considered appropriate to draw on a wide selection of literature dealing with foreign currency rather than a narrow Australian focus.

At a practical level, while Australia issued one of the first accounting exposure drafts dealing with foreign currency accounting, the major studies dealing with selection of appropriate foreign currency accounting methods were conducted in the USA and Canada. In light of the attention directed to the impact of foreign currency fluctuations on Australian companies during the 1970's (evidence of this will be provided from newspaper reports) it is somewhat surprising to find so little attention given to the issue in professional publications. As Chambers commented in 1983:

Accounting for foreign operations, balances and interests does not seem to have attracted as much attention as the scale of international business suggests it deserves (1983, p14).

Once the arguments for and against the major methods of accounting for foreign currency translation have been outlined, the events which led to the eventual adoption of two methods within one standard will be discussed. The focus of the discussion initially will be the USA and the replacement of FASB 8 (which eliminated all
flexibility) with FASB 52 (which allowed a choice of accounting methods). The FASB's rationale behind adopting a flexible approach will be questioned by reference to FASB-sponsored studies which demonstrated that FASB 8 did not have significant adverse economic consequences for firms adopting its provisions. Given that research in general did not support industry claims that the application of FASB 8 would cause income volatility and adversely affect share prices and returns, the FASB's decision to change the standard can only be explained as a compromise arrived at to avoid further conflict between standard setters and business interests.

The promulgation of the Australian standard and its various amendments will then be examined in light of the FASB's experience and also by reference to submissions on proposed accounting standards or revisions to existing standards received from industry and other interested parties. The analysis of submissions is not intended to provide irrefutable evidence that the views expressed therein had a substantial impact on the decisions of standard setters in response to exposure drafts. Submissions are only one form of lobbying activity. Nonetheless, analysis of submissions is considered useful because it provides some evidence of views held by those with an interest in a particular accounting standard. Furthermore, the analysis undertaken for purposes of this study does provide some evidence to support the research discussed in the previous chapter that standard setters are responsive to submissions received in response to exposure drafts of proposed accounting standards. Responses to the 1973 and 1979 exposure drafts have not been analysed. Prior to 1979, responses to exposure drafts were confidential and are not available for public scrutiny. The responses to the 1979 exposure draft have been archived and are not readily available for examination. For this reason, secondary sources have been used. In addition, following the withdrawal of FASB 8, the Australian profession announced its intention to suspend its own work on a foreign currency standard pending the outcome of further investigation in other countries (eg. Stevenson, 1980, p10; 1982, p11). This would suggest the responses to the 1979 exposure draft were not a
consideration in the standard setters' decision to amend the requirements in the proposed standard.

The flexibility inherent in the present foreign currency standard will also be examined from the perspective of regulators who have argued that flexible, vague and ambiguous accounting standards make their lot very difficult in terms of prosecution for the publication of misleading financial statements. Specific reference will be made to AWA Ltd v Daniels (1992) 7 ACSR 759. In this case there was no suggestion of deliberate publication of misleading financial statements. The case is used in the context of demonstrating the need for executive management to possess a high level of knowledge of foreign exchange risk management and the result of failure to ensure that foreign exchange managers also have this knowledge and are strictly supervised. It also shows the result of the lack of an accounting standard dealing with speculative dealings in foreign currencies. An issue not yet addressed in an Australian accounting standard.

The technical merit of the various methods of accounting for foreign currency translation will not be an issue other than to show the extent of disagreement within the profession itself and between the standard setting bodies and the business community as to what is the appropriate method of accounting for foreign currency translation. The overall analysis of the foreign currency debate will be undertaken within the power and autopoiesis frameworks developed in Chapter 2.

NATURE AND SOURCE OF THE FOREIGN CURRENCY PROBLEM

Accounting problems associated with foreign currency translation fall essentially under two headings: foreign trade (including international financing arrangements) and foreign investment.
The immediate problem arising from foreign trade is that there is no unique international currency. In general, countries have their own currency which is not readily negotiable in other countries. Therefore, a corporation may be required to convert units of its own currency into that of another country for purposes of settling a transaction. If settlement has not been made at balance date, there is the additional problem of determining the appropriate measurement of assets or liabilities arising from the transaction. If settlement of the transaction is to be in the domestic currency, this does not present a problem. However, if the transaction is expressed in terms of a foreign currency, a means of translating the measurement to the domestic currency must be determined. There are two reasons for this. First, using two currencies in one set of financial statements would be meaningless. Secondly, it is not unusual for company regulation to require the domestic currency to be used in the preparation of external financial reports. For example, in Australia Schedule 5 Part 1 4(2) (Regulations to the Corporations Act) states: "In accounts and consolidated accounts all amounts must be expressed in Australian currency".

A similar problem arises with foreign investment when a parent company/subsidiary relationship exists. However, the situation is even more complex because, in order to prepare consolidated accounts, all of the financial statements of the subsidiary have to be re-stated in terms of the domestic currency of the parent company.

The solution to the purchase or sale of goods and services is not difficult. The exchange rate prevailing at the time of settlement determines the consideration to be paid or received. The more complex issues arise when determining how to account for differences in the exchange rates between the time the transaction takes place and settlement. Should any gain or loss be included in the calculation of profit or loss for the year? Should it be taken to a reserve? Should any gain or loss on foreign debt be taken into consideration in determining the book value of an asset acquired with the proceeds of the loan? The question becomes even more pertinent and complex when
settlement has not taken place at balance date. How should the asset or liability be valued in the balance sheet and, as the gain or loss on exchange has not yet been realised, how should it be accounted for particularly when exchange rates are likely to change again before settlement? Similar problems arise when adjusting the accounts of foreign subsidiaries to the domestic currency of the holding company for purposes of consolidation. The problem of accounting for unrealised exchange gains and losses is potentially even greater in this situation than in that of international trade because now the exchange problem is not confined to a small number of transactions but to all profit and loss and balance sheet items.

While there is still some debate on the matter (eg. Chambers (1983) who advocates using exit prices for assets and liabilities in the same manner as his proposed CoCoA model; Clarke (1977) who outlines arguments for and against the use of purchasing power parities for translation procedures and Lorensen (1972) who also outlines proposals to use a "constructed rate approach" based on an index of changes in the general price level) in general, it has been accepted that foreign currency exchange rates should be used to account for international transactions and to translate profit and loss account and balance sheet items of foreign subsidiaries to the domestic currency of the parent company. However, there is less agreement on what the appropriate rate should be or how gains or losses arising on translation should be accounted for. Herein lies the real problem with the translation of foreign currency transactions and foreign currency financial statements as the selection of exchange rate and treatment of translation gains and losses can have a significant impact on the reported earnings and financial position of a company. Quite often, gains and losses and assets and liabilities arising from foreign currency translation and reported in financial statements, have little connection with operations and arise purely from the translation method adopted. Flexibility in accounting for foreign currency translation, therefore, provides ample scope for manipulation of financial statements. Parkinson states the problem as follows:
The combination of . . . choices for translating asset and liability accounts, together with a degree of flexibility within each choice, coupled with a wide choice for disposing of translation gains and losses, produces an almost infinite range for computing and recording the exchange gains and losses appearing in published statements (1972, p97).

The volatile nature of foreign exchange markets resulting from the decision to float the major world currencies in the late 1960's early 1970's added a new and difficult dimension to company management with the result that the management of many companies made maximum use of the various methods and combination of methods available to account for foreign currency movements.

TRANSLATION METHODS

Four methods of translation of foreign currency financial statements based on foreign currency exchange rates have been identified either as being used in practice or as recommended by professional bodies. This is not to suggest that companies necessarily select one translation method to the exclusion of other methods. It is not uncommon to find a combination of the following approaches being used in practice either now or in the past:

- current/non-current classification
- monetary/non-monetary classification
- current rate (also referred to as closing rate)
- temporal method

A number of methods of accounting for foreign currency gains and losses have also been either recommended or found to be used in practice, for example, the Australian exposure drafts, *Translation of Amounts in Foreign Currencies* issued in 1973
(hereafter referred to as ED 1973) and *Translation of Foreign Currency Transactions and Foreign Currency Financial Statements in the Context of Historical Cost Accounting* issued in 1979 (hereafter referred to as ED 1979), identified 5 alternative methods of accounting for translation gains and losses (paragraphs 17 and 13 respectively). For purposes of this study, consideration will be given to the following on the basis that these methods have been the most common methods used in practice:

- immediate recognition in the profit and loss account
- defer and amortise
- transfer to reserve

The first three of the four translation methods listed above were used in practice to varying degrees prior to the adoption by the AICPA of the temporal method which was developed as a result of AICPA Research Study No 12 *Reporting Foreign Operations of US Companies in US Dollars* which was published in 1972. A brief description and history of each translation method and the accounting treatment of translation gains and losses will be given followed by an analysis of the accounting standards dealing with foreign currency translation. The purpose of detailing the major translation methods and treatment of gains and losses is to demonstrate both the diversity of accounting practice adopted overtime and the diversity of views as to appropriate accounting practices within the profession itself. This diversity contributes to the contentious nature of the foreign currency debate and provides a basis for the view that resolution of the issue will not be founded on technical merit but on expediency.
1. Current/Non-Current Method

This approach applies the current exchange rate (that is, the rate prevailing at balance date) to all current assets and liabilities and the historic rate to all other assets and liabilities. This method has the longest history of the four approaches under consideration. It was described by Lorensen as "traditional", having been outlined and recommended in an AICPA report, *Foreign Exchange Losses* issued in 1931 (1972, p6). In a report, *Memorandum on Accounting for Foreign Exchange Gains*, in AICPA Bulletin 117 issued in 1934, the method was again recommended. These recommendations were essentially repeated in Accounting Research Bulletin No 4 *Foreign Operations and Foreign Exchange* issued in 1939; the Committee on Accounting Procedures' Accounting Research Bulletin 43, *Revision and Restatement of Accounting Research Bulletins* (1953) and APB Opinion 6, *Status of Accounting Research Bulletins* (1965) (Lorensen, 1972, pp6-7). The ICAEW's *Accounting for Devaluation - Institute Recommendation on Accounting Treatment of Major Changes in the Sterling Parity of Overseas Currencies* (1968) also argued that it was an acceptable method of foreign currency translation (Henderson & Peirson, 1988, p722). However, it is no longer recommended by any standard-setting body (p697).

The major criticism of this approach is that it effectively revalues current items in the balance sheet due to changes in the exchange rates rather than changes in economic conditions or in the items affected. Two areas in particular, long term debt and inventory, have been the focus of criticism.

Long term debt, being a non-current item, would be valued at balance date at the exchange rate prevailing at the time the debt was incurred. If the exchange rate rises, the debt will be undervalued at balance date because the amount that would have to be paid to settle the debt at that date would be the foreign currency value of the debt times the current exchange rate. The rationale for this argument lies in the fact that...
the debt represents an obligation to pay a fixed number of foreign currency units regardless of the foreign currency exchange rate.

The arguments regarding inventory valuations are similar. In other words, because inventory is a current item, it would be translated at the exchange rate current at balance date. Any change in the exchange rate between time of purchase and balance date would be reflected in a change in the recorded measurement of inventory. This is a contradiction of the historical cost concept and does not provide a meaningful measurement of the value of inventory in the financial statements as it does not represent the acquisition cost of the inventory, its replacement price or its selling price. The resulting measurement of both long term debt and inventory cannot be explained in terms other than as the multiplication of two unrelated numbers.

A further criticism offered by Lorensen is that the current/non-current classification of assets and liabilities does not provide a theoretical basis for the application of particular exchange rates because translation is for measurement purposes rather than for classification of items disclosed in financial statements (1972, p32).

2. Monetary/Non-Monetary Method

This approach prescribes the current rate for monetary items, for example, cash, accounts receivable, accounts payable and debentures and the historical rate for non-monetary items including inventory and most non-current assets. The monetary/non-monetary distinction is based on the idea that monetary items are fixed to the obligation to pay or the right to receive a specified "number of foreign currency units" whereas the value of non-monetary items will vary with exchange rates.

While this method has never been prescribed by a standard setting body, it has received some support from the profession. For example, Baxter and Yamey
described the monetary/non-monetary method in 1951 and stated that "any properly primed examinee" could "rattle" off the rules for consolidating branch returns when the exchange rate was not excessively unstable (1951, p117). Lorensen, however, credits the method's comprehensive development and refinement to Samual Hepworth (Reporting Foreign Operations, 1956) and the National Association of Accountants (NAA) (Research Report, No 36, Management Accounting Problems in Foreign Operations, 1960) (1972, pp7, 33). According to Lorensen, at the time the NAA report was released, most companies used the current/non-current method. However, the NAA report precipitated a trend away from the current/non-current method in favour of the monetary/non-monetary method. By 1972, companies used a mixture of methods including a combination of the current/non-current and monetary/non-monetary methods (p7).

The arguments used to justify this method are similar to those used in support of the current purchasing power model for inflation accounting, that is, the purchasing power is the relevant measure. Therefore, current and non-current monetary items should reflect the purchasing power in terms of the domestic currency after translation. In other words, if a foreign currency is revalued upwards, the domestic equivalent of the foreign currency will increase because the foreign currency will now purchase more of the domestic currency. If a company's foreign currency monetary assets exceed foreign currency monetary liabilities, a foreign currency gain will result. On the other hand, net borrowers will record a loss because the domestic equivalent of both monetary assets and liabilities will increase when a relevant foreign currency increases relative to the domestic currency. The opposite will occur with a devaluation.

Non-monetary items and shareholders' equity, however, are not fixed monetary amounts. Their value will vary with changes in exchange rates. For this reason, the
monetary/non-monetary method requires translation to be based on the exchange rates prevailing at the time items are recorded or revalued in the company's books.

While using it as the basis of the temporal method, Lorensen rejected the monetary/non-monetary method on the grounds that "... a comprehensive principle of translation cannot be derived solely from the monetary/non-monetary distinction" (p33).

There are two reasons for this view. First, assets and liabilities may have both monetary and non-monetary characteristics. Some marketable securities carry a contractual right to a fixed amount of money on maturity which makes them monetary items. However, these securities can also be traded on the open market where prices tend to vary over time and this makes them non-monetary items. A decision has to be made as to which characteristic is relevant for reporting purposes before the appropriate exchange rate can be selected and applied. This gives rise to Lorensen's second objection to the monetary/non-monetary method

... The developers of the monetary-non monetary method have implied that non monetary items are measured solely on the basis of historical cost (p34)

While historical cost may be the most commonly used method of measuring financial statement items, it is no longer the only method. Accounting has long recognised the lower of cost and net realisable value measurement of inventories (for example, AAS 2 & AASB 1019 - *Measurement and Presentation of Inventories in the Context of the Historical Cost System*) and the revaluation of depreciable assets to the lower of cost and recoverable amount (AAS 10 & AASB 1010 - *Accounting for the Revaluation of Non-Current Assets*). Other proposed measurement methods include replacement cost (Edwards & Bell) and current exit price (Chambers). Unless pure historical cost
is used in the preparation of the foreign subsidiaries financial statements, the monetary/non-monetary method is not appropriate.

3. Current Rate Method

Under the pure form of this approach, all balance sheet and profit and loss items are translated at the exchange rate prevailing at balance date. A variation of this method (which has been adopted for purposes of accounting standards in Australia and elsewhere) translates assets and liabilities at the exchange rate current at balance date; owners' equity and revenue and expense items are translated at historical rates.

This method has received substantial support from the profession over time. For example, ED 1973 advocated the use of the current rate method on the basis that it was "relevant . . . to the users of . . . financial statements of an Australian company" (paragraph 13). Why the current rate method was considered to be more relevant than the current/non-current approach or the monetary/non-monetary approach which the exposure draft identified as the other main methods used in practice, was not really explained. The Canadian Institute of Chartered Accountants (CICA) also recommended the adoption of the current rate method on the basis of a research study, *Translation of Foreign Currencies (1972)*, sponsored by the CICA. The conclusions of the study seemed to be based more on pragmatics than on sound accounting practice. In the Preface to the study, its author, R M Parkinson, states that while the conclusions of the study were not in accord with what was then current accounting practices in Canada, they were justified on the basis that the majority of companies in the United Kingdom and the United States of America used the current rate method (Preface, 1972). Flower contends that this is the prime reason for acceptance of the method in other countries, too (1981, p306). Similarly, the current rate method appears to have been adopted in Australia on pragmatic grounds.
A study of the top 100 Australian companies at 30 June 1982 revealed that 69 per cent had foreign subsidiaries. It is interesting to note, that of the 69 per cent with foreign subsidiaries, 83 per cent used the current rate method (Wise & Wise, 1985, p16, citing Kanga). At a practical level, advocating the use of a particular accounting method on the basis of its widespread use can be dangerous. The Royal Mail Case [1932] 1 KB 442 provides evidence that a widely accepted accounting practice will not necessarily be recognised by the courts as sound. While professional opinion and accepted practices provide guidelines to the courts, the ultimate decision as to the appropriateness of accounting practices lies with the courts (Pacific Acceptance Corporation v Forsyth and Others (1970) 92 WN (NSW) 29; US v Simon (1969); Escott v Bar Chris Construction Corp (1968)). At a political level, the profession's acceptance of an accounting method on the basis of its extensive use in practice could be seen as a means of avoiding conflict and resistance both within the profession and from corporations which may be required to adopt an alternative accounting practice. This issue will be returned to later in the chapter.

Other arguments in favour of the current rate method include its ease of use and understanding; preservation in the group accounts of the relationships between items in the financial statements of the subsidiary; and that this method reflects the holding company's net investment in the foreign subsidiary (Flower, 1981 p307; Henderson & Peirson, 1988, p699; Wise & Wise, 1985, p16). The validity of these claims have been questioned.

The claim that the current rate method is easy to understand has shortcomings. As a starting point, the claim seems unsubstantiated by empirical evidence. Research into users of financial statements and their information needs in general are not difficult to find but research on this specific area is not apparent. In addition, it has been argued that while the current rate may be simple to understand in the sense that the same exchange rate is used for all financial statement items which has the additional
advantage that the relationships between financial statement items are maintained on translation, the result defies understanding (Storey, 1972 p107; Flower, 1981 p307; Wise & Wise, 1985, p16). In other words, it is meaningless other than as the product of two unrelated numbers. As Storey further elaborates

> Multiplying the historical cost of a machine . . . by a current exchange rate that differs from the rate at date of acquisition produces a number that is not historical cost in dollars . . . replacement price . . . sales price . . . Nor is it any other measure of cost or value in dollars . . . it cannot be added to the dollar cost of domestic machines to obtain a number that may validly be called a total acquisition cost of machines in dollars (1972, p107).

It follows that simplicity versus complexity alone should not be grounds for adoption of a particular accounting method. What is important is the impact of the accounting method on the validity of the resulting financial statements. This gives rise to another criticism of the current rate method in that not only are resulting financial statement values meaningless but they are subject to revaluations consistent with changes in exchange rates rather than by any change in economic conditions or in the properties of the items concerned (Henderson & Peirson, 1988, p699; Storey, 1972, p109; ED 1979, Appendix 1). Furthermore, when a country is experiencing high inflation relative to other countries, the exchange rates may deteriorate to such an extent that translation of assets, liabilities and owners' equity effectively reduces them to insignificance (Wise & Wise, 1985, p16).

In spite of these criticisms, support for the current rate method is still very strong and will be taken up in more detail in the discussion of accounting standards dealing with foreign currency translation.

To overcome the perceived limitations of the above translation methods, the temporal method was developed.
4. Temporal Method

The temporal method is a variation of the monetary/non-monetary approach. It was developed by Lorensen in Accounting Research Study No 12, Reporting Foreign Operations of US Companies in US Dollars, published by the AICPA in 1972. Lorensen considered that it was essential to effective translation that the original measurement methods in the accounts of the subsidiary be retained on translation. For this reason the appropriate exchange rate is based on the attributes of the items being measured:

Money and receivables and payables measured at the amounts promised should be translated at the foreign exchange rate in effect at the balance sheet date. Assets and liabilities measured at money prices should be translated at the foreign exchange rate in effect at the dates to which the money prices pertain (1972, p19).

The temporal method of translation has received considerable support from within the profession but its adoption has been strongly resisted by the business community wherever it has been proposed. In 1975, the FASB issued FASB 8. FASB 8 made application of the temporal method obligatory. In June 1977, the CICA apparently disregarded the findings of Parkinson's 1972 study and issued an exposure draft which prescribed the temporal method. Similarly, in 1979, the Australian standard setters issued an exposure draft prescribing the temporal method. As already indicated, both the UK and International Accounting Standards Committees were prepared to accept both the current rate method and the temporal method. This approach has also been adopted now by Australia, USA and Canada.

The major advantages of the temporal method are that it can be used regardless of the measurement method used in the financial statements of the foreign subsidiary (pp17-18) and that these measurement models are retained on translation (Flower, 1981,
A de facto revaluation of assets does not occur as under the current rate method.

The major disadvantage appears to be that different exchange rates are applied to balance sheet items. For example, non current assets and owners' equity are translated at rates prevailing at time of purchase, revaluation or entry into the accounts while many monetary items are translated at the current rate. This has implications for ratio analysis and also reported profits or losses depending on the degree and direction of changes in exchange rates. For example, depreciation expense is a function of the measurement of depreciable assets. Under the temporal method, depreciation will be based on the cost or revaluation amount of the asset translated at the historic rate. If the domestic currency of the subsidiary company weakens relative to that of the parent company, profits recorded by the subsidiary may well be reduced or, at the extreme, converted to a loss on translation. In response to this apparent weakness in the temporal method, Flower argues that translation is to facilitate consolidation and consolidated financial statements should not be used to determine ratios or performance of the subsidiary (1981, pp308-310). The accounts of the subsidiary should be used for this purpose. Consolidated financial reports are prepared from the perspective of the shareholders of the parent company. The acquisition of a foreign subsidiary represents a "financial sacrifice" by the shareholders of the parent company. Fluctuations in currency markets contribute to the extent of this sacrifice:

When . . . the foreign currency falls in value relative to the home currency, the sacrifice made by the holding company's shareholders will become valued rather more highly . . . hence the paradox of a profit being translated into a loss (Flower, 1981, p310).

It should be clear from the foregoing, that the issue of foreign currency translation is highly contentious and, as with accounting for inflation, is unlikely to be resolved to
the satisfaction of all concerned. At least the scope for potential conflict has been reduced to the extent that two translation methods only are now prescribed by professional accounting bodies, the current rate and the temporal method. However, the selection of the appropriate translation method is only part of the issue. The treatment of foreign currency gains and losses is arguably the more contentious aspect of the issue. The reason for this being that while the translation method selected will have an impact on the financial statements, the treatment of translation gains and losses have the potential for a greater impact.

TREATMENT OF FOREIGN CURRENCY GAINS AND LOSSES

Foreign currency gains or losses 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 or, alternatively, the date of translation for purpose of consolidation of financial statements. The extent of the gain or loss on individual items will obviously be governed by the exchange rate used for translation and the degree of change in rates. If historic rates are used for translation, no gain or loss will be recorded because exchange rate changes are irrelevant. However, if current exchange rates are used for translation purposes, a gain or loss will be recorded. The total foreign exchange gain or loss will be the net change from one accounting period to the next in the assets and liabilities subject to translation at the current rate.

Before undertaking an examination of the accounting treatment of foreign currency translation gains and losses listed previously, it should be noted that each of these methods treats gains and losses consistently whether realised or unrealised. In Accounting Research Bulletin No 43 it was considered that unrealised translation gains should be taken to a "suspense" account but unrealised losses be included in the determination of operating profit. Parkinson argued that this approach was unduly conservative and possibly misleading to users of financial reports:
The . . . requirement that translation losses be recorded in the income statement covering the period in which there is an exchange rate movement establishes the fact that the information is pertinent - that it is something a reader of a financial statement should know. It should be obvious that information concerning a translation gain is of equal significance . . . (1972, p50).

Similarly, Parkinson argued that there should be no distinction between realised and unrealised gains and losses because realisation of a gain or loss is not synonymous with settlement of an obligation (p52). Realisation of a foreign currency gain or loss occurs when the exchange rate changes.

The idea of treating exchange gains and losses differently was also specifically rejected as inconsistent in the 1973 and 1979 Australian exposure drafts dealing with foreign currency translation (paragraphs 17 and 14 respectively). ED 1979 made an implied distinction between realised and unrealised gains and losses. The proposed accounting standards (paragraphs 50 and 51) dealt only with unrealised exchange gains and losses. The 1983 exposure draft made no reference to either realised or unrealised translation gains and losses.

1. Immediate Recognition of Gains & Losses in the Profit and Loss Account

This approach appears to have been favoured by professional bodies from the time the first exposure draft on the matter was issued. ED 1973 recommended this practice as being the only method to provide "adequate accounting and disclosure". Similarly, FASB 8 issued in 1975 prescribed this treatment. However, there is a distinction to be made. The 1973 exposure draft recommended the use of the current rate method of translation which means that the translation gain or loss is measured in terms of net assets. FASB 8 prescribed the temporal method so that gains and losses would be measured only in terms of net monetary items. The implications of this difference will be returned to later. Parkinson also recommended the immediate recognition
approach but only when the change in exchange rate is significant and it is reasonable to assume it will not reverse in subsequent periods (1972, p54). The rationale behind the latter restriction on immediate recognition is that when exchange rates are subject to reversal, it is not possible to reliably estimate the ultimate gain or loss (p55). Eddey supports this argument with regard to long term monetary items:

... for long-term monetary items exposed to floating exchange rates, the probability that a cash flow equivalent to the unrealised gain or loss will occur is not high enough to meet normally applied accrual tests for gain or loss recognition (1985, p21).

This view appears to be part of the major argument against the immediate recognition approach that in times of wide fluctuations in exchange rates, there is likely to be a parallel fluctuation in reported profits (or losses) (Kenley, 1978, p38; Eddey, 1985, p22; ED 1979 paragraph 14). Evidence of this is available from the financial press and various research studies and will be discussed in more depth later. However, one example will serve for illustrative purposes here. In February 1978, the Financial Times made the following comment with regard to Utah Development

The profit was boosted by exchange gains on overseas borrowings, caused by spasmodic upward revaluations of the Australian dollar. In the previous year, Australia's devaluation had caused a large exchange loss (cited by Staunton, 1978, p56).

Two points should be made here. First, as already indicated, FASB 8 required the gain or loss on translation to be measured in terms of net monetary assets which is consistent with the temporal method. ED 1973 specified immediate recognition based on the current rate translation method which measures the gain or loss on net assets. The two approaches are likely to give vastly different results which will also vary from company to company depending on the composition of assets and liabilities. This is evident in the Utah Development example to a certain extent and also relates to the second point, namely that the gain or loss will depend on changes in exchange rates.
over time. The respective translation gains and losses of Utah Development related to overseas borrowings. If Utah Development had been a lender rather than a borrower, the timing of the gain and loss may have been reversed. However, if the exchange rates had not fluctuated from year to year, no gain or loss would have been recorded. With regard to this point, it is perhaps useful to note the variations in preferred treatment of translation gains and losses overtime.

In 1974-75, of 93 Australian companies surveyed, 34 per cent recognised gains or losses in the profit and loss account immediately. This represented the dominant accounting treatment of translation gains and losses of the companies surveyed (Kenley, 1978, p40). However, 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 (1985, p22). Part of the explanation for this is perhaps that in 1974-75, there was less volatility in exchange rates than in the mid 1980's.

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 expected (Lovett, 1983, p11). In general, having reached a peak in 1972, the Australian dollar subsequently declined relative to the world's major currencies (Minchin, 1986, p48). Figures 1, 2 and 3 in the appendix to this chapter clearly illustrate the peak of the Australian dollar in 1972 and its persistent decline thereafter. This in itself could be seen as a reason to abandon the immediate recognition method and adopt the defer and amortise approach.
The rise in speculative dealings and volatility in exchange rates was not confined to Australia. The 1980's saw the emergence of a progressively more sophisticated foreign exchange market which 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, p46). By August 1986, trading was estimated at $US200 billion per day. Australian dollar trade accounted for $A3 billion of this daily rate (Behrmann, 1986, p26). This comparatively small proportion of Australian dollar trade suggests that the Australian dollar was far from being a major world currency. The implication is that Australian borrowers and traders would generally be required to denominate their dealings in a currency other than the Australian. Given that the Australian dollar has a history of devaluation, it is not surprising Australian companies preferred to defer and amortise gains or losses on long term monetary items.

2. Defer and Amortise

The defer and amortise method was recommended by Parkinson in the 1972 Canadian research study and subsequently adopted in modified form 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.

Initially, Parkinson's recommendation appears to have been applicable to unrealised gains or losses arising on translation of all "receivables and payables" (1972, p57). Arguments to support the recommendation, however, appear to be aimed at long term monetary items rather than short term. There were two reasons for Parkinson's proposed solution. As already indicated, Parkinson considered immediate recognition
was only appropriate when exchange rate changes were permanent (p55). Given that exchange rates historically were subject to reversal, translation gains or losses may never be realised (p57). 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 (p57). 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.

This proposal was adopted for long-term monetary items in the 1979 and 1983 Australian exposure drafts and in AAS 20 issued in 1985. The justification for this method 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. At 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, Hamersley Holdings Limited and Conzinc Riotinto of Australia Limited (Philip, 1980, p29). The arguments against accepting an accounting method purely on the basis of its widespread use have already been outlined and are relevant here. Furthermore, this treatment of translation gains and losses can be seen as arbitrary and as a method of income smoothing. Three examples drawn from
Australian experience demonstrate the deficiencies of the defer and amortise method of accounting for foreign exchange gains and losses.

In 1977, BHP altered its accounting policy for the treatment of foreign exchange gains and losses and turned a 25 per cent fall in net earnings into a 41.2 per cent increase in profits. This was achieved by adopting the defer and amortise approach in place of immediate recognition in the profit and loss account used previously. Some $20 million in foreign exchange losses due to the devaluation of the Australian dollar relative to the US dollar were deferred (Byrne, 1977, p17). Henry Bosch, then chairman of the NCSC, used two companies, CRA Ltd and CSR Ltd, to highlight the problems presented to those who wished to compare financial statements of different companies of what he considered arbitrary application of the defer and amortise option (1985, p88). Early in 1985, the Australian dollar suffered a "major depreciation" (Coombe, 1985, p24) which by July of that year amounted to a 25 per cent drop from the previous year (Bushnel, 1985, p1). CSR Ltd wrote off unrealised exchange losses on the basis that the devaluation was permanent. CRA Ltd continued to defer and amortise unrealised exchange losses. According to Bosch, CRA Ltd would have shown a net loss of approximately $178 million if it had adopted the immediate write off policy instead of a $22 million profit under the defer and amortise approach. Similarly, CSR Ltd would have recorded a profit under the defer and amortise approach instead of its reported $63 million net loss due to writing off $156 million exchange losses (Bosch, 1985, p88).

While the two approaches produced significantly different results and supports Bosch's claim that such diversity makes inter-company comparisons meaningless, it was pointed out in the financial press that the balance dates of the two companies were 3 months apart. CRA Ltd balanced its books prior to the devaluation of the Australian dollar while CSR Ltd balanced after the devaluation. Hence, it could be argued that the different approaches were justified. It is interesting to note, however,
that in 1987, CRA Ltd wrote off unrealised foreign exchange losses of $173 million (Killen, 1987d, p24). This amount represented losses accumulated up to the end of 1985. CRA argued that it still supported the defer and amortise approach but considered the Australian dollar had reached its peak and the write off of accumulated losses to 1985 would "protect its foreign currency debt portfolio". The balance of $15 million foreign exchange losses would continue to be amortised (Killen, 1987a, p14).

Clearly, the BHP, CRA and CSR examples support the argument that the deferral and amortisation of foreign currency gains and losses is arbitrary and also suggests that diversity in accounting methods reduces the comparability of financial statements not only from company to company but also for one company from year to year. This is more evident from a further analysis of the CSR example. At the time of its 1984-85 write off of foreign exchange losses, CSR did not apply the same principle to accumulated losses of $385 million relating to a $1.3 billion debt. Instead, the loss was amortised by a mere $13 million. Later in 1985, CSR announced its intention to retire the debt in full within 6 months (Buduls, 1985, pp1, 8). This approach seems at odds with both the treatment of other losses and with the intentions of the 1983 ED which recommended the defer and amortise method on long term monetary items with the proviso that

Care would need to be exercised in carrying out such an allocation to ensure that this procedure is achieving its objective, and not simply forestalling the recognition of mounting gains or losses (paragraph 11).

CSR could, of course, have argued that when the decision was made to defer and amortise the loss, it did not intend to retire the debt. In addition, the recommendations of the ED 1983 were not binding and, therefore, were irrelevant.
Lorensen argued that defer and amortise practices meant gains and losses were reported in the balance sheet but not in the income statement which is inconsistent because it both denied and affirmed the gain or loss at the same time (1972, p61). It also does not provide users of financial statements with information needed to evaluate management performance (p61; Parkinson, 1972, p57). Finally, it is not consistent with traditional accounting concepts "such as matching costs with revenue" (ED 1973, paragraph 18) and can distort reported results (ED 1979, paragraph 14). An explanation for this apparent about-face by the profession in general will be offered later.

3. Transfer to Reserves

Under this approach, all translation gains and losses are recorded in a foreign currency translation reserve. Reserve accounting of this nature has, in general, been rejected as unacceptable because it "tends to hide the real situation" (ED 1973, paragraph 18); it is not consistent with the all-inclusive concept of profits particularly as losses would effectively be shown in the balance sheet as a deduction from share capital and reserves which is "tantamount to a write off of the loss directly against reserves"; and gains and losses may never be reported in the profit and loss account even when realised (ED 1979, paragraph 14, 17). As will be taken up later, this final argument appears to be most relevant to the present AAS 20 and AASB 1012 Foreign Currency Translation.

Evidence suggests, however, that reserve accounting was in existence in Australia during the 1970's. For example, G. E. Crane effectively adopted reserve accounting for foreign currency fluctuations. Losses of $751,574 arising from a Swiss franc loan taken up in 1972 were not recognised in the profit and loss statement. Instead, shareholders' funds were reduced by the loss. On settlement of the loan in 1977, part of the total loss of $937,540 was reported as an extraordinary item in the profit and
loss statement. The balance, amounting to $751,574, was charged directly against unappropriated profits (The Australian Financial Review, 1977b, p45). Bougainville Mining also accounted for foreign currency fluctuations through a reserve pending settlement of debts (Dawson-Grove, 1972, p16). Lombard Australia adopted a similar practice (Ogg, 1977a, p27).

The foregoing provides some insight into the controversial nature of the foreign currency translation debate. No matter how compelling the arguments of proponents of one method may consider their arguments to be, opponents will probably not be convinced. In addition, as will be discussed shortly, a solution will not be found by reference to accounting theory or sound accounting practice. Rather, the solution or compromise solution, will be determined on the basis of the perceived economic consequences of the various alternatives.

The next section will examine Australian attempts to develop a foreign currency standard - a process spanning some 12 years from September 1973 to September 1985. Even after such a lengthy gestation period, the first standard, AASB 1003: Foreign Currency Translation - Disclosure was subsequently withdrawn and replaced in 1987 with AASB 1012 Foreign Currency Translation which was revised in July 1988. The profession sponsored standard, AAS 20 Foreign Currency Translation, was issued in October 1985 and amended in 1987. A history such as this and the recent AWA v Daniels case reaffirms the contentious nature of the issue and indicates the debate is not yet resolved.

FOREIGN CURRENCY TRANSLATION IN AUSTRALIA

The purpose of this section is to highlight the events which led to attempts by the accountancy profession in Australia to formulate a foreign currency accounting standard. These events included the changing nature of foreign trade and
international money markets. As evidence from the financial press suggests, these changes had a substantial impact on the financial statements of many Australian companies. For users of financial statements, the relative impact on a particular company compared with others was not necessarily discernible as companies were at liberty to adopt the accounting method(s) of their choice. This led to criticism of the profession and calls for the promulgation of an accounting standard. The profession's inability to produce a standard within what some (eg. the NCSC and the financial press) saw as a reasonable length of time brought further criticism of the profession.

While this is a history of the Australian foreign currency standard, extensive reference will be made to the standard setting efforts in other countries, in particular, the USA. The reason for this is that the Australian standard setters were greatly influenced by what was occurring in other countries. Evidence of this concern for developments in the foreign currency debate in other countries will be provided where applicable.

The Development and Demise of ED 1979

As with the rest of the world, the Australian search for an accounting standard for foreign currency translation began in earnest in the early 1970's. The reasons for this flurry of activity at this particular time can be attributed to the rise in foreign investment (Lorensen, 1972, p1) and foreign trade including financing arrangements and changes in international monetary developments (Kenley, 1972, p47) such as abandonment by the USA of the exchange of gold for dollars as a means of maintaining the stability of world currencies (Lorensen, 1972, pp4-5; Kenley, 1972, p47); the realignment of major currencies in the wake of the USA decision and the "Smithsonian" agreement in Washington DC in December 1971 under which currencies would be permitted to "float" within 2 1/4 per cent, as opposed to the former 1 per cent, of the official rate set by the International Monetary Fund (IMF)
(Kenley, 1972, p47, Lorensen, 1972, p3, Parkinson, 1972, Preface) and the progressive unrestricted floating of many of the world's major currencies.

The exposure drafts and accounting standards issued by professional bodies in the early 1970's reflect concern with the issues outlined above. For example, ED 1973 states:

The continuing expansion of international business activities, combined with the many significant changes occurring in the relative values of world currencies in recent years, has highlighted the problems of translating (or converting) into Australian currency amounts which are initially recorded in foreign currencies (paragraph 1).

The FASB expressed similar views adding that opinions to date (refer to discussion of methods) were no longer relevant as a consequence of changes in the nature of business and in the foreign exchange markets:

... the accounting pronouncements for translation of financial statements of foreign entities were formulated before overseas capital investments and foreign currency borrowings of US corporations became extensive, and before significant changes in the world monetary system, including two devaluations of the US dollar, took place (Monthly Notes, 1974, p54).

The decision to promulgate an accounting standard on foreign currency translation and transactions is a problematisation process. It is clear from the discussion of the various translation methods and the treatment of foreign currency gains and losses that the issue of how to account for foreign currency fluctuations was considered from as early as the 1930's. It is also clear that a variety of "solutions" to the foreign currency problem had been developed and, in many cases, adopted overtime. The "problem" which business and users of financial statements now faced and for which the profession sought to provide a solution was the diversity of methods for
translating transactions and foreign financial statements. In other words, on the basis of its superior and specialised knowledge, the profession sought to determine, from the range of methods available, the most appropriate method to be used, and thereby eliminate the diversity problem. Clearly, if the need to translate foreign currency transactions and financial statements is increasing and there is a plethora of translation approaches, the scope for diversity in reported results is also increasing which makes inter-company comparisons impossible. When firms alter accounting practices from year to year, intra-company comparisons on a year by year basis are also impossible. As Kenley illustrated this was indeed the case in Australia, the UK and the USA (1972, p47).

**Evidence of Diversity in Accounting for Foreign Currency Translation**

In 1972, Kenley surveyed six Australian companies (Australian Consolidated Industries Ltd, John Lysaght Australia Ltd, Esso Australia Ltd, Philips Industries Holdings Ltd, Comalco Ltd and Comeng Holdings Limited). Diversity in accounting for foreign currency translation was found across companies and within companies. One company used the current rate for translation of all assets, liabilities and profit and loss items except for one long term liability which was translated at the historic rate. Some companies adopted immediate recognition of gains and losses in the profit and loss account but even then companies were not consistent as some companies disclosed translation gains and losses as extraordinary items while others included them in operating profit. Others deferred recognition until realisation either by taking the relevant amounts to a foreign currency reserve or to a liability account.

A review of relevant literature in the UK and the USA revealed similar variations. One UK company cited by Kenley made exchange adjustments in respect of fixed assets directly against the relevant assets (p49). Other exchange adjustments were debited to "share premium and surplus".
Both the USA and Australia issued exposure drafts dealing with foreign currency translation in the early 1970's. Neither resulted in the promulgation of an accounting standard. The APB issued its exposure draft in December 1971 but did not proceed with the issue pending the outcome of the Lorensen research study. Kenley suggests that one reason for the failure of ED 1973 to proceed to the standard stage was the change occurring in the international monetary and exchange system which began in the late 1960's and gained momentum throughout the 1970's (1978, p 38). Corsi was more cynical and considered the urgency of developing a standard abated in line with the decline in volatility of the exchange market which had characterised the early 1970's (1987, p8). This meant that the issue could be deferred thus avoiding the problems inherent in achieving consensus on what was becoming a highly contentious issue or, as Pierpont put it "... they [the accountancy profession] ... dropped it into the too-hard basket ..." (1977, p88).

It could also be the profession in Australia decided to await the outcome of research studies undertaken by Lorensen (USA) and Parkinson (Canada).

In June 1979, the AARF issued Australia's second foreign currency exposure draft, ED 1979. The diversity of accounting methods had continued to be a problem during the 1970's. Evidence of this was again found by Kenley in two separate surveys of 100 randomly selected companies. The first survey covered 1975-1976 financial statements while the second survey dealt with accounts for 1976-1977. The same companies were not necessarily included in each survey. In addition to diversity, the 1976-77 survey revealed an increasing trend for companies to change their accounting methods from year to year. In some instances, changing accounting methods had "... important effects on disclosed results" (Kenley, 1978, p40).

In a similar vein, but without providing empirical evidence, Pierpont stated
one vexed point this season is going to be the treatment of foreign exchange fluctuations. There is no uniformity among companies in their treatment of this item . . .

Unrealised gains and losses are a more difficult area and subject to wide variation in treatment (1977, p88).

Pierpont went on to note that exchange markets were again volatile (1977, p88).

This point was also noted in ED 1979

The increase in international business activity, combined with significant and frequent changes in the relative values of world currencies, has highlighted difficulties arising from translating into Australian currency amounts initially expressed or recorded in foreign currencies (paragraph 1).

The significance of foreign currency fluctuations for companies during the 1970's is evident from the financial press. In the early 1970's, the Australian dollar was strong relative to other world currencies. Where foreign debt was to be settled in a foreign currency, the strengthening Australian dollar meant windfall foreign currency gains for Australian net borrowers but losses to net lenders. Importers also benefited from effectively reduced prices while exporters faced shrinking markets. Australian companies with foreign subsidiaries also found that group profits declined when subsidiaries whose original financial statements were expressed in weaker currencies were translated for purposes of consolidation. On the other hand, Australian subsidiaries with foreign parents benefited when dividends were paid in weaker foreign currencies. When the Australian dollar was devalued in 1974, the opposite situation was likely to occur. The changing foreign exchange market had the potential to make the flexibility in accounting for foreign exchange very attractive.
Bougainville Mining Ltd provides an example of foreign exchange gains arising from overseas loans taken out before the Australian dollar was revalued in 1971. The *Australian Financial Review* of March 21, 1972 reported

> The currency revaluation last year helped reduce Bougainville Mining Ltd's $184 million loan bill almost five per cent.

> It meant a windfall gain to the company of nearly $9.2 million . . . (Dawson-Grove, 1972, p16)

However, Bougainville Mining Ltd also provides an example of the flexibility in accounting treatment prevalent at the time. After the exchange rate realignment, the company decided to translate loans at the rates prevailing at balance date rather than following the prior practice of using historic rates. This treatment was not adopted consistently as all other accounts continued to be translated at historic rates. The gain of $9.2 million was credited to an exchange fluctuation account for subsequent profit and loss recognition on settlement of the debt (p16).

**Fickle Exchange Rates and Changing Fortunes**

General Motors-Holden (GMH) also announced a currency windfall on the payment of a dividend to its US parent, General Motors. According to Sykes, the decision to pay the dividend may have been influenced by an 18 per cent revaluation of the Australian dollar against the US dollar since the December 1972 realignment (1973, p40). On the other hand, GMH expressed concern that the realignment of the Australian dollar may have a negative impact on GMH's export business (p41).

Alcoa of Australia Ltd expressed similar concerns over the future of Australian exporters in light of currency realignments. However, as with GMH, reductions in income due to the upwards revaluation of the Australian dollar were offset by currency gains on overseas debt.

In 1973, Davis Consolidated expressed the same reservation about the upwards revaluations of the Australian dollar:

> The recent variations in exchange rates have already placed many exporters, including our company, at a severe disadvantage and it is sincerely hoped the situation will not be aggravated by any further appreciation of the Australian currency . . . (cited from Davis Consolidated Interim Report in *The Australian Financial Review*, 1973a, p29).

In March 1974, directors of Davis Consolidated reported that their fears were being realised. Sales had increased by 22.9 per cent but exchange variations had restricted profit growth to 10.5 per cent. Directors further argued that had it not been for variations in the Australian dollar relative to the currencies of Canada, the UK, USA and South Africa, the increases in group sales and net profits would have been 25 per cent and 13 per cent respectively (*The Australian Financial Review*, 1974, p24). The failure to realise the higher increases was attributed to both reductions in sales and the profits of overseas subsidiaries which were effectively reduced on translation.
The Queensland sugar industry also argued that the upwards revaluation of the Australian dollar in December 1972 would have unfavourable repercussions on export markets (*The Australian Financial Review*, 1973b, p30).

In September 1974, the Australian dollar was devalued. 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 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, p30).

Lamson Industries Australia Ltd claimed the devaluation of the New Zealand dollar reduced its operating profit before tax by $173,000 for the year ended December 11, 1975. They further claimed that New Zealand profit was reduced by $73,000 due to the impact of exchange fluctuations on overseas borrowings (*The Australian Financial Review*, 1976a, p28).

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*, 1976b, 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, p17).

As already indicated, Lombard reported a $6.5 million foreign currency gain in 1973. However, for the 6 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, 1977a, p27).

**Diversity, Criticism and ED 1979**

Fluctuations in foreign exchange rates around the world, coupled with the lack of guidelines for appropriate accounting treatment of the effects of these fluctuations brought criticism of the profession for its lack of activity in this area:

About five years ago the accounting bodies circulated an exposure draft on foreign currency fluctuations, but since then they have spent their time playing games with current cost accounting systems instead.

... they might have spent their time better doing a little hack work on something less glamorous.

Like foreign currency fluctuations (Pierpont, 1977, p88).

While Pierpont's criticism may have some validity, it should be pointed out that the foreign currency issue has direct links to inflation accounting. Many of the arguments over the appropriate method of accounting for foreign currency fluctuations are related to the inherent limitations of historical cost accounting (eg. Eddey, 1985; Flower, 1981). Hence, it could be argued that the profession was not ignoring the foreign currency debate because it was not glamorous but because a solution to inflation accounting would also help solve the problems of accounting for foreign currency fluctuations. At present, the important point is that the profession was under attack for the apparent diversity of methods being used to account for foreign currency fluctuations.

Kenley referred to accounting for effects of foreign translation as "one of the most pressing problems facing the profession . . ." and, given the diversity found in practice, and the often large amounts involved meant "... the urgency of having a
definitive standard . . . has become extremely pressing" (1978, p38). It was against this background that ED 1979 was released.

ED 1979 followed the lead of FASB 8 and prescribed the use of the temporal method for translation of foreign currency financial statements (paragraph 49). FASB 8 mandated immediate recognition of foreign currency gains and losses in the profit and loss account. ED 1979 departed from this approach and provided that unrealised exchange gains and losses relating to long term receivables and payables be deferred and amortised over the life of the item (paragraph 50). The commentary section of ED 1979 indicated that unamortised exchange losses should be shown in the balance sheet as intangible assets. The Proposed Accounting Standards of ED 1979 stated that unamortised exchange gains and losses were to be disclosed in the balance sheet as deferred income or deferred expenses respectively (paragraph 53 b, c). The adoption of this method is in direct contradiction to the views 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).

While not denying this, ED 1979 permitted 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). It was further argued that the defer and amortise method provides an 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. Unless the duration of the loan coincided with the useful life of any asset purchased with the borrowed funds, matching of costs with benefits would not occur which makes this argument invalid. In addition, the defer and amortise option only applied to long term monetary items so that if a short term loan was used to finance a long
term asset, the application of the defer and amortise method would not apply which could be seen as inconsistent.

ED 1979 did not provide any guidelines on appropriate accounting for long term debt payable by instalment. In the absence of any such guidelines, a strict interpretation of the defer and amortise option to long term monetary items and the immediate recognition of short term monetary items adds the potential for complexity in the situation where repayment of the loan is progressive. Under such a situation, gains or losses would need to be allocated between instalments falling due in the short term and the balance of the loan to be paid in subsequent periods. Gains or losses on the short term portion would be dealt with in the profit and loss statement while the balance would continue to be amortised.

As implied by the wording of paragraph 16, the defer and amortise method is also a form of income smoothing:

... many believe that the inclusion in the results for a period of material unrealised gains and unrealised losses on long term monetary items whenever an exchange rate changes produces results which are distorted ...

This is inconsistent with a further argument presented in paragraph 16 that amortisation results in

... matching the income from lending with the risk attaching to a lending of funds.

One may well ask how an income smoothing device can achieve such a matching? The volatile and unpredictable nature of the foreign exchange market and the impact, in terms of gains and losses arising from exchange variations, on foreign debt was well established by the end of the 1970's (some examples have already been given, others
will be outlined in subsequent discussion in this chapter). The implication is that the proposed accounting standard had the potential to allow management to conceal errors in judgment as to the risk associated with foreign borrowings by deferring losses incurred on them. While it may be true that subsequent foreign currency gains will offset losses, the pattern of the Australian dollar’s relative value compared to those of other world currencies, particularly those favoured for foreign borrowings, would suggest that losses are more likely to be incurred than gains. Figures 1, 2 and 3 in the appendix to this chapter show clearly that the trend of the Australian dollar has been consistently downward since the early 1970’s. Admittedly, these graphs are based on yearly averages so gains could have been made in short term. Furthermore, it could be argued that losses on foreign borrowings could also have been offset by gains on overseas lending. However, Figure 4 in the appendix clearly shows that borrowing by Australian companies has far exceed foreign lending since at least 1980. The losses reported by Australian companies suggests that overall, companies reported losses. Figure 5 also shows a marked increase in interest payable by Australian companies on foreign debt. Overall the increasing levels of foreign debt coupled with rising interest charges and exchange losses, would suggest that users of financial statements are entitled to information regarding foreign borrowings and the impact of exchange rate changes in the interests of management accountability.

Management Accountability and Foreign Currency Loans

In spite of the fluctuations in exchange rates and the impact of such fluctuations on foreign currency loans, there was some support for "concealment", in the short term at least, from some quarters. For example, Barron’s Editorial Commentary of November 1, 1976 considered the provisions of FASB 8 meant
... projects which formerly were undertaken in the knowledge
that their expense could be delayed until they began to produce
revenues now must be considered in a different light. How, for
example, do their potential, often speculative, benefits rate against
the drawbacks of their drain on earnings, the resultant impact on
the price of a company's stock and its need and ability to raise
capital (p9).

However, is this valid in the Australian context? The losses incurred by some
Australian companies, as already demonstrated, were substantial and, in many cases
have continued to be so. Surely those who deal with corporations are entitled to
know management policies for raising foreign debt and the impact this has on financial
statements. One wonders if management would be so keen on income smoothing if
the results were profitable?

The financial press had also commented on the impact of exchange variations on the
cost of financing loans (eg. Pierpont, 1977, 1978; Haselhurst, 1978; Mumford, 1985a,
1985b). In some instances, management subsequently sought to lay the blame for
these losses on either the auditor or the bank responsible for advising the incurrence
of foreign debt (the AWA & Citibank cases provide relevant examples and will be
discussed later). Once again, given the fact that there was already clear evidence of
the risks associated with foreign-currency denominated debt, one has to ask firstly
whether management has any valid claim against auditors and financial advisers and
secondly whether an accounting standard should permit them to effectively hide their
mistakes by allowing exchange losses to be deferred and amortised. The first question
is a matter for the courts to decide and will be discussed briefly later in the chapter.
The second point could be evidence of the political nature of standard setting. Given
the lack of consensus dealing with appropriate accounting measurement techniques, as
evidenced by the total lack of a conceptual framework in the area of accounting
measurement and the debates on the issue of inflation accounting outlined in the
previous chapter, the possibility that lobbying on the part of management must be
considered. This is particularly so given the arguments presented in the exposure draft do not adequately explain the standard setters' change in attitude towards the defer and amortise approach.

Uther (1983) analysed submissions on ED 1979 but did not raise this issue. However, submissions dealing with subsequent exposure drafts indicate that management in general argued that as Australian corporations were net borrowers, the defer and amortise option was more acceptable than the immediate write-off of exchange gains and losses. In addition, the defer and amortise method was widely used by Australian companies (Philip, 1980, p29). This, however, was not offered as a reason for advocating the method. The question of the political nature of the defer and amortise option will be discussed further in subsequent sections of the chapter as the proponents of the method successfully withheld opposition to the method until 1987.

Confusing Terminology and Other Issues

A further problem is the proposed treatment of deferred gains and losses. Under the exposure draft's proposals, deferred losses would appear in the balance sheet as intangible assets. Deferred gains would effectively be disclosed as a liability (refer paragraphs 17, 18, 53 b, c). The logic of such classification is debatable. Theoretically, how can a deferred loss be classed as a future benefit and a future gain be classified as a future consumption of economic benefits? In addition, while the commentary section of ED 1979 suggests deferred losses should be classified as intangible assets, the Proposed Standard section simply requires classification as deferred income (paragraph 53c).

Apart from the matter of the defer and amortise option, the standard was criticised on other technical and non-technical grounds within the ranks of the profession (eg. Leo & Grundy, 1980; Wise and Wise, 1985) and in the 72 submissions in response to the AARF's request for comments on the draft standard. (ED 1979 can be considered
exceptional if for no other reason than the large number of responses received by the AARF.) The major technical grounds of complaint were the lack of provisions dealing with hedging contracts and the adoption of the temporal method (Uther, 1983). The temporal method was the most contentious of these issues. According to Uther 19 of the respondents stated a preference for the current rate method (p62). Given that a total of 72 submissions were received, 19 does not really represent substantial opposition. However, it should be remembered that submissions are not the only avenue for lobbying.

At a non-technical level, 19 respondents stated that overseas developments, principally those in the USA, should be followed (p63). As will be discussed shortly, the desire to follow developments in the USA is consistent with the preference for the current rate method as by the time ED 1979 was released, moves were being made to amend the FASB's foreign currency standard and permit either the current rate method or the temporal method. Opposition to the temporal method and the change in stance by the FASB appear to be key factors in the Australian profession's decision to drop ED 1979 (Prosser, 1985, p15; Roberts, 1981, p1; Uther, 1983, p59; Wise & Wise, 1985, p16). This may be explained in part as a flow on of the barrage of criticism levelled at FASB 8 (to be discussed shortly). However, the reason may be more in keeping with Flower's observation of the approach adopted by the UK and International Standards Committee (1981, p303-305). In other words, companies did not want to be forced to change accounting methods.

The results of surveys in 1974-75 and 1978-79 clearly show the current rate method was favoured by a majority of Australian companies (Corsi, 1987). In contrast, Kenley's survey of 100 Australian companies for the 1975-76 financial year found only one company using the temporal method (1978, p40). As already indicated, Kenley's research also showed considerable diversity in accounting for foreign currencies both across companies and within companies. Clearly, the prescription of
the temporal method as the one and only acceptable method would mean that companies would not only be faced with adopting a new accounting method but would also be precluded from applying differential accounting policies from item to item and from year to year.

Prescription of the temporal method was also a departure from ED 1973 which had advocated the current rate method. However, this is not as significant a departure as the defer and amortise method because at the time ED 1973 was issued, the temporal method had only recently been developed. One possible explanation for the standard setters' reversal of opinion on the defer and amortise method is that this represented a compromise. Rather than forcing management to change both the method of translation and the method of treating gains or losses on long term debt, there was a trade-off which eliminated flexibility in the former and permitted income smoothing in the latter. Compromises such as this point to the political nature of accounting standard setting and raises questions as to the usefulness of the final standard as a regulatory device. Staunton raised this issue with regard to the furore over FASB 8:

What is the test for financial accounting standards - time-honoured traditional fashions even if they lack credibility or a search for truth? Would the heated corporate protests be based on a wish to disclose the true situation or on a wish to preserve the status quo in which particular pressure groups held sway? (1978, p56)

ED 1979 & Criticism of FASB 8

The removal of flexibility in accounting for foreign currency translation and the ability to smooth income patterns over time appear to be the major underlying factors in the furore which erupted in the wake of FASB 8:
Intended to bring some order out of the chaotic variety of methods used to translate the results of foreign operations, the Financial Accounting Standards Board's Standard No 8 has instead substituted a new chaos of its own. (Editorial Commentary, 1976, p9).

The overall criticism of FASB 8 was that when currency fluctuations were erratic profit patterns were also erratic and the adjustments required under FASB 8 were confusing to users of financial statements (Merjos, 1976, 1977; Forbes, 1976; Rodriguez, 1977; Copeland and Ingram, 1978; Staunton, 1978). These arguments were summed up in Forbes just six months after the release of FASB 8:

... [FASB 8] may make your quarterly reports look like a profile of the Swiss Alps...

That sort of thing baffles investors and even sophisticated analysts... by obscuring the real trend of a company (Forbes, 1976, p37).

In addition, it was argued the impact of the provisions of FASB 8 on the financial reports of multinationals would deter investment in those corporations (p40). Similar claims were made in Barrons:

The new standards have created some serious economic problems. Investment by multinationals is likely to have been curtailed and the allocation for a given volume of investment distorted.

It's tough to say how the stock market will adjust to the more erratic earnings patterns likely to be fashioned by the rulings coming down from the FASB. But instability and lessened predictability aren't the stuff that usually make for extravagant price-earnings ratios (Editorial Commentary, 1976, p8).

The Forbes article went on to provide examples of the variations in reported quarterly earnings of some companies. Increases of up to 1200 per cent were recorded by some companies while reductions of up to 60 per cent were reported by other companies. It was claimed that half, if not more, of the variations on previous
earnings were attributable to the application of FASB 8. This meant, for example, that a company with high operating results but relatively minor foreign currency gains, may show a lower overall result than a company with high foreign currency gains and a lower operating result (1976, pp37-40).

As the following discussion will demonstrate, evidence suggests, with the exception of the impact of FASB 8 on quarterly earnings, the claims of management as to the effects of FASB 8 were unfounded.

The impact of the provisions of FASB 8 were claimed to be felt in four areas in particular: depreciation of non-current assets, cost of goods sold, long term debt and immediate recognition of gains and losses on translation of financial statements of foreign based operations. The first three items relate directly to the temporal method of accounting for foreign currency translation and, as such, are most relevant to ED 1979. ED 1979 did not require immediate recognition of gains and losses on long term items in the profit and loss account so it could be claimed the arguments raised with regard to this issue and FASB 8 may not be entirely relevant to the decision of Australian standard setters to abandon ED 1979. On the other hand, the arguments may be relevant to an understanding of why ED 1979 took the rather softer option in allowing gains and losses to be deferred and amortised.

**FASB 8, Depreciation and Cost of Goods Sold**

The major criticisms of the impact of the temporal method on the depreciation of non-current assets and cost of goods sold revolve around the costs of implementing the change in accounting method. Recall that under the temporal method, inventory and non-current assets are translated at historical rates. Research by Evans and Folks (1979) suggests one pragmatic reason for resistance to the temporal method. According to their survey, 63 to 68 per cent of responding firms would be required to change from translation of inventories at the current rate to translation at the historical
rate (pp34-35). To facilitate this change, additional clerical, managerial and audit costs are likely to be incurred. In addition, translation at historical rates means when the foreign currency weakens relative to the domestic currency, depreciation and cost of goods sold will be higher than if the current exchange rate were used for translation purposes. The opposite occurs when the foreign currency strengthens. The translation of inventory and depreciation of non-current assets held by a foreign subsidiary will continue to have an impact on group accounts until such time as the inventory is used and relevant non-current assets fully depreciated or disposed of. These arguments would be applicable to the Australian situation because, as already indicated, research by Kenley and others found widespread use of the current rate method by Australian companies.

**FASB 8 and Long Term Debt**

Prior to the issue of FASB 8, most US companies translated long term debt at the historical rate. The temporal method prescribed by FASB 8 requires long term debt to be translated at the current rate (Rodriguez, 1977, p42). Again, there is the potential cost to the firm of changing accounting methods and, also, a potential income effect. If exchange rates remain stable the use of the current rate does not present a problem. In the 1970's, as now, foreign currencies were not stable. When a debt is expressed in a foreign currency which strengthens relative to the domestic currency, liabilities increase on translation because the amount of domestic currency that the borrower has to pay to settle the debt has increased. In this case, the borrower would report a foreign currency loss on translation. The opposite occurs when a foreign currency weakens relative to the domestic currency. Similarly, net lenders in a foreign currency would face a currency gain when the foreign currency strengthens and a loss when it weakens.

A further complaint against FASB 8 relates to both non-current assets and long term debt. Where a long term debt has been incurred in order to finance acquisition of a
non-current asset, it has been argued (for example, Joseph Connor, senior partner of Price Waterhouse & Company) the translation of these items should be at the same rate rather than the current rate for the debt and historical rate for the asset as prescribed by FASB 8:

> It (FASB 8) requires accounting to separate business activities which are completely intertwined in their conception and implementation and to treat them as unrelated events (Connor, 1979, p78).

It must be pointed out, that the extent of the gains or losses incurred by companies with foreign operations or borrowings depends on the composition of the balance sheet, for example, debt versus equity, the size of the relevant accounts and the turnover of debt and inventory. For example, according to Rodriguez, if FIFO (which Rodriguez claims is the most common valuation method used by multinationals to value inventory) is used and inventory turnover is rapid, say three months, the impact of exchange rate fluctuations is not likely to be great. On the other hand, where inventory turnover is slow, the potential increases for a large difference between the historical rate and current rate and a consequent impact on net profit through cost of goods sold (1977, p43). To a certain extent, management can control these factors and large gains or losses resulting from foreign operations or borrowings may be more a result of poor management than exchange rates.

The impact of FASB 8 will not only depend on the size of the debt but the difference in exchange rates between the time the debt was taken up and balance date. Obviously, if the exchange rate remains stable, no exchange gain or loss will occur. A further consideration is the relative strength of the domestic currency compared to that in which the debt is expressed. Hence, companies that borrow overseas when the domestic currency is weak will tend to show foreign currency losses. The extent of these losses overtime would in turn depend on the strength of the foreign currency.
Rodriguez uses the example of long term debt denominated in Swiss francs contracted in 1971. In 1974, the debt would have appreciated by more than 40 per cent (1977, p44). Recall the situation was the same in Australia as evidenced by Ciba-Geigy Australia which in 1974 reported a $1,588,712 foreign currency loss on a Swiss franc loan. On the other hand, not all world currencies were as consistently strong as the Swiss franc so that loans denominated in less stable currencies could easily result in a loss one year and a gain in the next. Currency fluctuations in 1976 and 1977 provide evidence to this effect. In 1976 the Australian dollar and the British pound fell relative to the US dollar by some 13 per cent and 16 per cent respectively. The following year both currencies strengthened relative to the US dollar (Merjos, 1977, p22). While management cannot control currency fluctuations, the potential for exchange variations should be a consideration in formulating overseas borrowing and lending policies.

**Empirical Research, Management and the Temporal Method**

Several studies into the impact of the temporal method on financial statements and company management have been undertaken. This research suggests that in response to FASB 8, management of US multinationals did alter policies with regard to debt and inventory management (Griffin, 1979, p12). Hence, as Rodriguez suggests FASB 8 has at least alerted the business world to the potential impact of foreign operations on reported earnings (1977, p47). This does not necessarily mean, however, that the response by management has had either a positive or adverse impact. Of the 13 major studies collated by Griffin, none were able to conclude that practices altered in response to FASB 8 had an adverse affect on companies' cash flows (1979).

It also appears the cost of compliance with FASB 8 in terms of clerical, managerial and audit activities were not significant (Evans and Folks, 1979, pp35-37).
Finally, Rodriguez concluded that while FASB 8 caused short term variations in earnings due to adjustments in inventory (usually positive) and long term debt (usually negative), in the long run positive variations tended to exceed negative variations (1977, p44).

The major criticism of FASB 8 appears to be its abolition of flexibility in the treatment of foreign currency translation gains and losses (Editorial Commentary, 1976, p7; Merjos, 1976, p11; Evans & Folks, 1979, p33; Rodriguez, 1977, p40). This in itself may not have been a problem, however, as already indicated, FASB 8 required all gains and losses to be reported in the profit and loss account in the period in which the change in foreign exchange rate occurred. In a world of fluctuating currencies, this meant that reported profit would also fluctuate in accordance with the changes in exchange rates.

It appears, however, that the abolition of flexibility argument is not entirely valid. Evans and Folks report that prior to FASB 8 the majority of firms included in their survey already recognised gains and losses in current income. On the other hand, there was evidence of flexibility in accounting for gains and losses with some 37 per cent of respondents adopting deferral options under unspecified criteria (1979, pp35-36). In addition, research suggests the treatment of gains and losses prescribed by FASB 8 did cause earnings fluctuations but only on an interim basis (Editorial Commentary, 1976; Merjos, 1976, 1977; Rodriguez, 1977; Copeland and Ingram, 1978; Griffin, 1979).

From a survey of 40 companies reportedly significantly affected by FASB 8, Merjos concluded in December 1976 that the impact of FASB 8 had been "considerable in all cases" (1976, p24). Of particular concern, according to Merjos, was the lack of comparability within companies from year to year. American Brands, for example, reported a $26 million foreign currency loss in 1976 compared with a $6.1 million
gain in 1975 (1976, p24). Similar results were reported by a number of companies including Armco Steel, Continental Group, Exxon, Heinz, Xerox (1976, pp24-26). In a follow up survey in 1977, Merjos found while the impact of FASB 8 continued to be "substantial" on a short term basis for the 1976-1977 year, it tended to be "benign" (1977, p11). In some cases, companies reporting foreign currency losses on a quarterly basis in 1976, reported gains for the same period in 1977. Other companies continued to report losses but in many cases, reported losses were substantially reduced. The 1977 Merjos survey showed, for example, that F W Woolworth reported a $3.6 million loss in the quarter to April 1976 compared with a $5 million gain in the like 1977 quarter (p11).

An earlier study of 70 US multinationals conducted by Rodriguez showed the impact of FASB 8 was not substantial for the majority of firms adopting its provisions in 1975. A comparison of reported earnings after application of FASB 8 in 1975 was made with pre-FASB 8 (1974) results. Only 23, less than one third, of the surveyed companies reported a significant impact on earnings. The impact of FASB 8 on ten of those companies was less than 5 per cent of earnings for the year and, in many cases, the impact was positive. On the other hand, one company reported a negative impact of 38 per cent (1977, p41).

As with inventory, non-current assets and long term debt, the extent of the impact on profit patterns of immediate recognition of gains and losses depends on the composition of the balance sheet which again raises the question of the efficacy of management policies. However, Merjos contends FASB 8 will have little if any impact in the long term because positive and negative adjustments will offset each other (1976, p25; 1977, p22).
As already demonstrated, the results of studies into the impact of FASB 8 have generally refuted the concerns expressed about its effect on income variations at least in the long term. Similar conclusions have been made concerning share prices and returns and foreign investment. Four of the studies examined by Griffin found no statistically significant impact on security returns beyond the 5 per cent level of probability (1979, p12). Where lower returns were found, for example, the Dukes study showed lower returns in 1975-76 for companies with substantial foreign interests compared with companies with similar risk but smaller foreign interests, the weakening US dollar could have been as much responsible as FASB 8 (1978, p102).

Shank, Murdock and Dillard provided evidence to support this hypothesis. Their study showed declining returns and declining price/earnings ratios for firms in general not just multinationals (1979, p90). Similarly, the study by Shank, Dillard and Murdock found some evidence to suggest that multinational companies lost market favour after FASB 8 was issued (p90). However, as with declining returns, it is possible these were caused by economic factors such as "... floating exchange rates, volatile foreign inflation rates, taxation of foreign-source earnings and widespread political rather than by accounting considerations" (p90).

From the foregoing, it is evident that FASB 8 did not have adverse economic consequences. It is somewhat puzzling, therefore, that in 1979 the FASB abandoned its previously firm stance on the appropriateness of FASB 8 and appointed a task force to consider amendments to it (News, 1979, p12). It is even more puzzling when two of the research studies cited above, Dukes and Evans, Folks and Jilling, were sponsored by the FASB itself and refuted claims that FASB 8 had adverse economic consequences on companies caught by its provisions.
The Demise of FASB 8 - An Explanation?

The impetus for change appears to have been initiation of a research programme in April 1977 into the economic consequences of FASB standards issued to date and a decision in May 1978 to institute post enactment review of those standards. The FASB's concern at the criticism aimed at FASB 8 is evident considering two of four projects initiated and funded by the Board in 1977 dealt with FASB 8. As already discussed, the study undertaken by Dukes found FASB 8 had no significant impact. The second study, *The Impact of Statement of Financial Accounting Standard 8 on the Foreign Risk Management Practices of American Multinationals: An Economic Impact Study*, was undertaken by Evans, Folks and Jilling. The Evans and Folks paper, previously cited, was based on this study and, as already indicated, found there had been an increase in risk management practices adopted by multinationals in the wake of FASB 8 (1979). However, Evans, Folks and Jilling were unable to come to a conclusion regarding the economic impact of these practices (News, 1979, p22). Given that FASB-sponsored research did not support the claims of adverse consequences arising from FASB 8, it must be concluded that there was another cause for the FASB's actions. That cause appears to have been pressure from management and suggests that actual economic consequences are not as important as perceived consequences. Additional research supports this.

In response to the FASB's post enactment review process, some 205 written submissions were received (Evans and Folks, 1979, p41). Most of the submissions were critical of FASB 8 (Evans and Folks, 1979, p41; Flower, 1981, p303). Furthermore, whilst the market-based studies of Dukes, Evans, Folks and Jilling, Merjos and Rodriguez (all previously cited) found FASB 8 had no adverse economic consequences, opinion-based surveys by Choi et al (1978) and Stanley and Block (1978) showed that management believed FASB 8 did have economic consequences. Furthermore, Evans and Folks (1979, p37-38) and Shank, Dillard and Murdock (1979, pp86-89) found firms adopted a number of strategies to lessen the perceived
impact of FASB 8. The identified strategies included borrowing in weaker currencies, changes in dividend policy (for example, paying dividends when the domestic currency of the holding company was weak relative to that of the subsidiary's domestic currency) and using forward contracts (Evans & Folks, 1979, p37). The strategies identified by Shank, Dillard and Murdock included altering the source of debt financing (1979, p86), increased hedging activities in the form of forward contracts (pp86-87), increased use of outside consultants (p87) and altered management reporting and control systems (pp87-89). Griffin also found evidence that firms adopted risk management practices (1979, pp12, 18).

In addition, Shank, Dillard and Murdock found that at least 80 per cent of the firms in their survey considered the financial impact of FASB 8 was significant because of the increase in management time and attention directed towards foreign currency accounting (1979, p89). However, in light of the minimal direct impact of FASB 8 on earnings, share prices and returns, management was not justified in incurring this expenditure. Griffin also points out that while risk management practices were adopted, none of the surveys could demonstrate the effect of these practices was positive (1979, p18).

It could be speculated that management could have spent resources more productively by adopting policies in these areas which would take foreign currency variations into account. On the other hand, it could also be speculated that management adopted risk management policies to demonstrate their concern at FASB 8 and to use the expenditure incurred as a lever to persuade the FASB to provide a more flexible approach to foreign currency. Evans and Folks found that more than 60 per cent of firms surveyed wished to have such a flexible approach (1979, p41).

Finally, the influence of management and others is best exemplified by a comment by FASB Chairman, Donald Kirk, that the foreign currency issue required "rapid and
immediate consideration" by the FASB in response to concerns expressed by constituents (Journal of Accountancy, 1979a, pp20, 22).

Uniformity Abandoned, Diversity Endorsed

A 14-member task force was subsequently appointed to consider amendments to FASB 8 (Journal of Accountancy, 1979b, p12). The outcome of this task force was an exposure draft, Foreign Currency Translation, issued in August, 1980. This exposure draft abandoned the notion of a uniform approach to accounting for foreign currency translation. It introduced the concept of "functional currency" as a basis for determining the application of either the current rate method or the temporal method and the treatment of translation gains and losses. Briefly, companies are required to determine the functional currency of foreign subsidiaries on the basis of the relationship of each subsidiary to the parent company. Where the subsidiary is independent (self-sustaining), essentially meaning there is no cash flow between parent and subsidiary, the functional currency of the subsidiary is its own domestic currency. The current rate method would be used to translate the subsidiary's financial statements for purposes of consolidation. Where there is a close relationship between the parent and subsidiary such that the subsidiary is effectively an extension of the parent (an integrated operation), it would be expected that frequent cash flows between the two entities would occur. The functional currency of the subsidiary would be the same as that of the parent and the temporal method of translation would be used.

The determination of the functional currency also determines the disposition of translation gains and losses. If a subsidiary is independent, gains and losses on translation are not part of the ordinary operations of the group and are taken to a foreign currency reserve. Conversely, gains and losses of dependent subsidiaries are reported in the profit and loss account.
The 1980 exposure draft was revised in response to opinions expressed in submissions and at a public hearing held in December 1980 (Roberts, 1981, p7). A further exposure draft was issued in June 1981. This exposure draft maintained the functional currency concept but provided, inter alia, for additional guidelines for its determination. A new standard, incorporating the provisions of the 1980 and 1981 exposure drafts, FASB 52 *Foreign Currency Translation*, was issued in December 1981.

Management had achieved two things. Firstly, it achieved flexibility in the application of translation methods to foreign operations. Secondly, and perhaps more importantly, for companies adopting the current rate method on the basis that its subsidiaries were independent or self-sustaining, management had achieved a method of reporting gains and losses which would tend to show gains rather than losses even if the domestic currency was weak compared to the currencies of foreign subsidiaries. This arises because, under the current rate method, the risk associated with currency fluctuations is measured in terms of the net investment or net assets of the subsidiary. This figure is usually positive which means a foreign currency translation gain would be reported. Whether a gain or loss was recorded, the profit and loss account is not affected because the activities of self-sustaining operations are not considered as part of the operations of the group and are therefore taken to a foreign currency fluctuation reserve. On the other hand, the temporal method, which would be appropriate for companies whose subsidiaries were classified as integrated, measures risk in terms of net monetary assets. For a net borrower, net monetary assets would be negative and a foreign currency translation loss would be recorded when the parent company's domestic currency weakens relative to that of the subsidiary. When the functional currency of the subsidiary is deemed to be the domestic currency of the parent, foreign currency translation gains and losses are included in the calculation of profit or loss. It is obvious that management could have a clear incentive to classify subsidiaries as self-sustaining.
Due Process or Survival

While this result could be seen as the working of due process procedures, it is also consistent with the thesis of this study. The accountancy profession is prepared to compromise its own principles in order to maintain its hegemonic domination of the standard setting process. As discussed in Chapter 5, dissidence and resistance can threaten domination particularly where those who are dissatisfied have an alternative. By ignoring management's unjustified behaviour with regard to accounting for foreign currency, the FASB ran the risk of a repeat of the investment tax credit and business combinations issues and a management lobby to the government. Should this occur and management achieve its purpose, as it did in the past, the FASB could have suffered the fate of its predecessor, the APB, and been replaced with yet another profession-sponsored standard setting body. Alternatively, in the face of what probably would have been a very public conflict, the government may have opted to have the SEC exercise its mandate and take over the setting of accounting standards. The profession stood to lose no matter which way it jumped and, perhaps, a flexible standard, suitably justified on theoretical grounds, was the lesser of the two evils. In other words, discretion was the better part of valour and rather than simply capitulating, the FASB attempted to use theoretical arguments to justify its actions even though the major argument used was a direct contradiction of the philosophy underlying FASB 8.

The release of FASB 52 could also be seen as an associative strategy. It appears the FASB initially was determined to retain FASB 8 in the face of arguments that it would produce income volatility. According to the chairman of the committee responsible for the development of FASB 8, it was anticipated that earnings would be volatile under the provisions of the standard when foreign currency rates fluctuated widely. However, the FASB obviously considered users of financial statements were entitled to know the impact of foreign investment when exchange rates changed.
It's not the function of accounting to minimise reported fluctuations in earnings. Past rate changes are historical facts, and the Board believes that users of financial statements are best served by recognising exchange gains or losses when they occur. On the contrary, it's the deferring or spreading of those gains and losses that is artificial . . . (Donald Kirk, cited in *Forbes*, 1976, p40)

It appears the Board still adhered to this view two years later

. . . the Board does not perceive that smoothing fluctuations in reported earnings should be a function of accounting standards, and SFAS 8 explicitly reflects that view. There is no question that SFAS 8 has increased the potential for volatility in earnings. That was a conscious decision made by the Board (Donald Kirk, cited by Copeland & Ingram, 1978, p16).

Perhaps in making this conscious decision and then maintaining it in the face of mounting criticism, the FASB was attempting to demonstrate both its superior accounting skill and knowledge and its domination of the standard setting process. When the criticism did not abate, the possibility of management withdrawing its support for the FASB meant that action had to be taken to regain or maintain that support. FASB 52 was a means of doing this. Nonetheless, the contentious nature of the issue and the FASB's response is highlighted by the fact that FASB 52 was passed by a bare majority of 4 to 3.

In light of the foregoing, it is not surprising the AARF deferred further consideration of the foreign currency issue pending the outcome of the deliberations in the USA, UK and Canada (Stevenson, 1980, p10). Furthermore, FASB 52 was in line with the provisions of ED 27 *Accounting for Foreign Currency Translations* issued in the UK by the Accounting Standards Committee in October 1980. It was also similar to recommendations considered by the IASC in 1980. The profession in Canada was also undertaking a review of its foreign currency standard, Section 1650 *Translation*
of Foreign Currency Transactions and Foreign Currency Financial Statements which was similar to ED 1979.

Australia, Isomorphism & ED 1983

Despite the emergence of what was clearly an international consensus of opinion, the reluctance of the Australian standard setters to come to a decision is evidenced by the elapse of 3 years before a further exposure draft was issued. (It should, however, be recalled that the early 1980's saw the establishment of the ASRB and a considerable amount of the profession's energy during this time was devoted to its battle with the government over copyright to existing standards and the functions of the ASRB. Obviously, setting accounting standards took a back seat to the battle over dominance of the standard setting process.)

In 1981, a report on AARF Standards Research speculated that a revised standard would be issued incorporating provisions similar to those specified in the US, UK and IASC exposure drafts (Roberts, 1981, p10). The September 1983 progress report stated that work on an Australian exposure draft was "well advanced" following progress on the topic by standard setters in the USA, UK, Canada and the IASC (Stevenson, 1983c, p530). An exposure draft, Foreign Currency Translation, (hereafter referred to as ED 1983) was issued in September 1983. As predicted, it closely followed the approach of overseas standards and adopted the functional currency approach. However, as with ED 1979, ED 1983 followed the Canadian approach to foreign currency transactions as opposed to foreign statement translation and permitted the deferral and amortisation of gains and losses. This method was also acceptable under the IASC standard. Both the US and UK standards required immediate recognition of these items in the profit and loss account.
ED 1973, 1979 & 1983 Compared

As with FASB 8 and FASB 52, ED 1979 and ED 1983 expressed different objectives of translation. ED 1979 was based on the premise that the underlying accounting principles adopted in the preparation of the foreign subsidiary's financial statements should be the same after translation as before (paragraph 25). The current rate method was explicitly rejected because it did not achieve this purpose (Appendix 1). ED 1983, on the other hand, adopted the view that the translation method used should "reflect the financial and other operational relationships which exist between the reporting entity and its foreign operations". This objective justified the use of different accounting methods in different circumstances (paragraph 14). Clearly, as with the standards issued in other countries, all semblance of uniformity in practice was foregone except that the exposure draft further stated that self-sustaining operations were expected to be more common than integrated operations (paragraph 19). Just why this expectation existed was not explained but it appears there was no empirical justification for it. In an article explaining the exposure draft, the then director of the AARF stated

It will . . . be interesting to see whether integrated foreign operations are more common in Australia than has been found to be the case overseas (Stevenson, 1983d, p707).

As will be discussed in more detail later, there is evidence to suggest that in the absence of quantitative guidelines, US multi-nationals have deliberately weighted the criteria to enable subsidiaries to qualify as self-sustaining. This would suggest that self-sustaining operations are not as common as the AARF asserted them to be.

By advocating the current rate method, the standard setters had returned to the position adopted in ED 1973. However, whereas ED 1973 rejected reserve accounting, ED 1983 permitted translation gains and losses for self-sustaining operations to be accounted for through a "foreign currency translation reserve"
Because the foreign operation does not expose the parent company to foreign exchange risk on a day to day basis, foreign exchange gains and losses relating to a self-sustaining operation are only of significance when the interest in the subsidiary is reduced through sale, liquidation, dilution of interest or other capital transactions (ED 1983, paragraphs 18 & 39). Where such a reduction occurs, an adjustment to the reserve may be made through the profit and loss account (paragraph 39). This approach is a de facto "deferral until realisation" concept which was rejected by Lorensen (1972) and Parkinson (1972) and in previous Australian exposure drafts:

... the inclusion of the total gain or loss in the results of one period, ie. the period of settlement, can cause distortion of the result reported for that period (ED 1979, paragraph 14).

In addition, this approach would mean that gains and losses would offset each other over time and would have an impact on shareholders' equity which was also rejected in ED 1979 (paragraph 17). One further deficiency of the exposure draft in this regard is that it did not provide for a dilution of interest arising from operating losses (Jansz, 1984, p40, 41).

ED 1983 overcame one of the perceived deficiencies in ED 1979 by providing for the treatment of hedge contracts (paragraphs 22 - 36; 56 - 62). However, the provisions were not altogether without flaw. For example, Jansz argued that the exposure draft permitted management to hide speculative dealings (1984, pp40-41). The rationale behind this argument is based on the concept of a self-sustaining foreign operation which, by definition, does not expose the parent company to foreign exchange risk on a day to day basis (paragraph 15). If this is the case, then hedging the net investment in a self-sustaining operation could be nothing more than a speculative transaction. Therefore, Jansz argues that management should be required to disclose the hedge activity. This issue was also raised in a submission on ED 1983. However, paragraph
1 of the exposure draft specifically excludes speculative dealings which would mean
that if hedging a self-sustaining operation is purely speculative, it is not covered by the
standard anyway.

A further inconsistency lies in the separate transaction philosophy underlying the
treatment of short term monetary and long term monetary items. Paragraph 8 states
and paragraph 10 implies that the purchase of an asset and exchange differences
arising from the financing of those assets are two separate transactions. Therefore,
exchange differences should not be included in the measurement of the relevant assets.
The separate transaction concept, however, is not applied to hedges of specific
commitments relating to the price of goods or services to be purchased or sold
(paragraph 29 (a)). ED 1979 specifically proscribed the offsetting of deferred gains
and losses in the balance sheet (paragraph 19). ED 1983 did not include this
provision and allowed for the offset of gains and losses arising on hedging
transactions relating to foreign currency payables and receivables against the relevant
monetary item (paragraphs 29, 31).

ED 1979 (paragraph 4(g)) also included a definition of "settlement date" which was
relevant to the amortisation of long term monetary items. ED 1983 continued to
permit the defer and amortise option but did not provide a definition of "settlement".
Instead, ED 1983 permitted the defer and amortise option on 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". However, ED 1983 failed to define "remaining life of the monetary
item" which left open the possibility of never bringing exchange differences to account
by rolling-over the debt. The implications of this will be discussed in more detail in
relation to the AWA v Daniels case.
ED 1979 required deferred gains and losses to be shown as intangibles in the balance sheet (paragraphs 17 and 18). ED 1983 paragraphs 10 and 11 also required gains and losses on long term monetary items to be deferred and shown as either deferred income or deferred expenses. The deficiencies of the defer and amortise option outlined previously were still valid and continued to be an area of contention until the option was withdrawn in 1987.

**ED 1983 and Lobbying Activities**

The submissions received in response to ED 1983 are enlightening in that they suggest the validity of the 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. Responses to the exposure draft were broadly classified as industry (13), individual (9), accountancy firm (7), government/regulatory bodies (5), professional association (2) and other (2).

The question of the treatment of gains and losses on short term and long term monetary items featured strongly in the submissions. 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. 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. One indicated a preference for reserve accounting and 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 term and long term monetary items should ever be included in the cost of the asset. This question is in direct contradiction of paragraph 8 of the exposure draft which, as discussed previously, adopts the view that the purchase of the asset and its financing are two separate transactions. 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.

A counter argument was put forward in a submission from an individual who argued that there was a difference between interest and gains and losses on overseas borrowings. Australian companies did not have to raise finance in other countries. When they did, they were effectively speculating on movements in the foreign currency. Therefore, companies should account for the economic consequences of their decisions. However, the industry argument won the day. The concept of qualifying assets was introduced in AAS 20 and its ASRB identical twin, Release 406.
Foreign Currency Translation, and became part of accounting for foreign currency transactions.

Foreign Currency Management, Financial Disclosure & Criticism

ED 1983 was referred back to the AARF for further consideration. It was to be 1985 before an accounting standard was issued. Surprisingly, after all the years of indetermination, two foreign currency standards were issued in 1985. In the interim, the profession was criticised for its lack of progress on the issue. Some measure of the dissatisfaction with the profession was given when the NCSC took matters into its own hands and issued a practice note dealing with foreign exchange disclosure.

The increase in foreign trade and raising of foreign debt and the inherent risks were also being recognised. One of the successes of the time was BHP. The Australian Financial Review of April 4, 1984 carried the headline, "BHP's Quiet $700 Million Foreign Exchange Coup" (Hubbard, 1984a, p1). The article clearly highlighted the risks involved in foreign currency dealings also the need for a high level of skill, not to mention, luck:

The operation involved highly secret deals in the local market to avoid spooking already nervy forex traders and pushing the exchange rate against the company, followed by a complex series of short-term investments with more than 22 Asian banks, and finally the marshalling of all the funds and transferring them to New York (p1).

The lack of disclosure in financial statements of foreign currency gains and losses was also causing concern particularly given the amounts involved as well as the risk. Bond Corporation for example, was challenged by the NCSC for failing to disclose foreign exchange losses. Bond Corporation argued that foreign exchange losses were included in the calculation of profit but were not disclosed separately because they were not material (Buduls, 1985a, p58). One financial journalist questioned whether
Bond Corporation was consistently and precisely applying existing accounting rules for the determination of profit (Coombe, 1985a, p52).

Robert Gottliebsen also levelled criticism at the profession for "dithering" and failing to produce a foreign currency accounting standard (1985a, p6). Gottliebsen contended that the delay in producing a foreign currency standard was because there were too many people to please (1985b, p6). In commenting on paper foreign currency losses of $200 million and $50 million for CSR and Bond Corporation respectively, Gottliebsen added

Neither has seen the light of a profit and loss account. I suspect that there will be other paper losses which, if no rules are set, will be festering away on corporate balance sheets (1985a, p6).

During the early months of 1985, the value of the Australian dollar deteriorated by 20 per cent. By July 1985, the devaluation stood at 25 per cent (Bushnell, 1985, p1). As a result, many Australian companies showed increasing foreign currency losses (Mackay, 1985, p59). One such company was Santos which increased its estimate of foreign currency losses from $86 million to $300 million (Loudon, 1985, p64). Santos clearly was not alone. Statistics released by the Australian Bureau of Statistics in July 1985 showed that Australian companies had lost more than $3800 million on foreign borrowings since the Australian dollar began its decline in February 1985 (McCran, 1985, p25).

At the end of July 1985, the NCSC released a practice note dealing with disclosure of foreign currency transactions. On issuing the practice note, the NCSC said it was concerned with the diversity of accounting and disclosure policies with regard to foreign currency dealings and the impact these practices had on reported results (Wilson, 1985, p40; Bushnell, 1985, p1; Uren, 1985, p13). In taking this action, the NCSC demonstrated its irritation with the profession's failure to produce a standard...
by pointing out that an exposure draft was issued in 1979 but that a standard was unlikely to emerge before the end of 1985 (Bushnell, 1985, p1). Even when the profession's long awaited standard did materialise, it was not have immediate application (Wilson, 1985, p40).

The move by the NCSC was seen by some as an intrusion into a profession dominated area. For example, one commenter stated

The practice note is likely to provoke a controversy in accounting circles as it is the boldest step the commission has yet made into the territory of accounting standards, which the accounting bodies regard as their own legitimate preserve (Uren, 1985, p13).

The profession's response, as expressed through the then executive director of the Institute of Chartered Accountants in Australia, Vic Prosser, was to defend its own lack of progress on two grounds. First, ED 1979 was issued shortly before "a change in world accounting and reporting" (ie. from the temporal method to the current rate method). Given the need for consistency between Australian and overseas standards, the AARF did not proceed with ED 1979. Second, the profession's standard setting machinery had been "held up" by the establishment of the ASRB (Prosser, 1985, p15). Prosser also criticised the NCSC for introducing another source of accounting requirements for financial reporting (p15).

*The Profession Responds - Release 402*

Perhaps to avoid the situation where preparers of financial statements were required to adhere to rules set by the AARF, the ASRB, the stock exchange and now the NCSC, the ASRB issued ASRB 1003: *Foreign Exchange Disclosure*. ASRB 1003 was the NCSC's practice note in a slightly modified form. Another likely explanation for the rapid release of ASRB 1003 is that the profession did not wish to have the NCSC seen as usurping its position as the source of accounting standards and
practices even if the NCSC's practice note was based on the profession's own exposure draft dealing with the issue. Some support for this contention is that the NCSC's practice note was issued late in July 1985. ASRB 1003 was approved a mere two months later. The ASRB went through its regular review process of issuing an exposure draft, Release 402 Foreign Exchange - Disclosure, for public comment. There was little time for considered comment or for analysis of comments. Release 402 was issued in August with a closing date for comment being September 16. ASRB 1003 was approved on September 27. In the history of the promulgation of Australian accounting standards, particularly on the foreign currency issue, this is extraordinary to say the least even if ASRB 1003 was only an interim measure!

In spite of the decidedly short time allowed for comment, the ASRB received 36 submissions. Equal representation came from companies and chartered accountancy firms with ten submissions being received from each classification. Five submissions came from universities or colleges. The remaining submissions came from individuals, insurance companies, superannuation funds, directors' groups and the Securities Institute.

The major criticism (more than half of the respondents) was that Release 402 was confined to disclosure. Many of those critical of the proposed standard on this basis (approximately one third) considered its requirements were already covered in existing accounting standards (eg. AAS 6 Accounting Policies: Determination, Application and Disclosure and AAS 5 Materiality in Financial Statements), Schedule 7 (now Schedule 5) and the NCSC practice note. In other words, the standard was redundant. Others considered that as the standard only dealt with disclosure, it did not meet the evaluative criteria of Release 100. However, a common response was that the proposed standard was a necessary interim measure pending the release and approval of the profession's standard, AAS 20.
The financial press also questioned the necessity for the standard, particularly as it would not apply for some months (Coombe, 1985b, p24). An alternative, according to one journalist would have been to amend Schedule 7 to include the provisions of ASRB 1003 (Coombe, 1985b, p24). This option would no doubt have been quite valid given that Schedule 7 already provided extensively for disclosure and format of the profit and loss account and balance sheet. However, one wonders if the profession would not have seen this as an even more dangerous intrusion into their domain. The profession had already made overtures to the NCSC to scrap Schedule 7 and replace its contents with approved accounting standards (Masel, 1983, p549).

AAS 20 *Foreign Currency Translation* was issued by the professional bodies in October 1985. A proposed approved accounting standard, Release 406, *Foreign Currency Translation* was issued by the ASRB two months later. Release 406 contained identical provisions to AAS 20 (Release 406). The issue of Release 406 was the beginning of yet another marathon battle over disclosure and measurement of foreign currency transactions. One of the major areas of contention was the treatment of foreign currency gains and losses on long term debt. The controversy was not as heated as that surrounding the temporal versus current rate method but it successfully delayed ASRB approval of AAS 20 for almost two years.

**AAS 20 and Release 406 - The Defer & Amortise Saga**

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". ED 1979 contained a brief definition of "settlement date" meaning

... 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)).
As already discussed, ED 1983 did not define either "settlement" or "settlement date".

The concern with Release 406 was that it 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). Settlement was defined 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)

Part (i) of this definition meant that the defer and amortise option was available where a loan was rolled over but not 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 reviewed, 19 rejected this definition 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 money 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. As discussed in connection with ED 1979, the defer and amortise method is a form of income smoothing. This point was also raised with regard to the provisions of Release 406.

As already discussed, a common disagreement with the defer and amortise method and the treatment of deferred gains and losses is the classification of these items in the balance sheet. Five submissions disagreed with these items being shown as assets (deferred losses) and liabilities (deferred gains). The arguments against this classification were based on the failure of deferred gains and losses to meet the criteria for assets and liabilities which meant that balance sheets and financial ratios would be misleading. There was not, however, universal agreement on the appropriate treatment of these gains and losses. There were three suggested solutions: immediate recognition in the profit and loss account; allocation to a reserve as part of shareholders' equity; and disclosure as intangible items as indicated as appropriate in the commentary of ED 1979.

One justification for the adoption of the defer and amortise method appears to be a contradiction of views expressed by respondents to ED 1979. Uther's study of ED 1979 submissions revealed a marked inclination to follow overseas practice, particularly that in the USA (1983). Some respondents to Release 406 considered that the immediate recognition of gains and losses on long term monetary items as
prescribed by the USA and UK standards was not valid in the Australian situation. The reasons being that Australia is an importer of capital and also that 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. This is yet another example of attempts to influence accounting practice on the basis of expediency rather than logic. Harmonisation with other countries was a valid argument when the result was a flexible standard, that is, the choice between self-sustaining and integrated operations which had the added advantage of minimising the impact of foreign exchange fluctuations on accounting profit. However, it would seem that harmonisation was not acceptable when it had the potential to reduce discretion and cause fluctuations in profit figures.

**Further Criticism of AAS 20**

AAS 20 also attracted attention in the academic and financial press. For example, in the *Chartac Accounting Report* of April 1986, it was claimed opposition to and support of the standard was in a ratio of 6:1 (1986, p18). The basis of this opposition was not disclosed. However, it was further claimed that the standard would mean that many Australian companies would be forced to change accounting methods and the cost of this change would be borne by shareholders (p18). In February 1986, *The Australian Financial Review* reported the results of research which supported the second of these claims (Ansley, 1986, p25). A paper detailing the research and its findings was published in 1990 (Taylor, Tress & Johnson, 1990).

Taylor et al analysed the annual reports of 200 of Australia's largest companies (by market capitalisation) and found that in 1982/83, ninety-one of these companies had foreign subsidiaries (1990, p8). Forty-six of these companies accounted for gains and losses through the profit and loss account (p4). Under AAS 20, such gains or losses would be allocated to a foreign currency translation reserve. This was the treatment adopted by 45 of the companies surveyed (p4). The researchers' claim to *The
Australian Financial Review that those companies which accounted for gains and losses in the profit and loss account would be forced to change accounting methods was apparently based on the assumption that their subsidiaries would all be self-sustaining operations. Kevin Stevenson, as director of the AARF, questioned this assumption and argued that if the subsidiaries were integrated operations, there would be no need to change accounting methods (Ansley, 1986, p25). This is something of a contradiction on Stevenson's part given that when ED 1979 was released, he stated that the subsidiaries of most Australian companies would be self-sustaining. Neither Stevenson nor the researchers pointed out that AAS 20 provided no quantitative guidelines to distinguish between integrated and self-sustaining operations. This left companies with the opportunity to weight the criteria to achieve the classification most suited to their purposes. Research in the USA where FASB 52 does not provide quantitative guidelines to facilitate identification of self-sustaining or integrated operations supports this view (Doupnik & Evans, 1988).

Taylor, Tress and Johnson argued that given the complexity of accounting for integrated operations, it was a "safe bet" all the companies surveyed by them would classify their subsidiaries as self-sustaining (Ansley, 1986, p25). The implication is that AAS 20 promotes flexibility in the classification of subsidiaries depending on management's objectives. According to Taylor et al companies had "economic" reasons for selecting whether to allocate translation gains and losses to reserves or take them into determination of profit (Ansley, 1986, p25). Reserve accounting was more likely to be selected if:

1. translation gains or losses were large relative to operating income
2. the company was large so that wide income fluctuations due to currency variations were likely to attract adverse political attention
3. the company auditor had international affiliations
4. the company had a broad based share holding
None of these reasons provide a theoretical justification for using a particular accounting method. The researchers also found that "almost all large companies" used the current rate to translate financial statements of subsidiaries (Ansley, 1986, p25). This provides a further reason why these companies would wish to classify subsidiaries as self-sustaining. Furthermore, as already discussed, the self-sustaining method of translation is more likely to result in a translation gain than a loss because it is measured in terms of net assets which would tend to be positive. However, the rationale underlying the self-sustaining method is that the subsidiary does not expose the parent company to foreign exchange risk on a day to day basis and, therefore, it is not appropriate to include exchange gains and losses in the profit of the group.

The treatment of unrealised gains and losses on foreign debt was also the subject of discussion. The ever increasing propensity for companies to raise foreign debt and the decline of the Australian dollar, as illustrated in Figures 1 to 4 in the appendix, meant that the treatment of these gains and losses (usually losses) was becoming a more important issue than the method used for translating the financial statements of foreign subsidiaries.

**The Definition of Settlement, Renegotiated Debt & Rollovers**

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, p31). 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.
Foreign Debt (Mis) Management - Diversity in Disclosure

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, 1986a, 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, 1986a, 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).

The difference in treatment of deferred losses by CSR and CRA discussed earlier in the chapter add further evidence of the doubtful validity of the defer and amortise approach. As Thomas also noted, CSR had written-off $400 million in foreign exchange losses earlier in 1986 (p126). 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, 1986a, 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. This approach is questionable given that by this time, foreign borrowings were a normal part of Australian business activity so that foreign exchange losses could hardly be termed "extraordinary". Santos capitalised $286.5 million in deferred exchange losses by including them as a component investments (Jukes, 1986, p146).

Given the risks involved in raising foreign-currency denominated debt, the suitability of the defer and amortise approach in providing useful information to those who deal with companies participating in such activities must also be questioned as must the profession's adherence to this approach. As already demonstrated, these risks were well known by the end of the 1970's. The floating of the Australian dollar in 1983 and the deregulation of Australian finance markets added to the problems and gave an element of gambling to the raising of foreign debt by Australian companies (Gill, 1987, p10; Justice Rogers, 1990, p204). By 1986, there could be no doubt as to the need for caution on the part of Australian business in taking out foreign loans. The profession itself was obviously aware of this. In 1982, the Australian Society of Accountants commissioned Graham Cocks, Director, Elders Finance Group Ltd to write a course on Foreign Exchange Risk Management (Cocks, 1987, p10). *The Australian Accountant* of February 1986 included three articles on foreign exchange. Two of these articles (Goss, 1986, pp44-46; Minchin, 1986, pp47-48) were written by bankers with a knowledge of foreign currency risk management and outlined the risks associated with raising foreign debt and some of the ways in which the risks could be minimised, for example, currency swaps, hedging, options contracts and
basket borrowings. The third article dealt with the technical details of accounting for hedges (Stevenson, 1986, pp51-54).

The Goss article reproduced a table and graph commonly used to promote offshore borrowings (1986, pp44 & 46 respectively). These illustrations purported to show the trade-off between low interest on foreign borrowings and the potential devaluation of the Australian dollar. The graph prepared in 1985 suggested that low interest rates over the life of the loan would more than compensate for "expected" depreciation of the Australian dollar. However, as a subsequent graph (p46) showed, during 1985 the actual decline of the Australian dollar relative to the Swiss franc was far greater than the first indicated. In fact, it took only six months for the depreciation of the Australian dollar to reach the level predicted for 1990 (p45). The volatility of the foreign exchange market and the difficulties inherent in attempting to predict exchange rate variations are obvious. As already indicated, this volatility in exchange rates was a result of a world-wide increase in foreign exchange trading much of which was speculative (Behrmann, 1986, p26). Under such circumstances, "herd instinct" is probably as good a predictor of future trends in exchange rates as any scientific model. According to John Phillips, Deputy Governor of the Reserve Bank of Australia, volatility and unpredictability of exchange rates go hand in hand (1987, p2). This is because market participants can influence the market by buying and selling. Therefore, a change predicted tomorrow may in fact occur today because of the activities of market participants in expectation of the change. Hence, Phillips contends it is just as likely for exchange rates to rise as it is for them to decline (p3). There is no certainty one way or the other.

Despite this, raising foreign debt continued. Minchin, then General Manager Victoria and International Banking Director of Australia, Barclays Bank Australia Limited, ranked Australia with some third world countries in terms of foreign debt (1986, p48). Furthermore, Minchin claimed that many companies did not manage foreign
risk exposures (p48). Gill concurs stating it is normal to hedge foreign exchange risk but since 1985 hedging is all but non-existent and has been replaced with "swap trading" and speculation in the spot market. Gill used the turnover in the spot market and forward contract which had increased on a daily basis from $4 billion to almost $32 billion and $800 million to $6.3 billion respectively to demonstrate the change from hedging to speculation in the Australian market (1987, p10). Phillips likened some senior management or directors to the emperor prancing around in his new clothes. If profits were being made or their foreign exchange managers were being highly paid, then the managers must be good and should be left alone (1987, p5). The AWA foreign exchange debacle is prime evidence of this.

Gains to Losses - The Case of AWA

AWA Ltd v Daniels [7 ACSR 759] (hereafter referred to as AWA Case) was a landmark case in auditors' liability but has important implications for the present discussion. It clearly demonstrates the need for experienced foreign exchange managers and the need for adequate means of ensuring the accountability of executive management to those who deal with companies involved in foreign exchange dealings. Hearing of the case ran in excess of 60 days and the length of the decision, almost 120 pages, are testament to the depth and complexity of the issues involved. From the judgment, it appears that the Chief Executive of AWA relied on senior executives in most areas and in particular, financial matters (AWA Case, p770). It further appears that this reliance was justified except with regard to the management of foreign exchange dealings where senior executives were almost entirely inexperienced and, furthermore, were directed to treat the foreign exchange manager "with kid gloves" (p772). The basis for this "kid glove" treatment sounds very much like what Phillips was referring to (1987, p5). In spite of being warned that the foreign exchange manager had to be involved in highly speculative dealings which could as easily lead to losses as to profits (AWA Case, p829), the Chief Executive and senior executives involved in finance management took no action for fear of losing their foreign
exchange "expert" who was making large profits for the company (pp772, 830, 876). On the basis of these large profits, the foreign exchange dealings were extended to covering up to a year's imports (p829).

As it turned out, the so-called "expert" had no foreign exchange experience prior to joining AWA as a trainee accountant (p779). The large profits, reported as early as October 1981 (Peers, 1986, p30) and continuing until February 1987 proved to be either "flukes" (Blue, 1987, p59) or arising from limiting reporting to profits while concealing losses by either rolling them over or paying them out of unauthorised foreign loans (AWA Case, p765). Almost one year to the day after announcing an undisclosed but "very large" foreign exchange profit (Peers, 1986, p30), it was announced that AWA had incurred a $49.8 million foreign exchange loss (Upton, 1987, p1). This was almost $20 million more than the loss foreshadowed in July 1987.

From October 1986, the foreign exchange profits reported to the board of directors had ranged from $8.3 million to November of the 1986-87 financial year to a peak $12 million for the month of January 1987 (AWA Case, p823). In February the total for the financial year to date reportedly stood at $26 million. The Chief Executive accepted these figures in spite of being warned by the company's banks and other advisers that the company had unrealised foreign exchange losses of $50 million (p816). It would seem that the focus on profits was more enticing than the possibility that the foreign exchange manager was taking excessive risks and was not accurately reporting the actual state of the company's foreign exchange dealings.

The treatment accorded foreign currency gains and losses by AWA's foreign exchange manager can, to a certain extent, be blamed on accounting standards. As one journalist reported, exchange managers claimed accounting standards contributed to foreign exchange problems "because they were lagging behind the increasingly
complex foreign exchange transactions" (Knight, 1987, p28). AAS 20 excluded rollovers from the definition of settlement which meant that AWA's treatment of losses was acceptable even if selective given that profits were recognised. Secondly, much of AWA's transactions were speculative and AAS 20 specifically excluded speculative dealings.

**Management & Risk - Further Evidence**

While not suggesting incompetence in foreign exchange management there is evidence of poor management of foreign risk exposures provided by the losses reported by companies such as CRA, CSR, Comalco and Santos. BHP, on the other hand, has not recorded similar losses. According to Thomas this is because BHP has provided a natural hedge against currency variations by matching its overseas debt with overseas assets (1986c, p132). Boral also took this precaution (Thomas, 1986b, p126).

In yet another article dealing with foreign currency debt, the decline of the Australian dollar relative to the Swiss franc and its impact on Australian borrowers were detailed (Meagher & Tingle, 1986). Australian companies and individuals who borrowed Swiss francs in 1984 saw both their principal and interest payments almost double by 1986 (p18). When a West Australian hotelier took out a Swiss franc loan in 1984, the Australian dollar bought 2.1 Swiss francs. By September 1986, the devaluation of the Australian dollar was such that it would only buy .9 of a franc (p20). The scope for losses, depending on the size of the original debt, is obvious. The article focused more on small business and farmers who had been caught by the devaluation of the dollar. Nonetheless, the plight of these borrowers was much the same as that of larger companies and is clear evidence of the problems and inherent risks faced by Australian borrowers seeking lower interest rates than those available in Australia and the need to effectively manage foreign risk exposure through hedging activities (Tingle, 1986, p66).
The result of the continued decline of the Australian dollar and the consequential losses incurred by Australian borrowers was an increase in litigation against banks for failure to provide adequate advice to borrowers (Skotnicki, 1986, p59; Meagher & Tingle, 1986, pp20, 22; Hotline, 1986, p13). The outcome of these cases has implications for both management and standard setters. In Lloyd v Citicorp Australia Ltd (1987) 11 NSWLR 286, Justice Rogers found that each case should be determined on the basis of facts including the background of the individual borrower. Hence in the Citicorp Case, the plaintiff failed in a negligence action against the bank on the grounds that he was an accountant with a business background and was well aware of the risk of taking out an unhedged foreign currency loan. In a similar case in 1991, Justice Cole found in favour of the Australian Bank because the plaintiff "was an experienced businessman who was aware of the risks" (Hudson, 1991, p48). The point in using these decisions is that if businessmen should be aware of the risks involved in raising foreign debt, then so should the standard setters. If this is the case, why did the Australian profession continue to permit companies to defer and amortise losses on foreign debt and effectively hide the results of management's poor judgment?

**Release 411 - The Saga Continues**

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. For purposes of analysis, the submissions were classified as companies (14), banks & bankers' associations (4), accounting firms (4), government authorities (4), professional groups (2), regulatory bodies (1) and individuals (1).

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. Respondents supporting the immediate recognition approach represented a cross-section of the above classifications being companies (4), banks and bankers' associations (2), accounting firms (1), regulatory bodies (1) and other professional groups (1).

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. As already demonstrated, some companies were already adopting this approach which was also consistent with AAS 20 paragraph 11 which provided inter alia:

The unamortised balance of any deferred foreign exchange losses carried in the balance sheet as deferred expense ought to be reviewed regularly and written down to the extent that the balance is considered not to be recoverable.

Those supporting the defer and amortise approach were classified as companies (9), government authorities (4), accounting firms (3), banks and bankers' associations (2) professional groups (1) and individuals (1).
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. 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.

Media Release 87/1 also announced the ASRB's intention to extend the approved standard to speculative dealings (p1). ASRB 1003 was to be withdrawn on approval of the new standard which was to cover both accounting and disclosure requirements (p2).

The decision by the ASRB to drop the defer and amortise provisions of AAS 20 and also its exclusion of speculative dealings was a slap in the face for the profession's own Accounting Standards Board which for the second time in the space of 18 months was being dictated to on the foreign currency issue. However, this "slap in the face" may have been more apparent than real. The ASRB's Media Release 87/1 was not a surprise to the AARF. The Accounting Standards Board of the AARF met late in March to discuss proposals put forward a week earlier by the ASRB (Killen, 1987c, p14). In what appears to be a bid to pre-empt the ASRB's media release, the AARF issued its own press release on April 2 - just one day ahead of Media Release 87/1.
The AARF's press release called for submissions on the ASRB's proposals to drop the defer and amortise method of accounting for long term monetary items and the extension of the standard to speculative dealings. The number of submissions or comments received in response to the AARF's press release, 74, is testament to the contentious nature of these issues. Of the 74 responses, four were either classified as confidential or a non-response. This left 70 submissions to be analysed. As before, the submissions were classified into broad categories as being companies (17), government authorities (16), individuals (13), accounting firms (7), banks & bankers' associations (5), academics (5), professional associations (3), other (3) and regulators (1).

The application of the standard to the public service accounts for the relatively large number of submissions from this group. While the speculative dealings issue was of concern to many of the respondents, the defer and amortise versus immediate recognition was clearly the most contentious of the two issues. 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.

**Speculative Dealings**

As opposed to the immediate recognition and settlement issues, there was much stronger support for the extension of AAS 20 to speculative dealings. Six submissions did not respond to this issue. Eighteen submissions expressed the view that AAS 20 should include provisions for speculative dealings. Five submissions were opposed to the suggestion while one submission considered the matter should be
the subject of a separate standard. The breakdown of those in favour of extending AAS 20 to speculative dealings were companies (9), government authorities (3), accounting firms (3), professional associations (2) and individuals (1).

Those against the extension of AAS 20 to speculative dealings were banks and bankers' associations (3) and companies (1). The major objection of the banks and bankers' associations appears to have been based on their position as foreign currency traders. In general, the respondents considered authorised foreign currency dealers should be exempt from the requirements of both AAS 20 and the approved standard. The standards do not provide the exemption. However, authorised dealers have been exempted by an NCSC class order from the ASRB 1012 paragraph .60 (d) requirements to disclose unhedged current and non-current assets and liabilities (Comments by Technical Editor, ASRB 1012: Foreign Currency Translation).

ASRB 1012 and the Re-Issue of AAS 20

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. AAS 20 was re-issued by the AARF in December 1987. As expected, both standards prescribed the immediate recognition of gains or losses on long term monetary items.

Both ASRB 1012 and AAS 20 require disclosure of methods used to translate speculative dealings but neither standard deals with the translation methods to be used. In the second half of 1987, the Australian Merchant Bankers' Association (AMBA) submitted to the ASRB a proposed accounting standard covering speculative dealings (Killen, 1987e, p28). The AMBA argued that only disclosing foreign currency amounts was too simplistic and misleading. Therefore, the AMBA proposed a more comprehensive standard aimed at tightening up accounting practices with regard to speculative dealings (p28). To date, however, none of the
recommendations put forward by the AMBA have been included in either AAS 20 or ASRB 1012 (Langfield-Smith, 1987, p17).

When AAS 20 was re-issued in December 1987, the guide to the re-issued standard stated that when the standard was reviewed by the AARF in 1988, the issue of speculative dealings would be addressed (p3). No changes to AAS 20 have been forthcoming. Media Release 87/4 indicated the method of accounting for speculative dealings would be added to the standard at a future date (p2). ASRB 1012 was reviewed and reissued in July 1988. However, with the exception of minor amendments to the requirements dealing with specific commitments (paragraph .34) and disclosure during application of transitional provisions (paragraphs .71 and .72), no significant changes were made.

The failure of both standards to prescribe methods of accounting for speculative transactions is clear evidence that this is still a contentious issue which will undoubtedly have to be addressed at some time. Even though the AWA case did not address accounting methods, the publicity the case generated might have been the catalyst to bring the foreign currency debate, in particular, accounting for speculative dealings, into the limelight once again. To date, this has not occurred.

The Defer & Amortise Debate - An Analysis

At a first glance it may seem that the profession and the standard setters effectively over-ruled majority opinion when prescribing the immediate recognition of gains and losses on long term monetary items. However, this is not necessarily the case. There was not what could be termed an overwhelming preference for the defer and amortise approach even though the majority of submissions supported this view. On the other hand, some of the submissions were confidential so the views expressed in them were not included in the analysis. With regard to AAS 20, a restrictive circulation exposure
draft was issued by the AARF and the responses were not available for public scrutiny. Obviously, the views expressed in these submissions were not included in the analysis. However, given that AAS 20 introduced the concept of a qualifying asset, a method of accounting for gains and losses on foreign currency loans used to finance the purchase of assets by including them in the cost of those assets, which was in direct contradiction of the separate transaction philosophy set forward in ED 1983 paragraphs 8 and 10, it is possible that the responses to this restrictive circulation gave rise to this innovation. Also, the number of submissions received in response to the various exposure drafts and media releases was not large by any stretch of the imagination. Formal submissions are also only one form of lobbying behaviour. Hearings were held with select groups by both the ASRB and the AARF. Finally, non-publicised meetings between the standard setters and interested parties may well have taken place. For these reasons, publicly available submissions cannot be judged as entirely representative of public views.

**Qualifying Assets & Hedging - Uniformity v Compromise**

In addition, the exceptions to the immediate recognition method relating to qualifying assets (first introduced in AAS 20 and Release 406) and hedges of the purchase of goods and services (first introduced in ED 1979) could be seen as compromises built into the standard in anticipation of the eventual need to conform with overseas standards. Both exceptions provide scope for flexibility in the application of the immediate recognition method.

Qualifying assets are defined in AASB 1012 as

. . . in relation to the inclusion of exchange differences in the cost of acquisition thereof, an asset -

(a) under construction or otherwise being made ready for future productive use by the company in its own operations; or
Paragraph .13 provides that exchange differences arising in respect of monetary items reasonably attributed to qualifying assets are to be included in the cost of acquisition of the asset. This is almost identical to a proposal put forward in a submission in response to ED 1983. There are two provisos, however. The first is that exchange differences can only be included in the cost of the asset up until the time it ceases to be a qualifying asset (paragraph 13(b)). The second proviso is that the asset cannot be carried at an amount in excess of its recoverable amount (paragraph 13). The word "reasonably" is what was described in an earlier chapter as a "weasel" word. What does it mean and in whose opinion? It provides scope for "professional judgment" which may or may not result in creative accounting.

For similar reasons, the treatment of hedges of certain specific commitments builds flexibility into the accounting for these transactions. AASB 1012 Paragraph .33 provides that a hedge can only be classified as applying to a specific foreign currency exposure if it is expected to continue to be effective. "Expected" is another weasel word and the same arguments as to other "weasel" words also applies here. This provision is also contradictory in that the standard includes as specific commitments hedges on the net investment in self-sustaining operations (paragraph .35).

Hedging is defined in the standard as

... action taken, whether by entering into a foreign currency contract or otherwise with the object of avoiding or minimising possible adverse financial effects of movements in exchange rates.

Gains or losses on such hedges are to be brought to account as exchange rates vary but are to be transferred to a foreign currency translation reserve on consolidation (paragraphs .12 and .35). However, if a foreign subsidiary is self-sustaining, by
definition, it does not expose the parent company or group to foreign exchange gains or losses (paragraph .06). If this is the case, it is questionable whether a hedge would be necessary.

As discussed in the previous chapter, flexibility or ambiguity in accounting standards can make it very difficult for regulators to launch a successful prosecution for the issue of misleading financial statements. The flexibility allowed by the self-sustaining/integrated operation dichotomy and in the financing of hedges and so-called qualifying assets provide management with potential means of manipulating financial statements to achieve a desired result and avoid prosecution if the result is considered misleading by regulatory authorities. The regulatory authorities would have to prove beyond reasonable doubt that the accounts were misleading. When this comes down to a matter of professional opinion or judgment, history has shown that prosecutions are unlikely to be undertaken or, if undertaken, are unlikely to succeed.

In terms of the circuits of power and autopoiesis, the compromises in the foreign currency standard are means of avoiding resistance to the standard. In other words, the profession had the foresight to build these measures of flexibility into the immediate recognition method to facilitate acceptance of this approach in place of the defer and amortise method.

POLITICS, THE PRESS AND ACCOUNTING STANDARDS

The purpose of this chapter was to use the issue of accounting for foreign currency transactions and translation of financial statements as an example of the political nature of standard setting. It is clear that standard setting, while it may be dominated by the profession, is more political than technical. The participants in the process include financial journalists, academics, individual members of the public, regulatory
bodies, government authorities, professional associations (including those of the accountancy profession) and standard setters.

The financial press clearly plays a key role in the process by reporting not only the activities of the standard setters but also raising public awareness of problem areas. The examples used in this chapter have included the reporting of foreign currency fluctuations and increases in the raising of foreign debt, the impact of these fluctuations and debt on companies in terms of gains and losses incurred and in some cases the accounting treatment of these gains and losses, the responses of the profession and standard setters to these matters and criticism by companies, academics and other interested parties of these responses. In some cases, newspapers and journals have used selective placing of text to surreptitiously link issues. For example, *The Australian Financial Review* carried an article outlining the lack of security and internal controls which contributed to the foreign exchange losses incurred by AWA. The article included a comment that deficient foreign currency accounting standards contributed to the loss (Knight, 1987, p28). Immediately below this article was another which mentioned the AWA problems and announced a new foreign currency standard dealing with speculative dealings had been proposed by the AMBA (Killen, 1987e, p28). *The Age* used a similar tactic in reporting the approval of ASRB 1012 (Haigh, 1987, p21) next to a further article dealing with AWA's foreign currency losses (Upton, 1987b, p21).

To take the political nature of media involvement in this issue a step further, the question should be addressed as to what was the source of the information subsequently printed in the press. In some cases, press or media releases are issued by participants in the standard setting or regulatory process, for example, the NCSC, the ASRB and the AARF. At other times, it would seem that those who are not satisfied with the outcome of lobbying activities, such as the lobby group of 14 headed by Western Mining, may take their dissatisfaction to the press.
Just what makes something newsworthy is debatable but the possibility of purely political influences cannot be discounted. This raises another question in regard to what is not reported in either the financial press or journals. The issue of accounting for speculative transactions is still not covered by an accounting standard but this does not appear to be attracting much attention. The AWA case generated debate over the issues of the liability and responsibility of auditors and directors but no attention to the speculative foreign exchange dealings which gave rise to the case. Is this an oversight or is it simply not considered newsworthy that companies can take excessive risks with shareholders' money and not disclose it?

To take the political aspects even further, what prompted professional accountancy associations to consider the foreign currency issue in the first place? It has been argued that the changes in the international money market and the progressive floating of world currencies provided the catalyst for this activity. However, foreign currency had clearly been of interest long before the late 1960's and early 1970's when standard setters and professional associations began to consider the matter in some detail. It was not a new area. On the other hand, it was around this time that formal accounting standards were beginning to be promulgated by the professional associations of countries such as the USA, UK and Australia and also by the International Accounting Standards Committee. Perhaps foreign currency was seen to be an issue "ripe" for promulgation of an accounting standard. The resistance that was to be encountered may not have been fully anticipated. For whatever reason, foreign currency was clearly an agenda item for the accountancy profession as a whole.

The resistance to the standard was also politically motivated. The opposition to both the temporal method and immediate recognition of gains and losses on long term monetary items was based more on the impact these approaches had on profits rather
than on any accounting theory. Indeed, the absence of a theory of measurement provided de facto support for a profit based argument in place of a theoretical justification.

In the final analysis, a compromise was struck. Flexibility in accounting for foreign currency translation was reduced but not eliminated. The accountancy profession had maintained its domination of the standard setting process but at a cost. That cost was the flexibility which permitted management to select the method of translation of subsidiaries' financial statements and also select either the defer and amortise approach or the immediate recognition method with regard to monetary items attributable to qualifying assets and certain hedges of specific commitments. On the other hand, this could be seen as a bonus to practising members of the profession in that professional judgment is required to help management make the appropriate choice so that the flexibility in the standard re-enforces the need for accountants. This has the added advantage of shrouding the work of accounting professionals in an aura of mystique. In addition, it adds yet another dimension to accounting work in the form of advisers to those who consider becoming involved in the foreign currency market. It also leaves the foreign currency debate open along with the opportunity to generate further accountancy work. Not only is there scope for debate as a result of the flexibility in the present AASB 1012 and AAS 20, the whole issue of accounting for speculative transactions is still unresolved. As long as there is scope for debate, conversation and communication will continue and the profession will have the opportunity to re-enforce and perhaps add to its domination of the standard setting process.
APPENDIX

Exchange Rates: US Dollar
US Dollars per Australian Dollar

Source:
Australian Economic Statistics 1949-50 to 1989-90

Figure 1

Exchange Rates: TWI
Australian Trade Weighted Index, May 1970=100

Source:
Australian Economic Statistics 1949-50 to 1989-90

Figure 2
Foreign Exchange Rates
Units of Foreign Currency per Australian Dollar
(End-period, Index June 1970=1, log scale)

Source:
Australian Economic Statistics 1949-50 to 1989-90
Reserve Bank of Australia Occasional Paper No8 Feb 1991

Figure 3
Overseas Borrowing & Lending - Private Sector ($1000)

Source:
Foreign Investment Australia 1979-80 A.B.S. 26/8/81 P31
Foreign Investment Australia 1985-86 A.B.S. 16/11/1987 P16

Figure 4

Interest Payable on Foreign Debt - Private Sector


Figure 5
CHAPTER 7

CONCLUSION

OVERVIEW OF THE ARGUMENT

The purpose of this study was to propose an explanation for the on-going pattern of regulatory reform, regulatory failure that has characterised the Australian corporate environment for more than one hundred years. In particular, the focus has been on unexpected corporate failures where the unexpectedness arose because the companies concerned had invariably published audited financial statements suggesting the companies were profitable and well managed. Investigations into these companies have revealed that the audited financial statements were misleading in that accounting practices were used selectively, and, in some cases, creatively, to produce the picture management wished to present to the world.

This situation has brought criticism of the accountancy profession on two counts. The first being that accepted accounting practices were so flexible, vague and ambiguous that management could produce such misleading financial statements and secondly, that external auditors were prepared to attest to the truth and fairness of the statements. This study maintains that the explanation for the in-built flexibility and indetermination in accounting practice and standards lies in the manner in which the accountancy profession achieved hegemonic domination of auditing and the determination of accounting practices and its desire to maintain its position in society.
To demonstrate this, a translation model of power has been adopted in preference to a diffusion model. At first glance, a diffusion model may seem to be appropriate because, as was discussed in Chapter 5, there is evidence to suggest that accounting standard setters are responsive to lobbying by large business concerns. However, on further analysis, it has been found that this bias occurs because large business concerns are more likely to make formal submissions regarding the provisions of proposed accounting standards. Further, there is no clear consensus on what business sees as appropriate accounting practice in a given circumstance. This was evident in the analysis of submissions received in response to the various exposure drafts dealing with foreign currency translation in Chapter 6.

The translation model adopted for purposes of this study is based on the works of Callon (1986), Latour (1986) and Clegg (1989). It argues that the accountancy profession used its claim to specialised knowledge and skill to form alliances and agency relationships with business interests and the general public to achieve hegemonic domination of corporate regulation through the accounting and audit provisions of company law. This domination extended not only to work of an accounting nature but also to the determination of who could undertake this work and the principles and practices to be applied. Chapter 3 demonstrated the manner in which the accountancy profession in Australia achieved this.

However, the achievement of domination is one thing, maintaining it is another. Elements of dissidence and resistance from both within accountancy itself and from external sources have threatened this dominance from time to time. The power framework adopted for purposes of this study maintains that dissidence and resistance threaten the stability of control of the obligatory passage points and, thereby, the exercise of power. Dissidence and resistance are countered at the levels of systems and social integration. Elements of dissidence and resistance explain why accountancy has undertaken activities such as research and the promulgation of
accounting standards to demonstrate its superior knowledge and skill and justify its continued domination. It is at this point, that autopoiesis is introduced to complement and enhance the power framework.

Autopoiesis is a theory of living systems first developed by Maturana and Varela (1988). It has been adapted by authors such as Luhmann (1986; 1988a, b), Teubner (1988a, b) and Robb (1989a,b; 1991) to explain the activities of social systems such as the law and accountancy. Autopoiesis provides an explanation for the emergence of accounting as an operationally closed but cognitively open system. As an autopoietic system, it has created a boundary to distinguish itself from other systems in the regulatory environment and has recursively reproduced itself through conversation and communication. It has also expanded its boundary by conversation and communication with other systems in its environment such as the legal system and business organisations. Through double entry bookkeeping, it became part of the operations of business organisations and was one of the means by which those business organisations achieved structural coupling with other elements in the environment. The concepts developed as part of the double entry system became part of the language of business and enabled double entry bookkeeping to become accounting (Baecker, 1992). This, in part, was achieved through the relationships of bookkeeping to the company, the company to the law, and bookkeeping to the law. These relationships have, overtime, given rise to accounting concepts such as the going concern, the distinction between assets and liabilities and the distinction between capital and profits.

As discussed in Chapter 4, the first laws granting general incorporation and limited liability included the keeping and annual audit of accounting records. One of the purposes of these provisions was protection of those who dealt with corporations. Audited financial reports were seen as a means by which management was answerable
for resources entrusted to them, that is, they facilitated structural coupling between business organisations and those who dealt with them.

To maintain its autopoietic state, however, accountancy itself must be compatible with the other elements of its environment. This study maintains that it is this need to remain compatible that has resulted in the inherent flexibility and indetermination of accounting practices. Accountancy has achieved its domination by the grace of legislative enactments including those requiring the keeping of records and the preparation and audit of financial statements. In Australia, additional legislation has created the Australian Accounting Standards Board that has responsibility for the development and promulgation of approved accounting standards. Under the legislation, most public companies must comply with applicable approved accounting standards. This study has argued that the accountancy profession dominates the standard setting process in Australia but this domination is tentative. It can be removed at any time and control of the standard setting process can be vested by the government in another organisation.

To maintain its position, accountancy has formed alliances with a number of groups including business interests. Business interests play a leading role in the determination of accounting practices. As noted previously, double entry bookkeeping, and subsequently, accounting and its concepts have become part of the language of business so there are shared meanings between business and accountancy. Accountancy is one of the means by which business achieves structural coupling with its environmental partners including government, current and potential employees, investors and creditors, lenders and depositors and the general public. Financial statements provide a means by which business is accountable to these groups for not only the resources that have been entrusted to them but whether these resources have been used efficiently, effectively and in the interests of the community.
In an environment where there is competition for resources, there is an incentive for business to want to project a positive image of itself. Such an image is likely to include profitability and being well managed. Business, therefore, is likely to prefer flexibility in accounting practices to enable it to project the image it feels will maintain and encourage the inflow of resources. Experience has shown that where the accountancy profession has endeavoured to remove flexibility in accounting practices, business interests have successfully campaigned against such moves. These campaigns have included lobbying the government and arguing that accounting practices imposed by the profession are detrimental to business activities and, thereby, not in the public interest. History also makes it clear that some governments have perceived proposed accounting practices as detrimental to their image or, at least, the public perception of their policies. In such instances, there has been either direct government interference or the threat of interference in the determination of accounting standards and practices. As an autopoietic system, accountancy has learned from these experiences. The result has been compromise so that flexibility in accounting practices has become the norm rather than the exception.

Flexibility in accounting practice serves to maintain autopoiesis in other ways. Conversation and communication are the means by which an autopoietic system creates and maintains its structures. It is not the purpose of conversation and communication to arrive at consensus. If consensus was reached, there would no longer be a need for conversation and communication. The system would cease to be autopoietic because without conversation and communication to recursively reproduce the structures of the system, it would effectively die.

In an accounting context, flexibility creates indetermination in the application of accounting concepts. It is this flexibility and indetermination in accounting practice that helps to maintain the dominance of the accounting profession and its members within the regulatory framework. Without flexibility and indetermination, there would
be no need for further research or searches for conceptual frameworks of accounting. Indeed, it is questionable whether accounting standards would be required. Accounting, including auditing, would be reduced to a set of mechanical steps. There would be no need for expert skill and knowledge or the exercise of professional judgment. There would be no need for an accountancy profession.

THE APPROACH

Demonstrating the view outlined above has been undertaken in a number of stages. First the means by which the accountancy profession in Australia achieved hegemonic domination of accounting were illustrated by undertaking an examination of the professionalisation processes used. These included the formation of professional associations by incorporation and Royal Charter and, in the later stages of development, the formation of a research organisation separate and distinct from the professional associations but sponsored and funded by them. Finally, the professionalisation process and domination were completed with the achievement of legislative backing of approved accounting standards developed and promulgated by an organisation, while ostensibly independent of the professional associations, was effectively dominated by them.

The platform upon which the professional associations argued for incorporation, Royal Charters and domination of accounting and the standard setting process was that the public interest would be served if only those qualifying for membership of such associations undertook work of an accountancy nature and determined the appropriate level of skills required as well as the practices to be used. Before an evaluation of accountancy's performance in this regard was undertaken, it was necessary to establish what was meant by "the public interest". Given the difficulty encountered in defining "the public interest", emphasis was placed on how the public interest is served. To do this, the profession's own concept statements were used to
establish that in the profession's view, accounting served the public interest by developing practices that would produce relevant and reliable information for the making of decisions that would facilitate an economic allocation of resources.

Once this was done, evidence was presented to demonstrate that accountancy has contributed to the unexpectedness of some spectacular corporate failures and/or the reporting of losses on activities that were formerly portrayed as being profitable. To the extent that audited financial information encouraged an allocation of resources to these corporations, the public interest was not served. It was further contended that the examples used were not isolated events. Unexpected corporate failures and losses have triggered criticism not only of accountancy but also of the regulatory system in general. In turn, this criticism has prompted action on the part of regulators supposedly aimed at ensuring such events do not recur. History, unfortunately, shows all too clearly that progress in regulatory reform has been more apparent than real. The same problems emerge time and again and often with the same disastrous consequences for those directly involved and for the community at large.

Explanations for regulatory failure are often premised on a diffusion model of power that would suggest that powerful interest groups are able to influence the content, scope and application of regulatory measures to their benefit. The regulatory framework is weak by the design of powerful interest groups. The contention of this study is instead, that weaknesses evident in the regulatory system in Australia are a response to dissidence within and resistance to the existing institutional order. To overcome this dissidence and resistance and to minimise any adverse consequences, accountancy, for its part in the system, is prepared to bow to endogenous and exogenous pressures and promulgate standards with in-built flexibility. This ensures the survival of the profession because it alleviates pressures directed at placing control of accountancy in another organisation and also the monopoly that individual members of the profession have over work of an accounting nature. It also ensures
the survival of accountancy by providing scope for further conversation and communication.

The accounting for foreign currency translation standard was used to demonstrate the profession's readiness to compromise an ideal directed towards uniformity in accounting for foreign currency transactions and translation of financial statements. Instead, the accounting standard eventually promulgated allowed for a choice of methods to be used in translating foreign currency financial statements and scope for flexibility in accounting for gains and losses on foreign debt and hedge transactions.

The following sections will seek to summarise, explain and justify the various components of this study.

1. Professionalisation

The processes of professionalisation adopted by Australian accountants were studied because it is contended that such activities provide the key to flexibility and indetermination in accounting practices. The first professional accountancy association in Australia, the Adelaide Society of Accountants, was founded in 1886. It was rapidly followed by a succession of other professional associations including the Incorporated Institute of Accountants, Victoria, the Federal Institute of Accountants and the Australasian Corporation of Public Accountants. The stated purpose of the formation of these professional organisations was invariably premised on a desire to serve the public interest by ensuring that only those with specialised skill and knowledge, as determined by the professional association, carried out work of an accounting nature.

At this stage in the development of accounting, there was not what could be clearly distinguished as a body of accounting knowledge. Nonetheless, there was a long
history of the keeping of records and progressive operational closure of this process. Chapter 2 provided an overview of the evolution of record keeping from ancient civilisations through to the emergence of the accountancy profession in the United Kingdom. The purpose of this overview was to establish the knowledge base claimed by the emerging professional bodies and the role of the double entry system in effecting the closure of accounting.

While operational closure of accounting was discernible from as early as 3500BC with the introduction of complex tokens representing abstractions such as the provision of services and the quality and nature of goods and services, the emergence of double entry bookkeeping accelerated this process. Drawing on the work of Baecker (1992), it was shown that double entry bookkeeping is characteristic of an autopoietic system. First of all, the principles of double entry bookkeeping made a distinction between assets (debits) and liabilities (credits). At the same time double entry bookkeeping created its own reality in that for every asset there must be a corresponding liability. In other words, double entry provided a means by which an asset could be looked at as a liability (pp163-164). The duality of the system shows both the ability to pay and the inability to pay. This duality also means that for every debit there must be a credit. The system determines the corresponding accounts without reference to anything outside the books, that is, it is self-referential (p164).

Double entry bookkeeping created a further reality in that the record books themselves are abstractions of transactions and events. The entries recorded in the books represent observations of economic events that have been reduced to classifications as assets and liabilities (p166). The rules for determining these classifications are determined by the system itself.

Initially, these records were a combination of domestic and business events. As the spirit of adventure and the pursuit of trade for profit spread, the double entry system
expanded and facilitated the separation of the owner from the business organisation. This was needed because ownership of business ventures was becoming increasingly diverse with the formation of large partnerships made up of partners actively involved in the ventures and silent partners who invested resources to be used and managed by others. The emergence of banking and lending activities as opposed to investment also provided impetus for the expansion of the double entry system. Double entry bookkeeping facilitated the making of a distinction between individual business concerns and also between individual concerns and the environment.

Double entry bookkeeping reacted to stimuli in its environment and expanded its boundaries by taking in energy and information from outside sources and using it to create further structures. Through the process of conversation and communication between the double entry system and other element in its environment, the language of the system became the language of business and, with the help of the legal system, further refinements in the double entry system emerged including the distinction between income and capital. This distinction was a further abstraction from the distinction between assets and liabilities whereby the wealth of the firm was both a liability to the owner(s) and an asset of the business organisation (p169).

Double entry bookkeeping became a system of communication not only within the business organisation but also as a means of communicating the results of operations to absentee owners. Again, the legal system was to play a part in this process. With the advent of general incorporation of the limited liability company, double entry bookkeeping made its transformation to accounting. From its earliest beginnings, record keeping was a means by which those entrusted with resources were accountable to the owners of those resources be they the state, the church or individuals. General incorporation with limited liability created an abstract entity completely separated from its owners. As an abstract entity, it had no feelings of obligation to its owners, no concept of right or wrong or how to use resources
effectively and efficiently in the interest of the community. It acted only through its directors and management. Accounting became the means by which directors and management were answerable for the activities of the company to ownership interests, others who dealt with it and to the general community.

The emergence of the modern corporate form was not the only impetus for the formation of professional accountancy associations. Nonetheless, it was a significant event in that it provided a platform on which to argue for the merits of entrusting to qualified accountants the role of ensuring that the financial information about the activities of corporations communicated to those who dealt with them was not misleading. In order to demonstrate an ability to serve the public interest, professional associations required prospective members to take examinations on prescribed areas of knowledge. Specified periods of training in public accountancy firms was also required by some organisations.

The formation of professional organisations was not sufficient to effect exclusion of the "unqualified" from the practice of accountancy. Closure of accounting in this sense has never been fully achieved. Even the granting of a Royal Charter to Australian public accountants did not preclude the unqualified from accountancy work. However, it was shown in Chapters 3 and 5 that the profession in Australia has achieved this to a certain extent by the use of identifying appellations and through control of the process of setting accounting standards. The manner in which this was achieved was by using a claim to expert knowledge and skill and forming alliances and agency relationships.

Evidence of the formation of alliances was given in Chapters 2 and 3. The examples included the alliances forged between the accountants, lawyers and merchants of Scotland in a bid to defeat legislation proposed by factions in London which would have given the courts control over the management of bankrupt estates (Walker,
undated, p21). In Australia, the pioneers of the accountancy profession forged alliances with members of parliament, the judiciary, the press, the business community and other professional associations in both Australia and the UK. Specific examples of alliances identified in the study include Brentnall’s claim as early as 1910 that financial reports prepared by public accountants would enhance investment from other countries because absentee lenders would be able to rely on them. Because Australia was a young country, it would need such investment to exploit its "illimitable resources" (ACPA, 1910a, p134). In more recent times, the ICAA has made submissions to the government and regulatory authorities on a variety of matters of interest to companies including depreciation allowances and double taxation of dividends (ICAA Annual Report, 1982, p7). Initially, alliances appear to have been aimed at overcoming criticism of accountants and financial reports stemming from the collapse of several companies in the aftermath of the Victorian land boom. Later, alliances were formed in a bid to overcome opposition to the granting of a Royal Charter to Australia's accountants in public practice.

The various Royal Charter bids provide clear evidence of the compromises the profession has been prepared to make almost from its inception in order to achieve and maintain a dominant position in the regulatory environment. As discussed in Chapter 3, the opposition, or resistance, to the granting of a Royal Charter came from a number of sources including accountants not in public practice, members of Parliament and chartered accountants in England. It was a battle that spanned almost a quarter of a century and raised issues such as appropriate education and training, the use of specified designations and the pride of a newly created nation. Victory was achieved at the expense of most of the ideals of the originators of the charter bid.

In the history of the accountancy profession, it appears that the formation and maintenance of alliances, or structural coupling, has played a more important role in the strategies of the profession than the public interest platform upon which their
original claim to domination was based. Although it could be argued that these alliances were made in order to put the profession in a position to serve the public interest, this study argues that it is the need to maintain these alliances that has given rise to the flexibility and indetermination of accountancy practice. The question then, is does this flexibility and indetermination serve the public interest or only the self interest of the accountancy profession?

2. Wither The Public Interest?

a. The Public Interest and Financial Information

Chapter 4 dealt initially with how regulation and accountancy, in particular, serves the public interest. According to the profession's own pronouncements, SAC 2 and 3, general purpose financial statements are the means by which management of business entities is accountable to resource providers and the public for the manner in which resources entrusted to them have been used. Furthermore, general purpose financial statements are meant to provide relevant and reliable information that will be used to make decisions about the allocation of scarce resources. This interpretation of accountability has its origins in the religious basis of stewardship whereby all things were created by God to be used for the common good of humanity. When the use of resources requires ownership or property rights and management of those resources is entrusted to an agent, stewardship has two aspects. The primary stewardship function is to society, the secondary function is accountability to the owner or principal (Chen, 1975). In other words, accountability to ownership interests, or resource providers, is secondary to social responsibility. There is, however, a link between accountability to resource providers and social responsibility.

Resource providers, current and prospective, must make decisions about the allocation of resources. When this allocation is economical, that is, resources are directed towards organisations that will use them more efficiently and effectively than other organisations, the public interest will be served. This is because the economy
itself will be more efficient and effective by the provision of goods, services and employment opportunities that in turn, result in further resource allocation. This is what is meant by accounting being the means of structural coupling between business organisations and the environment.

This interpretation of the public interest and how accounting is to serve it is consistent with the role of regulation of financial markets as articulated in the reports of at least two government appointed enquiries, the Rae and Campbell Committees (Australia, 1974; 1981), by a Deputy Chairman of the NCSC (Williams, 1987) and by authors such as Chambers, Ramanthan and Rappaport (1978) and Friend (1976).

b. Management Accountability and Accounting - The Reality?

The balance of Chapter 4 was concerned with an evaluation of accountancy's performance in serving the public interest by facilitating an economic allocation of resources. The analysis focused on the reports of investigations into three of Australia's most notable and unexpected corporate collapses, Reid Murray Holdings, Cambridge Credit Corporation and Rothwells. The selection of these three companies was not based on any substantial pre-existing knowledge of investigators' reports or commentaries dealing with the companies and subsequent investigations provided in the press or by academics. In fact, much of the literature dealing with these three particular corporate failures was deliberately ignored in order to allow an independent assessment of the investigators' reports. The selection of these three particular companies was based on factors such as the timing of the failures in terms of the development of the accountancy profession and the spectacular nature of the failures in terms of their unexpectedness and the size of the losses incurred.

While the analysis began with the collapse of Reid Murray Holdings in 1963, this is not to imply that Australia was devoid of significant corporate failures prior to this time. Reid Murray was chosen because the losses incurred in the collapse were an
Austalian record at the time (Sykes, 1988, p322). In addition, the criticism of the profession arising out of this particular case, saw, for the first time, an Australian professional accountancy association issue its own report on corporate failures and defending its practices and making recommendations for actions to ensure such events did not recur (ASA, 1966).

The investigators' reports for all three companies criticised the auditors and branded the financial statements as misleading not only for the year immediately prior to collapse but for several years before. This suggests that during those years, there was not an efficient or effective allocation of resources because resource providers were deceived by the financial statements.

(i) Reid Murray Holdings

The investigation into Reid Murray Holdings did not reveal any fraudulent activity but it did show that management was keen to present a public image of a well managed and profitable concern (Victoria, 1963, p9). The financial statements for 1958, 1959 and 1960 did precisely that. Financial statements for 1961 showed a profitable organisation but that profits had declined. Nonetheless, directors were optimistic that this was only temporary.

Investigators considered that the positive corporate image conveyed by the financial statements prompted a substantial inflow of cash from debenture issues with some $46.6 million being subscribed between October 1959 and May 1960. After this, the inflow of debenture funds declined but by May 1962 a further $34 million was subscribed (Chambers, 1972, p189). Cash was also derived from credit facilities made available to the group presumably on the strength of the generous dividends paid by the group and the glowing profit reports.
The reality was that the Reid Murray Group was not well managed. In fact, it had a no management policy with each company in the group being left to its own devices (Victoria, 1966, p62). Emphasis was placed on increasing sales, first of retail goods and, subsequently, land and housing. Most of these sales were on credit but with little or no control over credit terms. Goods were sold on no deposit terms with the result that credit sales increased. On the other hand, because sales personnel were remunerated on the basis of sales and not on debt collection, little effort was expended in this direction. In spite of this, most members of the group did not provide for bad and doubtful debts. Hence, even though sales were increasing, these activities were probably not as profitable as they appeared and assets, in the form of accounts receivable, were probably overstated. In addition, because of the slow turnover in accounts receivable, Group members faced liquidity problems.

The decision to enter the land market also paved the way for the “creation” of profits. Subsidiaries were set up specifically to enter the land market with another company being established to finance the acquisition of land. As already noted, emphasis was on sales and these were invariably on credit terms and usually over long periods. There was no control over the granting of credit even though Group members had to repay acquisition costs with interest and pay for the development of land for resale. Nonetheless, profits were taken into account at the time of sale. This occurred even where the contract could be avoided. In some instances, profits were recognised when agreements to build houses were entered into even though building had not commenced. On the other hand, interest and development costs were capitalised rather than expensed. Therefore, not only were profits and assets overstated because bad and doubtful debts were not accounted for but also because expenses were capitalised and added to the book value of land. The financial statements were further misleading because no disclosure was made of the extent to which interest and development costs were capitalised.
Profits were further inflated because land developments were financed by borrowings from Reid Murray Holdings. The loans from Reid Murray Holdings were, in turn, financed by Reid Murray Acceptance Limited. Subsidiaries notionally paid interest on these loans to Reid Murray Holdings and Reid Murray Holdings notionally paid interest to Reid Murray Acceptance Limited. Reid Murray Holdings made “profits” on these transactions because the interest “paid” to Reid Murray Acceptance Limited was less than that “received” from subsidiaries.

Clearly, the accounts of the Reid Murray Group were misleading. The Group was far from being well managed and was not profitable. It also had liquidity problems arising from poor management policies. These factors were not apparent from the audited financial statements. Furthermore, investigators considered that the inflation of profits by less than conservative accounting policies encouraged investors and creditors to provide the cash necessary to fuel the Group’s expansionist activities. If funds from investors and creditors had been less, these activities may have been checked and the Group may never have failed. Accounting policies and tolerant, lazy or timid auditors did not provide a check on management activities.

In addition to the liquidity problems arising from poor management of the retail and land activities, Reid Murray Holdings faced liquidity problems arising from its debenture issues. The Group had used incoming debenture subscriptions to fund its expansion and also meet the payment of interest on earlier subscriptions. However, consistent with the evidence of poor management in the retail and land market activities of the Group, there was no management plan for the retirement of debentures. Cash was spent as quickly as it came in with no regard for how the Group would meet its future commitments. When a downturn in the economy diminished the inflow of debenture subscriptions, the expansionist activities were checked but so was the Group’s ability to meet commitments to retire debentures or, indeed, pay interest. It was the failure of Reid Murray Holdings to meet a $1.2
million debenture interest payment in October 1962 that saw it placed in receivership on 10 January 1963. A government sponsored investigation was appointed in April 1963.

(ii) Cambridge Credit Corporation Limited

There were striking similarities between the events leading to the demise of the Reid Murray Group and that of Cambridge Credit and affiliated companies. Cambridge Credit was placed in receivership when it failed to meet a commitment to pay interest to debenture and note holders in 1974. Like Reid Murray, Cambridge and its related companies had a history of liquidity problems and had survived by virtue of public borrowings through Cambridge. On a reconstruction of Cambridge accounts, investigators concluded that Cambridge had been in a precarious position since at least 1966. Not only this, but Cambridge had also been without borrowing capacity since 1966. These matters were not evident from the audited financial statements or audit reports included in prospectuses. In fact, just two weeks before Cambridge defaulted on the $2 million interest payment, a press release announced a record profit in excess of $3 million.

Unlike Reid Murray, there was no evidence of poor management. It appeared that Cambridge's difficulties were attributable to its increasing activities in real estate development. These activities required large capital outlays with little prospect of cash inflows until development of the projects was completed and they were sold. These difficulties were exacerbated by diversification into other areas including share trading, film production and hotel management. These ventures proved unprofitable and added to Cambridge's liquidity problems. Maintaining the inflow of debenture funds required public confidence and public confidence was considered to require profitability. To this end, profits were engineered by selective use of accounting methods.
Cambridge devised a method whereby it was able to recognise profits at early stages of the development of land projects. Companies were formed by Cambridge with the sole purpose of forming joint or tri ventures with Cambridge to purchase land. A second joint venture would be formed to buy the land from the first. A member of one of the ventures financed the development of the land and also its subsequent sale to outside parties (pp.52-53, 4.9; pp69-70, 4.52). Cambridge recognised profits on these transactions even though it invariably held an interest in the members of the joint and tri ventures and frequently financed the various transactions (p.52, 4.7). Had consolidated accounts been prepared, the profits on these transactions would have been eliminated. Cambridge management, however, took the view that unless ownership of companies exceeded 50 per cent, consolidation was not necessary. Control and financial dependency were conveniently ignored. The financial statements did not provide any indication of the inter-relationships of the parties to these transactions. The auditors also ignored the fact that some joint venture agreements and sales transactions were backdated to allow Cambridge to recognise profits in particular years.

Profits on front end transactions were also determined on an ad hoc basis. At least three methods of calculating profits were used for virtually identical transactions. These methods were the cash and profit emergence and accrual bases. In addition, these methods were used in an inconsistent and arbitrary manner (pp140, 8.8; p142, 8.16). These methods were deliberately used to maximise profits, tailor profits to a pre-determined target or to minimise profit fluctuations from one period to the next (p140, 8.8). In one particular instance, a $3 million profit was allocated over ten years using the profit emerging basis. It was stated in evidence that this method was used because it was the largest six months profit ever made within the group. Furthermore, it was derived almost entirely from one transaction (an intra-group transaction, at that) and no one would believe a profit of that magnitude had been earned (p210, 9.55). Finally, it was a deliberate decision to smooth income or, more
appropriately described, to distort the profits of future periods. In the economic climate of the time, it was likely the group would be trying to find profits in the future (p210, 9.56).

Investigators estimated that for the year ended 30 June 1974, front end transactions, failure to eliminate intra-group transactions and changes in accounting methods resulted in an overstatement of profits after tax of at least $3,732,629. Reported profits after tax were $3,055,635. It was further contended that the accounts of Cambridge and its affiliates were misleading because the method of calculating profits was not disclosed (p179, 8.152)

In addition to the charge of misleading financial statements, investigators maintained that Cambridge had been insolvent since 1966 and had exceeded its borrowing capacity under the terms of debenture trust deeds since at least that time (p226, 10.2; p251, 10.39; NSW 1979, p277, 6.5, 6.6). The lack of borrowing capacity was concealed by failure to disclose the relationship between Cambridge and related entities. In particular, advances to related entities were included at full value in the accounts and, thereby, as liquid assets for purposes of determining the borrowing capacity of Cambridge under the debenture trust deed.

It also became apparent during the course of the investigation that shareholders' funds were deliberately manipulated to allow Cambridge to issue a prospectus in May 1974. Cambridge's borrowing capacity was limited to the lesser of three quarters of liquid assets or five times shareholders' funds (p20, 2.23). Prior to May 1974, the operative limit had been shareholders' funds. At the end of 1973, shareholders' funds were inflated by a revaluation of all real estate and assets held by the group (pp226-227, 10.4). The result was a net surplus of $43 million (p227, 10.5). This amount, however, was not included in the accounts but was disclosed in a note to overcome any adverse taxation complications. Nonetheless, the revaluation was used to inflate
shareholders’ funds so that the operative borrowing limit became liquid assets. This fact was not disclosed in the accounts. The auditors apparently failed to realise that the revaluation had this effect or even that this was the purpose of the revaluation.

As noted previously, Cambridge continually faced liquidity problems and relied on the inflow of debenture funds to meet interest and redemption commitments. When the inflow of debenture funds diminished in the wake of yet another downturn in the economy, Cambridge was faced with the prospect of not being able to meet its commitments. Local banks and finance companies also refrained from extending further credit. Cambridge began negotiations to raise finance overseas. It was admitted in evidence to the investigation that the desire to promote debenture income and safeguard the success of the loan negotiations had prompted the September 1974 press release announcing record profits (p191, 9.14; p192, 9.15). Ironically, only fourteen days later, Cambridge went into receivership.

The reports of the investigations into Reid Murray and Cambridge make it obvious that accounting methods were used to deceive those who dealt with these companies. The purpose of the deception was to encourage investment or the granting of credit. To the extent that the deception was successful, there was not an economic allocation of resources. The fact that not only shareholders, but also debenture holders and creditors lost most, if not all, of the resources entrusted to the companies is testament to this.

There are also elements of the Cambridge disaster that raise questions about the commitment of the accountancy profession, or at least individual members, to safeguard not only those who deal with companies but also the public interest. For example, with regard to both companies, it was stated that the failure to disclose accounting methods made the accounts misleading. The ASA report (1966) recognised that the use of different accounting methods was potentially misleading yet
the auditors of Cambridge did not make any statement concerning the use of different methods even though they were aware that the changes were directed towards achieving the profitable image desired by management.

The investigators into Reid Murray criticised management's policy of recognising profits on credit transactions at the time of sale and suggested a more appropriate method may have been to recognise profits as payments were received. The ASA report defended the accrual method stating that the profits or cash emerging bases were contrary to modern accounting practice (1966, p12). Further, the ASA argued that accounting methods should not be adopted simply because they were conservative (p46). Yet the management of Cambridge used both the profits and cash emerging methods of calculating profits and justified this on the grounds that they were conservative. The auditor did not make any comment regarding this.

In addition, the ASA report had recommended the elimination of the effect of intra-group transactions on the basis that the results of individual companies could be manipulated if such transactions were not eliminated (1966, p19). Evidence to the Cambridge investigation made it clear that members of the audit firm considered consolidation should be determined on the basis of beneficial ownership not actual ownership as espoused by Cambridge management. The auditor in charge of the Cambridge audit conveyed this view to management but did not pursue the matter. As investigators concluded, the auditor appears to have been more interested in catering to the interests of Cambridge management rather than to ensuring that the results conveyed in the financial statements were not misleading (p276, 5.64).

A further point suggested by the elimination of the effects of intra-group transactions is that both the legislature and the accountancy profession were less than interested in ensuring that manipulation of accounts did not occur by a failure to eliminate intra-group transactions. An accounting standard dealing with consolidation and based on
the notion of control rather than ownership was not forthcoming until 1990 - some fifteen years after the collapse of Cambridge and more than twenty years after the ASA report. The legislature did not act to close this loophole until 1991. Until this time, consolidated accounts were not mandatory. Consolidated accounts were only one means of preparing group accounts. As noted in Chapter 5, intra-group transactions were implicated in many of the corporate failures of the 1980s. In a regulatory environment premised on protection of participants in capital markets and, thereby, an efficient allocation of resources, one wonders why it took so long for this reform to be introduced.

(iii) Rothwells Limited

The third Australian corporate failure examined was the merchant bank, Rothwells Limited. Investigations into the events that led to Rothwells being placed in liquidation on 3 November 1988 suggest that the financial statements effectively deceived not only investors, creditors and depositors but also a team of would-be rescuers, including the West Australian Government, that attempted to ease Rothwells through a liquidity crisis in the aftermath of the October 1987 share market crash. The special investigator, McCusker, maintained that if the audited financial statements issued shortly before the launch of the rescue had not misrepresented Rothwells’ situation, the rescue would not have taken place and Rothwells would have been placed in liquidation a year earlier. The losses incurred would, thereby, have been less. However, it was not simply a matter of the 1987 financial statements misrepresenting Rothwells’ financial position. Evidence to the investigation revealed that the bank had been incurring substantial losses, but reporting profits since at least 1985.

In McCusker’s opinion, the failure of Rothwells was directly attributable to poor management of its major asset, its receivables portfolio (Australia, undated, p26, 2.2). As in the case of Reid Murray, the investigation revealed that there was a lack of
control and supervision of credit facilities. Rothwells was described as a lender at the high risk end of the market in that it lent to ventures that other banks would not consider. In spite of this, an independent review of the receivables portfolio undertaken prior to the ultimate collapse of Rothwells showed that in approximately 60 per cent of the files, there was no documentation as to terms of repayment or security for loans. There was also a lack of formal application approval (pp276-277, 11.3). Furthermore, for most of the years under investigation, 1985 to 1988, either no provision was made for doubtful debts or the provision was grossly inadequate. In addition, examination of the receivables portfolio found that unpaid principal and interest were rolled over and capitalised, thereby further inflating the reported value of the asset. Unpaid interest was taken to account in the calculation of profit in each year even though it was obvious the debts were non-performing. To the extent that bad and doubtful debts were not provided for or written off and interest was capitalised, profits were also overstated.

Perhaps of greater concern was that the executive director of Rothwells, Laurie Connell, effectively treated Rothwells as his private bank. During the years 1985 to 1987 Connell, through two family companies, borrowed some $35 million, $138 million and $324 million respectively. It was estimated that by mid-1988, just prior to Rothwells' collapse, Connell's debt to Rothwells amounted to some $500 million. However, this was not evident in the financial statements. Indeed, at the time of the 1987 "rescue" of Rothwells, rescuers were told that Connell-related debt was less than $20 million (p237, 10.6). The financial statements supported this contention.

The facts were, however, that Connell-related debt was systematically removed from the accounts by a series of sham or fictitious transactions at or near each balance date and re-instated, sometimes in a slightly different form, during the subsequent financial year. The major method used to effect these transactions was an assignment of debts from Connell family companies either to Rothwells or to $2 shelf companies. The
debts assigned to Rothwells were substituted for Connell-related debt. When debts were assigned to $2 shelf companies, Rothwells financed the transaction. The debt of the $2 shelf company was then substituted for Connell-related debt. The purpose of these transactions was to obviate the need to disclose the extent of Connell's debt to Rothwells. Such disclosure was mandated by the corporations legislation and the stock exchange listing requirements.

Apart from the deliberate ploy to thwart the legal and stock exchange requirements, these transactions raised other serious questions. First of all, the assignments were never completed. Mainly because the debts themselves were usually fictitious. In some circumstances, directors of the $2 shelf companies did not know of the purported assignment or the consequential indebtedness to Rothwells. Even if they did know, being shelf companies with share capital of $2, there was no way these companies could repay their debt to Rothwells.

In addition to the overstatement of profits and assets brought about by the capitalisation of interest and the roll over of unpaid principal and inadequate provision for doubtful debts, the investigation found that procurement and management fees were recorded as income by Rothwells. It was invariably found that the transactions giving rise to these fees had not been completed at the time of inclusion in the accounts or, once again, the directors of the companies purportedly owing the fees denied the liability.

The auditors of Rothwells, in particular, the auditor in charge, was accused by McCusker of not only failing to be independent but of being deliberately blind. Evidence was given that two independent reviews of Rothwells' loans portfolio conducted prior to its collapse, revealed that the records and files were totally inadequate but on conservative estimates, by 1987, an adequate provision for doubtful debts or the write off of bad debts would have eliminated all of shareholders' equity.
This view was confirmed by a review conducted by a senior member of Rothwells' staff. On a reconstruction of the accounts by the accounting firm engaged by McCusker to assist with the investigation, by 1987, there was a deficit in shareholders' funds of $58,351,000. Most of this was attributable to the write off or the making of provisions for bad and doubtful debts.

In spite of this, the accounts never received an audit qualification. The auditor in charge was aware, in some years at least, that Connell-related debt was being systematically removed from the accounts. In the years where there was a claimed ignorance of this, the auditor realised that the records were inadequate and therefore, relied on discussions with management to determine the adequacy of provisions for doubtful debts. It is ironic that the two people relied upon by the auditor were the very people responsible for the creation of the lists of fictitious debts used to remove Connell-related debt from Rothwells' books. Where the audit team at least went through the motions of verifying debts by the sending of audit confirmation letters, those sent to debtors on the assignment lists contained a different wording to those sent to other debtors. In particular, debtors on the assignment lists were simply asked to verify the debt facility not the debt itself.

The deception of investors, creditors and depositors was magnified following the October 1987 share market crash. Like Reid Murray and Cambridge, Rothwells faced persistent liquidity problems. Just as Reid Murray and Cambridge had survived because the inflow of cash exceeded the outflow, Rothwells similarly survived until the October 1987 share market crash precipitated a run on the bank. To help Rothwells through what was seen as a temporary liquidity crisis, a rescue bid was launched aimed at raising some $300 million being $150 million in share capital and a $150 million overdraft facility. The need for speed precluded an in depth review of Rothwells' financial position. However, Rothwells had recently issued its audited, and unqualified, financial statements. These statements depicted Rothwells as a
profitable and well managed organisation. Furthermore, the accounts had been audited by a member of the “big six” accounting firms. On this basis, the rescue was effected.

What was not known to the rescuers was that the financial statements were totally misleading. Nonetheless, the deception was maintained and re-enforced with the release of audited half yearly financial statements in January 1988. These statements did not paint as bright a picture of Rothwells as had previous statements. Unlike previous years, a substantial provision for doubtful debts of $100 million was raised but otherwise it appeared that Rothwells was on the way to recovery. However, Rothwells continued to be beset by liquidity problems. It had little or no income because most of its receivables were non-performing. Depositors were also withdrawing funds.

Around June 1988, the West Australian Government and others involved in the rescue became aware of the serious bad debt problem facing Rothwells. A further rescue package was devised whereby the government and Alan Bond purchased an asset from Connell for $350 million. The value of Connell’s share in the asset was estimated to be $50 million. The $350 million was to be used by Connell to purchase the bad debts of Rothwells. A further $15 million was provided indirectly to Rothwells by the West Australian Government in October 1988 but to no avail. Rothwells was insolvent and no further assistance was forthcoming. Liquidators were appointed in November 1988.

From an analysis of the investigation into the collapse of Rothwells, it is clear that there was an extensive allocation of resources to Rothwells on the basis of misleading financial statements. This inefficient allocation of resources was not limited to the “rescues” of Rothwells but also to each of the years from 1984. A reconstruction of the accounts reproduced in Chapter 4 demonstrates that from this time onwards,
Rothwells reported profits when losses had actually been incurred. The methods used to achieve this could not be said to arise from flexibility in accounting practice although capitalisation of interest is permitted in some circumstances and the adequacy of provisions for bad and doubtful debts is a matter of professional judgment. What the Rothwells case demonstrates more than anything else is that some members of the profession are more interested in pandering to the interests of management than to those who deal with the organisations concerned. It follows, that there is also a total lack of concern for the public interest.

It was suggested in Chapter 4 that these incidents may not be generalisable. The auditors and preparers of financial statements in the cases analysed may only be a fringe element. However, there is evidence to suggest that this is not the case. While only a handful of authors were cited, Chambers (1973), Justice Rogers (1991) and Clarke and Dean (1992), it is apparent that unexpected corporate failures have been a persistent problem in Australia for some time. The unexpectedness of these failures is frequently the result of financial statements depicting profitable and well managed organisations sometimes issued within weeks of a company failing. Subsequent investigation invariably has revealed the financial statements were not representative of the position of the companies concerned. Others, including Cannon (1972) and Sykes (1988; 1990), have also provided evidence of this from as early as last century. There is also evidence that companies may not fail but activities once reported as profitable subsequently are revealed as unprofitable. AWA's foreign currency dealings are a case in point. Clarke and Dean provide similar examples (1992, p186).

This situation has prevailed for more than one hundred years in spite of activities, including legislation and accounting standards, purportedly aimed at preventing the abuse of the corporate form and the provision of relevant and reliable information to those who deal with corporations. The stated purpose of regulation of this nature has extended to safeguarding the public interest by ensuring an efficient and effective...
allocation of resources. So why has regulation failed? Chapter 5 was directed towards providing an answer to this riddle.

3. Regulatory Failure - Accidental or by Design?

In Chapter 5, a number of weaknesses in the regulatory system in Australia were identified. These weaknesses have contributed to regulatory failure. However, this study maintains that these weaknesses are themselves the result of factors explainable within the frameworks of the circuits of power and autopoiesis. In other words, they are the result of a desire to maintain hegemonic domination and autopoiesis in the face of dissidence and resistance. Dissidence and resistance, or conflictful relationships and tensions, can weaken the relationships within and between dominant groups within an organisational field and threaten the control of obligatory passage points.

This study maintains that in-built weaknesses in regulation are defensive activities or compensating measures adopted to minimise the adverse effects of dissidence and resistance to regulation. At the same time, by introducing regulation, including accounting standards, regulators are able to convey an impression that actions have been taken to ensure fair dealings between corporations and those who deal with them. Thus, regulations appear to provide a means of structural coupling between corporations and other members of the environment, including the general public. On the other hand, the flexibility inherent in the regulations promotes compatibility between the regulators and the regulated because the application of the regulations will not impinge on the public image the regulated want to present. As the analyses of Reid Murray, Cambridge Credit and Rothwells demonstrated, the need to maintain a steady inflow of investment and credit necessitated a public image of a profitable and well managed concern. A further benefit of flexibility and indetermination to regulators is that this guarantees their existence because at some future time, the
results of the flexibility and indetermination will have to be addressed. In other words, there will be a need for further conversation and communication.

There is support for the view that corporate regulation in Australia is characterised by inherent weaknesses. Chambers, for example, has argued that the rules underlying the financial information on company affairs have been "vague, toothless and often self-contradictory" (1973, Preface, unpaginated). Similarly, Grabosky and Braithwaite maintain that the enforcement strategies of business regulatory agencies in Australia are ineffective because they are fragmented and unco-ordinated (1986a, p2). As indicated above, the weaknesses in corporate regulation may be by design. McCraw has argued that regulation serves diverse and contradictory ends that may be economic, political or cultural (1975, p180). Furthermore, Cranston maintains that it should not be assumed that regulation is really intended to alter company practices (1982, p3). The outcome may be that legislation is little more than a symbolic gesture but it enables governments and regulators to assure the public that something positive has been done to ensure that activities detrimental to society will not occur or recur.

Specific weaknesses in the Australian regulatory system discussed in Chapter 5 included the uncertainties resulting from Australian federalism, frequent changes in legislation and legislators, lack of authority of regulatory bodies and lack of funding. It was argued that Australian federalism was identified as a weakness in the regulatory system almost from the dawn of federalism itself. For those who dealt with companies, it meant they had to be familiar with the laws of the state of incorporation. Given that Australia has six states, the task of knowing the intricacies of each, where necessary, was potentially enormous but necessary because companies could incorporate in the state with the most lenient rules. The potential problem was greater still in that there were also federal ordinances governing the activities of corporations in the Northern Territory and the Australian Capital Territory.
Progressive steps have been taken during the course of the past century to overcome the problem of Australian federalism but these have been characterised by variable success. These steps included the introduction of uniform legislation in 1963, the co-operative scheme in 1978 and, finally, a federal corporate regulatory scheme in 1990. Each of these has proven to be problematic. In particular, each system has called for complex legislation, monitoring and enforcement structures. Under the uniform legislation and co-operative schemes, each state had to pass legislation complementary to that in each other state and the territories. The individual states could have delegated to the Commonwealth their constitutional powers to make laws dealing with corporations. However, this has not happened and raises questions about the commitment of individual State Governments to the effectiveness and efficiency of the corporate regulatory system. This point is particularly pertinent when it is considered that the states launched a successful, if limited, constitutional challenge that has hampered the workings of the federal scheme.

As indicated in Chapter 5, some of the direct and indirect problems this has created include frequent changes in legislation and legislators, lack of authority and lack of funding. Frequent changes in legislation adds to the complexity of regulation, involves expenditure of time and effort by legislators and also in the training and retraining of not only staff of regulatory bodies but also the regulated. Apart from this, where there are frequent changes in regulation, Doyle argues that there is an incentive for the regulated to effectively ignore rules because the law is only temporary (1981, p98).

The machinations of the accountancy profession in the promulgation of a foreign currency standard were given as evidence of this. Because opinion as to the most appropriate treatment of gains and losses on long term loans varied so frequently, business adopted the method most suitable to its own purposes. This occurred not only from year to year but also from item to item. A further accounting example was
the manner in which the profession used frequent changes in membership of both the Ministerial Council and the ASRB to thwart the activities of the ASRB and regain control of the standard setting process (Walker, 1987, pp284-285). Frequent changes in legislation and legislators or regulation and regulators is symptomatic of a lack of organisation. Agency relationships and ultimate control of obligatory passage points requires effective organisation. Also, lack of organisation can be seen as a lack of structural coupling within the structures of an autopoietic system. Without structural coupling or compatibility, autopoiesis cannot be maintained. The profession, on the other hand, was effectively organised and had a stable leadership.

The profession also made the most of the ASRB's lack of authority. Because it was not established by an act of Parliament but by a memorandum of the Ministerial Council, there was no clear statement of its role, duties or responsibilities in the regulatory system. This made it all the easier for the profession to use its superior organisation to renegotiate the translation process and regain control.

Lack of authority and funding have been constant problems for Australian regulatory agencies. Grabosky and Braithwaite cite interviews with members of regulatory bodies in Australia evidencing a deliberate withholding of resources to prevent investigations (1986a). Attempts to prosecute the auditor and some of the directors of Cambridge Credit were also thwarted by lengthy delays in the completion of investigations. The court specifically criticised the New South Wales State Government and Corporate Affairs Commission for failing to provide resources with the result that it was ten years between the collapse of Cambridge and the laying of charges. In this time, a co-accused and potential witnesses had died. Others had given evidence in civil proceedings which could now be used against them in criminal proceedings. The court ruled that the charges be permanently stayed.
Other evidence was provided in Chapter 5 that suggests relationships between regulatory bodies and the Director of Public Prosecutions (DPP) is less than ideal. The antagonism is, in part, related to the lack of authority of the regulatory body to undertake prosecutions meaning that recourse must be had to the DPP. On the other hand, the regulatory body must undertake the investigation and effectively build the case. The cost of these investigations and the subsequent prosecution are borne by the regulatory body. There is a lack of liaison between those undertaking the investigation and those who will ultimately direct the prosecution. Friction has arisen because the DPP has, in some cases, refused to accept material prepared by the regulatory body on the basis that it is not sufficient to support a prosecution. This means that the regulatory body is effectively sent back to the drawing board. The Bond case was used in Chapter 5 to illustrate the problems this poses. These problems include the length of time involved and, in turn, gives rise to problems such as changes in membership of the investigating team. The Rothwells saga is another example. As discussed in Chapter 5 and above, Rothwells was placed in liquidation in November 1988. A trial arising out of conspiracy charges against Laurie Connell, the auditor and another former director of Rothwells is not expected to commence until March 1995. It is estimated this trial will run for a year (AAP, 1994, p9).

Ambiguous and flexible legislation and accounting standards were also identified in Chapter 5 as a weakness in the regulatory system because of the problems of enforcement and prosecution arising from uncertainty engendered by such ambiguity and flexibility. In particular, attention was focused on the statutory standard of a true and fair view. Most of the arguments against true and fair are centred on its qualitative nature and the lack of authoritative definition. This has led regulatory bodies such as Corporate Affairs Commissions and the NCSC to prefer actions under the general criminal law for the publication of misleading statements rather than charges under the corporations law for failure to show a true and fair view. The major reason for this being that when a decision in a case turns on professional
judgment, it is likely to be very difficult to convince the court that one professional opinion as to what shows a true and fair view is better than another. The removal of the statutory override on true and fair view was directed at overcoming this problem. Compliance with applicable Australian standards now rates before the qualitative requirement to show a true and fair view. Given that accounting standards are flexible and ambiguous and that compliance with accounting standards are just as likely to result in creative accounting as non-compliance, it is unlikely that removal of the statutory override will achieve anything. It may even be a retrograde step.

While it is obvious that there are weaknesses in the Australian regulatory system and that these have contributed to regulatory failure, the underlying reasons for these weaknesses is not readily apparent. The problems arising out of Australian federalism could be argued to be the result of State versus Commonwealth rivalries, in particular, the preservation of State rights. Limitations in legislation and/or funding policies that result in a failure to ensure that regulatory bodies have unassailable authority and adequate resources to undertake their publicly proclaimed function such as the effective conduct of investigations and expeditiously bringing miscreants to trial, could be explained by reference to private interest theories. However, it has already been argued that private interest theories do not provide an adequate explanation because they do not provide an explanation for how power is achieved, maintained or undermined. In addition, not all private interests have common objectives. Therefore, it is argued that the explanation for weaknesses in regulation are attributable to dissidence and resistance to the existing institutional order.

While dissidence and resistance affect, to some extent, all factions within the regulatory environment, specific attention was directed to instances where dissidence and resistance have threatened accountancy's domination and control of the standard setting process. An extended focus was adopted and examples from the UK and the USA were used in addition to Australian experiences. The reason for this being that
an autopoietic system learns to survive. It "remembers" past interactions and what was and was not successful. Its reactions to triggers from the environment are directed to maintenance of the autopoietic state. There is evidence that the Australian accountancy profession monitors events in other countries. It tends to adopt what is seen as acceptable in terms of accounting standards and desirable in terms of conceptual framework projects. In other words, it appears that the Australian accountancy profession learns or absorbs what it perceives to have worked in other countries and emulates them.

Examples of dissidence and resistance, or conflictful relationships or tensions, examined in Chapter 5 included the inflation debates in the UK and Australia, the investment tax credit and accounting for business combinations in the USA, the Australian experience with SAC 4 and consolidation and equity accounting and the conceptual framework projects of both the USA and Australia. In all of these examples, the tensions or conflictful relationships came from both within the profession and outside parties including the government. Due process was also discussed in Chapter 5 as not only evidence of dissidence and resistance but a way to minimise the detrimental effects of such tensions.

Due process allows those who will be affected by an accounting standard or who have an interest in it, to formally participate in its development. It recognises that accounting standards can have economic consequences on the allocation of resources arising from the way in which an organisation is perceived in the community and also through more direct effects such as taxation and possible costs incurred in changing information systems to accommodate new accounting methods prescribed in a standard. Due process provides an avenue whereby interested parties are able to make their views known. It also is political in that participation in the rule-making process may ensure compliance with the resulting rules.
Henry Bosch blamed due process for the slow progress in setting accounting standards in the early 1980s (1985, p20). Gottliebsen has also suggested that the time taken to develop the foreign currency standard was because there were too many people to please (1985b, p6). While due process does extend the time taken to promulgate an accounting standard, it would appear to be political suicide to do away with it. In this sense, due process is a means of effecting structural coupling within the accountancy profession itself and with other members of the regulatory environment, in particular, government and business interests. Perhaps in recognition of this, due process in accounting standard setting has been extended. *Policy Statement 1. The Development of Statements of Accounting Concepts and Accounting Standards* issued in 1993 includes the requirement to establish a broadly-constituted Consultative Group to participate in the standard setting process.

There is evidence in Australia to suggest that formal submissions, part of due process, have had an impact on the standards developed (Coombs & Stokes, 1985; Morris, 1986; Gavens, Carnegie and Gibson, 1989). While there is no evidence to suggest that the views of particular industry groups have been favoured, larger business concerns are more likely to make submissions so that the resulting standards may be biased. Evidence of informal lobbying is also indicated by reports of private talks between the standard setters and select interest groups. The extent to which informal lobbying has an impact on resulting standards can only be surmised but its potential significance cannot be ignored.

It is contended, here, that both formal and informal lobbying activities and the threat of potential dissidence and resistance to the profession's dominance of accounting are the source of flexibility and indetermination in accounting standards. This threat is perceived as being more detrimental than the potential harm caused by financial information that has been manipulated by virtue of the flexibility in accounting practices. Even where this flexibility clearly results in a non-economic allocation of
resources, the profession can take action to demonstrate its commitment to the public interest. With any luck, the public will have forgotten the last spate of corporate failures and be reassured that the profession is doing its best to overcome regulatory weaknesses.

Where there is criticism of the profession, as has occurred throughout the past hundred years, the profession still has the safety net of its specialised skill and knowledge. The skill and knowledge of the profession and its demonstrated organisational talents, not to mention its alliances with business interests, will assist it to outmanoeuvre any would-be encroachers. The ability of the profession to undertake organisational outflanking activities aimed at undermining the newly created ASRB is evident by the merger of the ASRB with the Accounting Standards Board of the profession sponsored AARF.

4. Flexibility and Indetermination - The Foreign Currency Standard

Chapter 6 provided an extensive analysis of the development of the Australian accounting standard dealing with foreign currency translation. This standard was chosen in preference to others because of the length of time taken to produce the standard from the issue of the first exposure draft in 1973 through to the issue of two standards, ASRB 1003 and AAS 20 in 1985. In 1987, an approved accounting standard, ASRB 1012 was released. At that time, ASRB 1003 was withdrawn and action taken to amend AAS 20 to make it compatible with its ASRB counter-part. The length of time to actually promulgate the standard is evidence of the contentious nature of the topic not only within the membership of the accountancy profession but for business interests.

The foreign currency standard was also chosen because it is an example of the willingness of the profession to compromise the ideal of uniformity in accounting.
For example, the need for a standard dealing with foreign currency translation was recognised with the increase in foreign investment and trade coupled with the progressive floating of many of the world's currencies and deregulation of financial markets. These events saw a variety of methods emerge for translating the financial statements of foreign subsidiaries and transactions denominated in foreign currencies. In addition, a number of methods of accounting for gains and losses on translation emerged. The result was that financial statements were not comparable because individual companies used different methods for different transactions from year to year. It was difficult to assess management accountability particularly where foreign debt was used in preference to local. On the basis that Australian companies could borrow on the local market, an important aspect of accountability was an evaluation of the propriety of the raising of foreign debt.

In the early 1970's when the Australian dollar was strong relative to the currencies of the countries with which Australian companies dealt, foreign exchange gains were recorded by net borrowers. However, when the Australian dollar began its decline in 1974-75, foreign currency losses began to be reported on foreign currency denominated debt. In some cases, the losses incurred saw an effective doubling of principal and interest repayments. Where companies had previously reported gains, losses were now being incurred. However, this did not mean that losses were reported. In previous years, there was a tendency for companies to recognise gains and losses on foreign currency translation in the profit and loss account in the year in which they were incurred. When the economic environment changed and losses were being incurred instead of gains, there was a marked tendency to adopt a variety of methods of accounting for gains and losses. These methods included the deferral and amortisation of gains and losses, capitalisation as part of investments, transfers to reserves or writing gains and losses off against the opening balance of retained profits.
The foreign currency issue presented an opportunity for the accountancy profession to reinforce its domination of accounting by identifying the problem, that is, inconsistency in the use of accounting methods, convince those involved that a standard was necessary and develop the accounting standard. In other words, commence the translation process, negotiate the circuits of power through problematisation, interessement, enrolment and mobilisation. This process began with the issue of an exposure draft in 1973. The period 1973 to 1987 when the standard in its present form was issued was characterised by a cycle of dissidence and resistance to the profession's proposals, followed by apparent inactivity on the profession's part until the financial press directed the spotlight on the foreign currency debate, usually by reference to the variety of methods being used by companies to account for foreign currency gains and losses, a flurry of activity by the profession and further dissidence and resistance to the profession's proposals.

The present standard is an improvement in that it has reduced the number of acceptable methods of translating the accounts of foreign subsidiaries from four to two, the current rate method and the temporal method. Companies must determine the functional currency of each foreign subsidiary. This determination is based on the relationship between the parent and the subsidiary. If the relationship is such that the subsidiary exposes the parent to foreign exchange gains and losses during the course of normal operations, the subsidiary is classified as an integrated operation and the temporal method applies. Gains and losses on translation are accounted for in the profit and loss account as incurred. Where the operations of the subsidiary are completely separate from those of the parent, the subsidiary is classed as a self-sustaining entity and the current rate method applies. Under the current rate method, gains and losses are taken to a foreign currency translation reserve. Quantitative guidelines are not provided in the standard to determine the classification of subsidiaries. The present foreign currency standard has also reduced the flexibility in accounting for gains and losses on foreign debt in that all gains and losses are to be
taken to the profit and loss account as incurred except where they relate to qualifying assets or specific hedge commitments. Flexibility was reduced but not eliminated.

The path to this compromise position was long, complex and tortuous and an exercise in ingenuity that saw the profession issue a succession of exposure drafts setting forth diametrically opposed viewpoints. Part of this is, perhaps, explained by the Australian profession's propensity to suspend action on difficult issues and wait to see what other countries come up with. For this reason, in order to trace the history of the Australian foreign currency standard, it was necessary to also draw on the experiences of other countries, in particular, the USA. For example, the Australian profession issued a foreign currency exposure draft in 1979 prescribing the temporal method of translating foreign currency financial statements. This was consistent with FASB 8 issued in the USA in 1975 but in contradiction of its own exposure draft issued in 1973. ED 1973 prescribed the current rate method. According to ED 1979, the temporal method was adopted because it meant that the underlying accounting principles adopted in preparing the foreign currency financial statements would be the same after translation as before (paragraph 25). ED 1979 did not call for the immediate recognition of translation gains and losses on foreign debt as did ED 1973 and FASB 8. Instead, it followed the Canadian model and opted for the defer and amortise option.

Clearly ED 1979 was aimed at eliminating diversity in the translation of the accounts of foreign subsidiaries but what was taken away with one hand was given back with the other. As revealed in the financial press, Australian corporate management were making extensive use of foreign debt usually on the basis that the interest rates offered were lower than those available in Australia. However, the declining value of the Australian dollar often meant that any gains from lower interest rates were eclipsed by increased interest and principal. The Parkinson study (1972), on which the 1977 Canadian exposure draft was based argued for the defer and amortise option on the
basis that exchange rates historically were subject to reversal and, as a consequence, exchange gains or losses would never be realised. However, as Figures 1, 2 and 3 in the appendix to Chapter 6 indicate, the trend of the Australian dollar has been downward since the mid-1970's. In addition, corporate Australia was a net borrower (refer Figure 4 in the appendix to Chapter 6) so that gains on foreign exchange lending were not available to offset losses on borrowings. Therefore, it would appear that the Canadian viewpoint was not relevant to the Australian situation. In addition, ED 1973 specifically rejected the defer and amortise option on the grounds that there was no logical basis for deferring recognition and spreading gains and losses over future periods (paragraph 18).

The only explanation for this apparent about face by the Australian profession appears to be pressure from management who, as indicated previously, were making extensive use of foreign debt at high cost. The defer and amortise option allowed them to keep the cost of this debt out of the profit and loss account. There was also evidence in the financial press that the defer and amortise option was widely used by Australian companies (Phillip, 1980, p29). While institutionalising the defer and amortise method in an accounting standard may be seen as an alliance or a means of structural coupling between the profession and business, it is questionable whether it was in the interests of those who dealt with companies and entrusted resources to them. This becomes particularly pertinent when evidence from the financial press makes it clear the defer and amortise option was being used to manipulate results. For example, one company changed from the immediate recognition method to the defer and amortise method and turned a 25 per cent fall in net earnings into a 41.2 per cent increase in profits (Byrne, 1977, p17). Other examples were given in Chapter 6.

ED 1979 was replaced four years later with ED 1983. ED 1983 was yet another contradiction of previous professional opinion in that it now adopted the functional currency approach and allowed the choice of either the current rate method or the
temporal method. Maintenance of the underlying accounting principles in foreign currency financial statements was no longer paramount. What mattered was the financial and operational relationship between the reporting entity and its subsidiaries. Uniformity was abandoned on the premise that different translation methods were appropriate in different circumstances (ED 1983, paragraph 14). The contradiction was the greater because paragraph 19 of ED 1983 stated that self-sustaining operations were more likely than integrated operations but no evidence was given to support this. Therefore, even though ED 1983 prescribed the functional currency approach, it virtually gave its blessing to the current rate method in lieu of the previously prescribed temporal method. Furthermore, ED 1983 was a direct contradiction of ED 1973. ED 1973 specifically rejected the transfer of foreign currency gains and losses to reserves. Under ED 1973, gains and losses were accounted for in the profit and loss account. The provisions of ED 1983 prescribed that gains and losses on translation of foreign currency financial statements of self-sustaining organisations be transferred to a foreign currency reserve. The defer and amortise option remained for long term foreign debt.

In order to understand the vacillations of the Australian profession, it is necessary to look to the reception accorded FASB 8 in the USA. That is not to say that there was not opposition to the temporal method in Australia. The current rate method was extensively used by Australian companies and the introduction of the temporal method would have required a change in accounting methods. However, the FASB's withdrawal of support of FASB 8, and thereby, the temporal method, was also a key factor in the decision to abandon ED 1979 (Roberts, 1981, p1, Uther, 1983, p59; Wise & Wise, 1985, p16; Prosser, 1985, p15).

In the USA, the temporal method was subjected to severe criticism by companies and in the financial press. For example, it was argued that because the temporal method as advocated in FASB 8 required translation gains and losses to be accounted for in
the profit and loss account, fluctuations in exchange rates made earning patterns erratic. It was argued that erratic earning patterns would deter investment (Forbes, 1976, p37; Editorial Commentary, 1976, p8). It was also claimed that implementing the temporal method would be costly because most companies used the current rate method and adoption of the temporal method meant a change in translation rates used for items including depreciation, cost of goods sold and long term debt. In addition to the clerical costs involved, it was maintained that as these items could be controlled by management whereas exchange rates could not be controlled, new management policies were required at additional cost. Furthermore, audit cost would increase because of these changes.

Research, however, did not substantiate these claims. For example, it was found that management policies did change but whether these changes produced positive or negative results was not known (Griffin, 1979, p12). Evans and Folks claimed that the results of their research showed that the cost of compliance with FASB 8 in terms of clerical, managerial and audit activities was not significant. Rodriguez reported that short term variations in inventory caused by adoption of the temporal method were offset by long term variations on long term debt (1977, p44). Similarly, Merjos found that the impact of FASB 8 was substantial in the short term but over the longer term, the impact was "benign" (1977, p.11). Other studies showed that FASB 8 did not have an impact on share prices, returns or foreign investment (Griffin, 1979; Dukes, 1979; Shank, Dillard and Murdock, 1979).

Even though research did not support management claims as to adverse consequences of FASB 8, it was replaced with FASB 52 in December 1981. The reason given for the review and subsequent replacement of FASB 8 was the concerns of constituents (Journal of Accountancy, 1979a, pp20, 22). It appears that perceived economic consequences were more important than actual consequences. FASB 52 introduced
the concept of functional currency and management again had flexibility in the translation of foreign currency financial statements.

The profession in Australia avoided extensive criticism of its preference for the temporal method by following the lead of the FASB. What the profession in Australia did not avoid was criticism for its procrastination in promulgating a foreign currency standard and also the accounting treatment of hedge transactions. Hedging was becoming a means by which companies could provide a cover against foreign exchange fluctuations. However, there was also evidence that suggested that hedging was being used for speculative purposes (Gill, 1987, p10). ED 1983 provided further scope for this by allowing management an opportunity to further conceal errors in foreign exchange risk management. This was achieved by allowing the cost of hedges for specific commitments, including gains or losses on foreign exchange, to be included in the cost of the asset. Furthermore, while ED 1979 paragraph 19 had specifically proscribed the offsetting of deferred gains and losses in the balance sheet, ED 1983 permitted gains and losses to be offset on some hedge transactions (paragraphs 29, 31). A further area of inconsistency in the exposure draft was where hedges were related to foreign subsidiaries. Where subsidiaries were classified as self-sustaining, by definition they did not expose the parent company to exchange gains and losses. Therefore, such hedges were purely speculative (Jansz, 1984, pp40-41). ED 1983 did not address the issue of speculative transactions.

Two more years elapsed before further progress in the development of an Australian foreign currency standard was evident. In this time, the Australian dollar continued its decline recording devaluations of up to 25 per cent between February and July 1985. The financial press reported that Australian companies had lost some $3800 million in this time (McCran, 1985, p25). Company management and the profession were criticised for the manner in which these losses were being accounted for (Buduls, 1985a, p58; Coombe, 1985a, p52; Gottliebsen, 1985a, p6). In seeming
irritation with the profession's obvious inability to produce an accounting standard, the NCSC released a practice note aimed at eliminating diversity in the disclosure of the reporting of foreign currency gains and losses (Wilson, 1985, p40; Bushnell, 198, p1; Uren, 1985, p13). Not surprisingly, both the profession and the ASRB managed to produce accounting standards within months of the release of the NCSC practice note.

ASRB 1003 *Foreign Exchange Disclosure* was little more than a modified version of the NCSC practice note. AAS 20 *Foreign Currency Translation* was a modified version of ED 1983. It still prescribed the functional currency method of determining whether a subsidiary was a self-sustaining or integrated operation as well as providing the defer and amortise option for gains and losses on long term monetary items. The major area of controversy in AAS 20 was the definition of settlement. ED 1979 had contained a brief definition of settlement which was effectively the due date of payment. ED 1983 did not attempt to define settlement or settlement date even though this was crucial in determining the period over which gains and losses could be deferred and amortised. The definition of settlement contained in AAS 20 effectively extended the defer and amortise time frame by including loans that were rolled over but excluded loans that were renegotiated or re-financed. Management was granted more scope to conceal mismanagement of foreign exchange risk but not as much as some apparently wanted.

A proposed approved accounting standard, Release 406 *Foreign Currency Translation*, was issued two months after AAS 20. The provisions of Release 406 and AAS 20 were identical. Attempts to have Release 406 promulgated as an approved accounting standard brought the defer and amortise and settlement issues to a head. In the debate over these issues, the Australian profession was on its own. The defer and amortise option was not allowed in either the USA or UK standards. This in itself is interesting because the profession steadfastly maintained that adoption
of the functional currency model was justified in the interests of harmonisation with other countries. However, harmonisation was not a valid argument when it came to the treatment of gains and losses on long term borrowings.

The debate over the definition of settlement raged for more than a year. Half of the submissions received in response to Release 406 called for the definition of settlement to be extended to renegotiations and re-financing. Apparently the selective release of AAS 20 had included renegotiations and refinancing of debt in its definition of settlement even though the final version of AAS 20 did not. A lobby group of 14 companies approached the AARF in a bid to have the definition extended (Newsitems, 1986, p18). The debate was effectively quashed when the ASRB announced in April 1987 that it would not approve a standard that allowed the defer and amortise option. With the elimination of the defer and amortise option, the settlement issue became redundant.

It can only be surmised why the defer and amortise option was unceremoniously dropped after almost eight years of maintaining its propriety in the Australian context. However, it is possible that the criticism of the profession arising from the inherent problems with the defer and amortise option was responsible. For example, one company officer implied that foreign exchange losses of $69 million had effectively been "hidden away" by the defer and amortise option until it was decided to write them off in one period (Thomas, 1986a, p125). Another company wrote off $400 million in unamortised foreign exchange losses during 1986 (1986a, p126). The profession was criticised for issuing a "lenient standard" because it allowed the defer and amortise option (Jukes, 1986, p144).

The unpredictable nature of foreign exchange fluctuations was raised in the context of foreign risk management (Goss, 1986; Minchin, 1986; Phillips, 1987; Gill, 1987). For example, during 1985, the decline of the Australian dollar was such that in six
months it reached a level not predicted before 1990 (Goss, 1986, p45). Clearly, any company acting on this advice would have incurred much heavier losses than anticipated. Some companies and individuals who had incurred losses on foreign currency loans took legal action against banks for failing to adequately inform them of the risks involved (Skotnicki, 1986, p59; Meagher & Tingle, 1986, pp20, 22; Hotline, 1986, p13). In the two cases used as examples in Chapter 6, the court held that the plaintiffs had a business background and should have been aware of the risks. In spite of the unpredictable nature of the foreign exchange market, overseas borrowing continued. One commentator placed Australia's foreign debt with some third world countries (Minchin, 1986, p48).

The abolition of the defer and amortise option would seem to have been obligatory by this time. ASRB 1012 Foreign Currency Translation was approved in September 1987. AAS 20 was modified to exclude the defer and amortise option and make it consistent with ASRB 1012. The modified version of AAS 20 was issued in December 1987.

Even though the defer and amortise option was eliminated per se, it was still there in an indirect form in the provisions dealing with qualifying assets and hedges relating to specific commitments. It is not readily apparent where these options came from but there is evidence that the qualifying asset concept owes its existence to lobbying activity. The idea of a qualifying asset was raised in ED 1983 where one of the questions asked was whether foreign exchange gains and losses should be included in the cost of the asset. Only one submission specifically addressed this issue and can hardly be said to be the reason for the appearance of the qualifying asset provisions in AAS 20. However, AAS 20 was released for selective comment before it was issued. Private hearings and meetings were also held prior to the promulgation of AAS 20. Once the idea of a qualifying asset appeared in AAS 20, it has all but been ignored even though it represents a departure from the immediate recognition approach now
embodied in both AAS 20 and AASB 1012. As suggested in Chapter 6, the profession, perhaps, had enough foresight to know that the defer and amortise option would eventually be replaced with the immediate recognition requirement. The notion of qualifying assets could have been a peace offering aimed at avoiding a possible backlash from the elimination of the defer and amortise option.

In the study of the development of the foreign currency translation standard, submissions on a number of exposure drafts and releases were analysed. It was not expected that these submissions would provide clear evidence of influence from any particular sector in the standard setting process. The submissions were of interest as indicators of the diversity of opinion on the issues raised in the exposure drafts and releases. As expected, and consistent with studies undertaken by Coombes and Stokes (1985), Morris (1986) and Gavens, Carnegie and Gibson (1989), a distinct influence could not be readily detected. This is perhaps due to the very wide views held by those making submissions.

Two conclusions drawn from the formal submissions was that there was not overwhelming support for any particular translation method or method of accounting for gains and losses on long term borrowings even though there was a preference for the current rate method and the defer and amortise option. To this extent, it could not be strongly argued that business had the immediate recognition method imposed on them against their wishes or that business in Australia, at least, had won a victory with the adoption of the functional currency approach. As indicated in Chapter 6, the decision to abandon the temporal method in favour of allowing a choice in methods was based on events in other countries. On the other hand, at least one submission in response to ED 1983 contained what could be identified as a precursor to the idea of a qualifying asset. ED 1983 also specifically asked for comment on whether gains or losses should be included in the cost of the asset related to the long term loan. Given that formal submissions are only one form of lobbying activity, that AAS 20 was given
selective exposure before it was released in 1985 and that private meetings were held between the standard setters and select business groups, it is possible that the concept of a qualifying asset was an initiative introduced in the expectation that the defer and amortise option would eventually be replaced with the immediate recognition requirement. It is possible that accounting for hedges related to specific commitments had the same origin and for the same purpose.

In addition to leaving scope for flexibility in accounting for foreign currency translation and transactions, neither AAS 20 nor AASB 1012 addresses the issue of speculative dealings other than requiring that the methods used to translate speculative dealings be disclosed. The AWA case indicated a clear need for guidelines dealing with speculative foreign currency transactions and there is no evidence to suggest that this was an isolated case. In addition, the AARF's 1987 media release proposing that AAS 20 be amended to replace the defer and amortise option with immediate recognition also specifically asked if the standard should be extended to speculative dealings. There was more support (18 submissions) for such an extension than against (5 submissions). In addition, the Australian Merchant Bankers Association submitted a proposed accounting standard to the ASRB in 1987. This proposed standard considered that mere disclosure of foreign currency amounts was too simplistic and misleading (Killen, 1987e, p28). No discernible action has been taken with regard to these proposals (Langfield-Smith, 1987, p17). Both the AARF and the ASRB stated in 1987 that the issue of speculative dealings would be addressed and added to AAS 20 and ASRB 1012 possibly in 1988. This has not occurred and, undoubtedly will not occur until another instance such as the AWA case casts the spotlight on this area once again.

Two reasons can be suggested for the failure of the AARF and AASB to address the speculative dealings issue. First, it is clearly a contentious issue and perhaps it has been left in the too hard basket until environmental pressures push it to the fore again.
Second, by leaving the issue open, it leaves the opportunity for conversation and communication at a later date.

The development of the foreign currency standard exhibits all the stages in the circuits of power framework. Identifying the "problem" of variety in the methods used to account for foreign currency translation and transactions was the starting point. This "problem" was exacerbated when foreign investment and trade increased and foreign currency markets were deregulated. The press effectively played a role in bringing these "problems" into the spotlight by reporting the large foreign exchange losses being incurred by companies as well as the diversity in accounting for them. While there is no evidence of an intentional alliance between the press and the accountancy profession, the actions by the press made public the need for action of some description. One possibility was the promulgation of an accounting standard. By developing an accounting standard aimed at ensuring uniformity in accounting practice and also disclosing the impact of management decisions regarding foreign loans, the profession was establishing an agency relationship not only between the users of financial statements and others who dealt with corporations but also with the public. In this sense, there was a move towards interessement and enrolment. Issuing exposure drafts and releases for comment could be seen as further alliance strategies and also mobilisation of support for the profession's proposed solutions. The final promulgation of the standards was the exercise of episodic power.

The various changes in stance on the part of the standard setters is also indicative of the activities of an autopoietic system. Issuing exposure drafts and releases for comment were part of the conversation and communication process. When dissidence or resistance were perceptible, for example, through formal and informal submissions, press coverage, in particular that in the USA over FASB 8, and comments in academic journals, conversation and communication recommenced. This process continued until dissidence and resistance were quelled. The fact that achieving this
meant that successive proposals were often in direct contradiction of previous ones
did not matter. The purpose of conversation and communication is survival and
survival is the overriding objective of the system.

Hence, in order to maintain autopoiesis and dominance, alliances, that is, structural
coupling, must be maintained. Conversation and communication must also continue.
Therefore, flexibility and indetermination have been institutionalised in the existing
foreign currency standards. When the next shock to the environment comes in the
form, for example, of some new scandal or the revelation that speculative dealings
have grown to what society is convinced is an alarming level, the process will begin
again. This study maintains that this is how the cycle of regulatory failure-regulatory
reform is perpetuated.

PROGNOSIS

The above suggests that the cycle of regulatory failure, regulatory reform that Justice
Rogers of the New South Wales Supreme Court has described as "endemic to the
Australian economy", will continue for the foreseeable future. However, the problem
lies not so much in the greed and avarice of the management of corporations but in
the uncertainty and indetermination of the rules and laws governing corporations.
This, in turn, makes it difficult to enforce regulation. Evidence was produced in this
study to support that contention.

The flexibility, ambiguity and vagueness in accounting standards are but one source of
uncertainty as was evidenced in Chapter 5. Nonetheless, it is a significant source
given that accounting is the means by which management is made accountable to
those who deal with corporations and, thereby, to the public through the allocation of
resources. Often in the wake of regulatory failure in which accounting is implicated,
there is the suggestion that if the accountancy profession does not lift its game, a new

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profession will emerge to take its place. Within the context of the circuits of power framework and autopoiesis, this is unlikely to occur.

The establishment of the ASRB in 1984 was an attempt to take the standard setting process out of the direct control of the accountancy profession. The NCSC and the New South Wales Corporate Affairs Commission initially appear to have succeeded in their mission to establish an independent accounting standard setting authority. However, the profession had a wealth of resources at its disposal to combat what was a temporary set back. The profession had an effective organisation in that it had stable leadership and long standing alliances with business interests. It also had experience in the standard setting process. The ASRB, on the other hand, lacked a statutory mandate. There was uncertainty as to its purpose and functions. The body that brought the ASRB into existence, the Ministerial Council, lacked organisation in that it had a transient membership dealing with a new and complex regulatory system. The membership of the Ministerial Council not only lacked experience but coming from separate State Governments, probably lacked clear direction as to what the role of the ASRB should be. In this environment, the profession was able to outmanoeuvre the ASRB, thwart its activities and ultimately regain control of the standard setting process. Any further attempts to create an independent standard setting body are likely to suffer the same fate.

Even if a new profession or independent organisation were to emerge and successfully achieve domination of the standard setting process, it is unlikely the situation would change. In order to achieve domination, the new organisation would have to go through the same processes of demonstrating its ability to solve the problems of corporate regulation and mobilising resources to form alliances and agency relationships. Once domination was achieved, the same elements of dissidence and resistance would challenge this domination and, perhaps, seek to once again change control of the obligatory passage points.
If this system was also autopoietic, a similar process would apply. The system would use conversation and communication to create its structures and a boundary around them. It would need to ensure structural coupling within the structures of the system itself and between the system and its environment. Conversation and communication would be needed to maintain autopoiesis and extend the boundaries where necessary to ensure its continued existence. Structural coupling or alliances would tend to require the same compromises made by accountancy in order to maintain domination and survival of the autopoietic state.

From this perspective, the prognosis for effective reform of the regulatory system is not hopeful. Justice Rogers argued that the primary flaw in the area of corporate regulation was "... the prohibitive difficulty and cost required to prove an infringement" (1991, p1). The underlying problem, according to Justice Rogers, did not lie in the corporations law, but in the difficulty in gathering evidence (pp2-3). This sentiment has been echoed throughout the course of this study with evidence provided from regulators such as Henry Bosch and Ian Langfield-Smith who have consistently complained that flexibility in accounting standards made it difficult to prove conclusively that financial statements did or did not give a true and fair view. As long as there is a commitment to flexibility and indetermination in the bid for survival either on the part of corporate management or on the part of regulators, unexpected corporate failures or the reporting of profits where losses have actually been incurred is likely to continue. If for no other reason than that management and company auditors can claim they have adopted the rules and be secure in the knowledge that even if losses are subsequently revealed there is little likelihood that a successful prosecution will be launched against them.

Finally, then, perhaps the solution to the problem of unexpected corporate failures or the reporting of large losses lies not in the making of ever more rules and accounting
standards but in a commitment to make the rules that are in existence work. This point was raised in a Parliamentary debate in the Senate in 1992. The speaker made reference to an article in the financial press regarding comments made by Henry Bosch about corporate transgressors and highfliers. According to Bosch, for every one of these there were thousands of professionals including lawyers, accountants and auditors who followed them. A point made in relation to this state of affairs makes a fitting conclusion to this study

... without their cooperation and without the belief in the ethics and the efficacy of all of the players in the corporate world, it does not matter how many millions of dollars we give to the Australian Securities Commission, it does not matter how hard nosed the head of the Australian Securities Commission is ... we will not achieve the results that we all desire ... in rebuilding the integrity in Australia's commercial sector and security sector (Australia, 1992a, p2205).


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