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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Australian Accounting Standards

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JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND FINANCIAL SERVICES

Monday, 7 February 2005

Members: Senator Chapman *(Chair)*, Ms Burke *(Deputy Chair)*, Senators Brandis, Lundy, Murray and Wong and Mr Bartlett, Mr Bowen, Ms Jackie Kelly and Mr McArthur

Members in attendance: Senators Brandis, Chapman, Murray and Wong and Ms Burke

Terms of reference for the inquiry:

To inquire into and report on:

The Australian Accounting Standards tabled in compliance with the Corporations Act 2001 in the Senate on 30 August 2004 and 16 November 2004. The Committee will consider:

(a) whether the proposed standards are consistent with the Corporations Act 2001 and its regulations (as required under s.334 (1) of the Act);

(b) whether the proposed standards will act in furtherance of the objectives of the Act; and

(c) any related matter.

WITNESSES

Committee met at 4.14 p.m.

BEECHER, Mr James, Reporting Committee Member, Australian Institute of Company Directors

EVANS, Mr Ralph, Chief Executive Officer, Australian Institute of Company Directors

SERVICE, Mr James, Reporting Committee Member, Australian Institute of Company Directors

CHAIRMAN—I call the committee to order. Today the committee will hear evidence regarding the Australian accounting standards tabled in accordance with the provisions of the Corporations Act 2001 and relevant and related matters. The committee expresses its gratitude to the contributors to this inquiry, including those who will be appearing before us as witnesses today.

Before we start taking evidence, may I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its committees and to its members and others, as necessary for the discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person that operates to the detriment or disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege.

I also state that, unless the committee should decide otherwise, this is a public hearing and, as such, members of the public are welcome to attend. This is the committee's only hearing on this reference. I now welcome representatives of the Australian Institute of Company Directors. We have received a written submission from you and I now invite you to make your opening statement, at the conclusion of which I am sure we will have some questions.

Mr Evans—The AICD is a member organisation. We have 19,000 members around Australia. A lot of what we do is provide education for company directors, and policy representations such as this are another important function. Our goal is to improve the quality and standard of corporate governance in all its aspects around Australia. AICD members, because of their number, are quite clearly not all concentrated at the big end. We do have a large representation among the big companies but, as we have 19,000 members, a very large proportion of them are with medium and smaller companies, not-for-profits, government entities or a variety of other bodies of that kind. Many of them sit on multiple boards at the one time.

We accept that the transition to international financial reporting standards is taking place but we are concerned, and we want to voice the concern brought to us by our members, that the transition presents some difficulties, particularly for the smaller companies. We are concerned about the potential costs and administrative burdens we expect to fall on many of the smaller companies. We have had lots of contact and submissions from smaller companies that are saying that, if they are looking at it at all, they may well be underprepared for when they have to get their accounts to comply with the international financial reporting standards and, therefore, in the way it is done it presents a problem for them. I do not think it is a problem for the large

companies. With that introduction, I would like to hand over to James Beecher to take up some of those issues.

Mr Beecher—Thank you, Ralph. From what we have seen it is clear that the larger companies have made or are making the transition to international financial reporting standards, IFRS. However, as Ralph pointed out, we do have anecdotal evidence and there is recent evidence from surveys conducted by a number of organisations that indicate that the smaller listed companies and unlisted reporting entities are less well prepared for the transition. We point out that Australia is unusual because there is a comparatively large number of listed companies for the size of the market. The top 300 companies account for 90 per cent of the market capitalisation. Ralph has statistics that suggest a market capitalisation of—

Mr Evans—About $5 million.

Mr Beecher—and there are, in total, something over 1,600 companies listed on the ASX. There are also somewhere between 20,000 and 25,000 unlisted reporting entities in the Australian market which are affected by the transition to international accounting standards.

This is different from what is happening in Europe. In Europe currently it has only been mandated that listed companies need to comply with international accounting standards. There the listed companies on the stock markets are much larger, comparatively or traditionally, than they are in Australia. Similarly, in New Zealand for example, the introduction of IFRS is only going to occur in 2007, so Australia is effectively one of the first countries that are putting in place IFRS, and it is doing it for all companies that need to do accounts. It is not just limited to the large companies. Therefore, we believe that the smaller companies are bearing the greatest relative burden on transition, with little tangible benefit. The benefits that are ascribed to going to IFRS are access to capital markets and the lower cost of capital for Australian companies, and the companies that are going to benefit from that are the larger companies.

Also happening in Australia at the same time as the transition to IFRS are a number of other significant corporate governance exercises. These are Sarbanes-Oxley, the introduction of CLERP 9 and the ASX corporate guidelines. A number of these affect both large companies and small companies but there is also the knock-on effect, in that the number of experts or people who have knowledge of these different exercises that are going on is limited in an economy like Australia, and that is taking out the educated and expert resources that are available across the market. For example, I was talking to somebody during the week who works for one of the large banks in Australia. They have had 20 people full time for the last 18 months on Sarbanes-Oxley. Of those, four people are internal and 16 are external, so they have taken 16 people out of the market to deal with specific Sarbanes-Oxley issues which only relate to a number of the large companies. That means the resources are not available for a lot of the smaller companies and, when they come to the transition to IFRS, which we believe they are not necessarily that well prepared for, the expertise and resources will not be there for them.

An additional factor in respect of that is that we understand that ASIC has stated that companies are not allowed to use their external auditors as advisers with respect to IFRS. Large companies can most probably buy in other expertise but the smaller companies cannot access that sort of expertise. Even if they could it becomes extremely expensive for a top 500 listed

company with a market cap of $5 million to get another set of accountants into the organisation to advise them on specific areas.

On that basis, AICD has been canvassing a number of possible solutions for the smaller listed companies and for the 20,000 to 25,000 unlisted companies who still have to comply with IFRS under the Australian model. The two major suggestions that we are putting forward are to allow smaller companies to use their auditors for IFRS transition and having ASIC dispense with their requirement that companies not use their auditors for advice on IFRS. The second suggestion is to defer the transition date for implementation for the smaller companies.

The transition date to IFRS is for accounting periods beginning on or after 1 January 2005. The standards have been promulgated for only a number of months; some of them are continually changing, and interpretations are coming out. So the stable platform that the Accounting Standards Board put in place in the first half of last year is not necessarily that stable. For example, a couple of companies I am involved in are in the mining and associated industries, and the standard in respect of the exploration and evaluation expenditure of mining companies only became final in December last year. So companies are only now looking at what that means.

The Australian standard was going to be grandfathered by the international board. That has happened but only in part. It has happened in relation to exploration and evaluation expenditure, but the Australian standard went further to include all associated expenditure in mining. For example, one of the companies I am involved in has large expenditure in treatment and processing in mining. Under Australian standards, that was definitively allowed to be capitalised; under international standards, it may be that that expenditure, because it is not dealt with and is specifically excluded from the international standard, may no longer be allowed to be capitalised. I do not know the answer, but that is the initial advice coming forward. That company is capitalised at somewhere between $35 million and $40 million on the Australian Stock Exchange. The company's major asset is the capitalisation of this expenditure. If it is no longer allowed to capitalise the expenditure, all of its balance sheet will be written off and it will revert to a company with net assets of less than a couple of million dollars. That company has one full-time employee—the chief executive officer—and a number of consultants. On the accounting side, it has a qualified accountant—who has other clients—who comes in two to three days a week and an accounting clerk who comes in a couple of days a week to do the processing. That is an example of a company in which the transition is not necessarily being handled and where there is a great impact. These are the sorts of examples we are seeing in which the move to international standards is going to impact them.

Another point we have had discussions about in the reporting committee of the AICD is what I term the 'Oh, my God!' reaction. What will happen is that these standards will be implemented and people will say: 'Oh, my God! No-one told me that's what it meant,' in relation to the sorts of things I was just talking about, where there is the impact of writing off significant parts of balance sheets. For example, Australia has a large number of cooperatives. Under an international interpretation that is being looked at this week by the Australian Urgent Issues Group—which is the interpretive subcommittee of the standards board—all cooperatives, under international accounting standards, will have to treat the shares members have subscribed to not as equity but as liability. So, quite possibly, a lot of them will be technically insolvent. Under

that interpretation, because of the impact of Australian law, they will have to treat what, in substance, is totally equity as liability, and they will no longer have any equity.

A number of other examples of that are coming out. Another major one that we are aware of is stapled securities. We believe that a lot more of these are going to come out. The large companies are aware of them, but it will take time for that to filter through, for the marketplace to become aware and for advice to be understood by the smaller companies. Therefore, we are submitting that a deferral of the transition date for smaller companies below the ASX 300 and for non-listed companies should be something that this committee recommends.

Mr Service—I entirely support what James has said. As the director of a number of small companies as well as big ones, I am aware that the costs and the practical challenges of dealing with IFRS are enormous. Some of us think that there is some difficulty in understanding what the national benefit of that effort expenditure is. Some deferment, I think, is essential; otherwise, what we are going to get is a botched application of IFRS, which is not going to suit anybody.

I will go to another subject, which is dealt with directly in the terms of reference. That effectively is the interplay of IFRS with the Corporations Law. Some of us are rather surprised that the parliament has chosen to give its legislative capacity in terms of accounting standards to what is a semiautonomous body in the UK. I do not propose to say more about that, except to continue to express surprise.

There are clearly some difficulties with IFRS in how it actually works with the Corporations Law. There are obligations under the Corporations Law for directors to state whether the accounts are true and fair. There are some very senior directors and very senior accountants who take the view that in some cases the application of IFRS will produce accounts that are not true and fair and, therefore, the accounts will be qualified. That is going to end up in a very considerable debate, because clearly the intention of the parliament was that directors ought to be able to say that their accounts are true and fair; otherwise, why bother having the accounts at all?

The other issues that are going to cause difficulty with legislation are particularly in relation to income tax. There will be some significant effects on the way people gear in relation to foreign investment. The Commissioner of Taxation, I understand, has allowed an interim period of only three years for people to change their financial structure to meet their tax obligations, simply because a London committee has changed the accounting standards. Nothing of substance has changed at all, yet the tax impacts can be very considerable. So an issue that the committee may wish to consider is to what extent, if any, the parliament may later wish to look at the Corporations Law to see where it actually does not work with international financial reporting standards.

Mr Evans—We would be happy to take questions.

CHAIRMAN—Have you raised these issues with Treasury and/or ASIC? If so, what response have you had?

Mr Evans—Indeed, and with the FRC. The main response has been to say, 'Show us the evidence.' We are saying that this is a problem that is looming. People in small companies are

unlikely to be concentrating on how they will implement IFRS until they have to. It is a bit like flying in a fog and saying, 'We think there is a mountain ahead.' There is reason to think there is one and it is best not to wait for the evidence actually to become very obvious.

CHAIRMAN—One specific reference you make is to an ASIC announcement suggesting that companies will not be able to use their audit firm for IFRS implementation and will be forced into a new relationship for that purpose. Has that been resolved or is that still an issue?

Mr Evans—No, but we do believe that it would be a good thing for smaller companies to be given general permission to use their audit firm relationships for advice on the transition. Otherwise they will have difficulty finding anybody with the expertise. There are just not enough people around. This may turn out to be the case in any case. We do not want to encourage people to go against ASIC's policies.

Ms BURKE—Might there not be a conflict of interest further down the track if they use them for advice and then they audit the accounts afterwards? My understanding is that is why they have said no.

Mr Beecher—That is one submission on it. For a small company to get another set of accountants through for accounts that are not necessarily that complicated, the conflict of interest would not outweigh the costs. For shareholders it is there; it is disclosed; it is understood; and the accounts are available.

Ms BURKE—Did you have a dollar figure of the turnover of the group that you are thinking of?

Mr Evans—Not in general terms but specifically for the IFRS transition, we think the people below the top 300 of the ASX. We have heard that ASIC are well disposed towards that idea, but we have not heard any definite announcement that they will give an exemption.

Senator WONG—I do not want to reopen the whole issue of auditor independence and the various recommendations that this committee has made previously in the context of CLERP 9, but are you proposing a limited exemption for the purpose of only the IFRS advice transition?

Mr Evans—That is right.

Senator WONG—You have raised a number of issues in your submission and orally today. The first issue I want to raise is the case you make for deferral. Whatever the merits of it, the decision to move to international standards was made some time ago by government. We can debate whether or not that was a good thing. I know of your comments, Mr Service; they have been put to me elsewhere. But whether it is realistic for this committee to readdress that issue is, I think, unlikely.

Another issue I want to raise with you, which has been put in a number of other submissions, is that these changes have been on the agenda for some time. I do not want to discount what you say about the difficulties of the transition, particularly for small and medium enterprises, but the point has been made in other submissions that, if we were to defer, what is the additional notice

going to add in terms of any real benefit to the sector when people have already had notice of this for a reasonable period?

Mr Evans—We are suggesting that it does not make great sense for this country to be right out in front, ahead of everybody else. In the EU, there are 7,000 listed entities which are obliged to take up IFRS in the first period, for a population of 450 million people. We have 20 million people and we are asking somewhere over 20,000 entities to adopt them straightaway. So we think there is going to be great difficulty in finding enough people who understand some of the technical aspects of this. There is a shortage of people with the skills or people to teach people the skills, and that is going to cause some problems for the smaller companies. So we would suggest that an appropriate response would be a deferral in their case.

Mr Service—The institute and a number of other organisations raised this issue of deferral a long time ago. It is not something that we have raised just today, by any means. So you are perfectly right to say that IFRS has been on the table for some time. It is not as if we have ignored the problems—quite the reverse; it has been getting a helpful response that has been difficult.

Senator WONG—Or the response that you are seeking?

Mr Beecher—IFRS has been around for a time but the detail has not.

Senator WONG—That is true.

Mr Beecher—That is the point that I was making in the mining example.

Senator WONG—I think that is more relevant. I think the move has been well publicised for some time. The FRC spoke about this two or three years ago and reaffirmed that again last year. But your point about the detail in the standards was well made.

Mr Beecher—And the detail is still coming out. The submissions before this committee point out differences between Australian standards and international standards with inconsistencies and all of those sorts of things. All of that is still coming out and will continue to come out, and there will be more of these things where an international standard has an unintended consequence in Australia because of Australian legislative and Australian tax requirements.

Senator WONG—I am going to come to the unintended consequences issue, but let us focus for a moment on your deferral proposal. What I am not clear about is that this is going to be an issue for small to medium enterprises in any event. What you are suggesting to the committee is a differential standard applying to different Australian businesses on the basis of their size. There are those who would argue that that is a net detriment. What is the benefit of it? Is the benefit simply that we are going to give small to medium enterprise a bit more time? Do you say that that is worth having a situation where for a period of time at least you are going to have different standards applying to different companies in this country?

Mr Evans—Yes, that is what we are proposing—not that there be a permanent difference, just a temporary one. Part of the reason for that is the shortage of people with skills to assist people in the transition.

Senator WONG—What do you say about the downside—the consequences of having differential standards applying?

Mr Evans—That is undesirable but probably better than having a situation where the directors of smaller entities are in a position where the accounts come up and they cannot be certain that they are a true and fair view of the state of affairs of the company.

Mr Service—The claimed benefit for IFRS is to make the raising of capital in international markets cheaper for Australian businesses. That is the only claimed benefit that has any substance at all in my view. The smaller companies that Mr Evans is talking about do not raise capital in the international markets. They are not interested in the international markets. That is not where they play. They only raise capital—and they raise it in small amounts—in the Australian markets. So I do not think it matters at all that their accounts may be presented slightly differently in the Australian markets. I think it is irrelevant.

Senator WONG—I am sure witnesses after you may have something to say about that. Can I ask about the relief in terms of the publication of comparatives. Mr Evans, you wrote to Treasury about that issue and made the point that:

... exempting these companies—

I presume that was a reference to SMEs?

Mr Evans—Yes.

Senator WONG—You continue:

from the requirement to provide comparatives will be of limited assistance ...

Given that, why would that be something that the committee should look at?

Mr Evans—We asked early on for that to be considered. We are not an accounting firm or in a position to generate data about the efficacy of that, but that was one thing the members of our reporting committee suggested might be a concession that would help smaller companies in the transition. But on investigation it turns out that gains from that will be slight, so today we are not advocating that.

Ms BURKE—Now on two occasions, Mr Service, you have made the statement that the directors will not be able to sign off that the accounts are true and fair. On what basis are you making that claim?

Mr Service—Accounting is not a science; it is an art. It is clearly all a matter of opinion. Australia has a set of accounting standards at the moment under which all directors have been obliged to sign accounts saying they are true and fair. We are now saying: 'Oh no, those standards really weren't right. We're going to have a different lot, which will produce a different answer.' So we are supposed to say, 'A is true and fair but next week X is true and fair.' True and fair is, in fact, in the eye of the beholder and the directors have an obligation under the law to form a view as to whether the accounts are true and fair.

It is very difficult to know what 'true and fair' means. There has been a lot of argument about that but, if you produce a set of accounts under any form of accounting standards and as a board of directors you form the view that those accounts do not properly represent the position of the business, you are obliged by the Corporations Law to say, 'Sorry, we've stuck with the rules, but the accounts are not true and fair.' You then explain why you think they are not true and fair. Those things have happened. I personally signed a set of accounts on that basis.

But the difficulty we face now is—and it involves this comparatives issue—that last year we signed a set of accounts which said 'Blah blah blah, they are true and fair.' Next year we are going to have to sign a set of accounts saying, 'Oh no, we changed all that; it wasn't really true and fair at all.'

Ms BURKE—But it is only just a different standard. The numbers are going to be the same; they are just going to be put over—

Mr Service—No. With respect, the numbers are going to be in some cases very different. With respect to one company whose board I sit on, the difference is $600 million. It is not a little number; it is a very serious number. I can form a view that this set of accounts is true and fair. Mr Beecher may form a view that they are not true and fair, and that is an issue we are obliged by law to deal with. It is not a matter of choice. I do think it has put directors in a very awkward position when last year they said, 'This is true and fair,' and this year they say 'Oh no, it was all a pack of lies.' That is in effect what—

Senator BRANDIS—That is not right, is it? True and fair means true and fair against certain stated criteria, which is what the standard is.

Mr Service—I am sorry, with great respect, I disagree with you, Senator. I do not think that is right and the advice I have had from some very eminent law firms does not support the position you have put; that the Corporations Law obliges you to form a view that in your mind the accounts are true and fair. I am obliged—that is the advice I have been given, so please do not think I am being impertinent.

Senator BRANDIS—Is true and fair a judgment based on two different things—based on the figures themselves and based on the standards? So if the standards change, it is quite logical for what is true and fair also to change, even though the raw figures do not change?

Mr Beecher—The Corporations Law prescribes that accounts have to conform with accounting standards and give a true and fair view. Effectively, you have to comply with accounting standards firstly and then you have to form an opinion whether it is a true and fair view. If I can also expand on Mr Service's point: our concern is about smaller companies having directors with both the expertise and the advice to form a view or a judgment in respect of the true and fair basis. Because of the rush to IFRS, the time involved, the changing of the standards, and the fact that the advisers and resources are not necessarily there, except for the big end of town, a lot of directors quite possibly will be put in a position of signing off on accounts without being able to form a judgment on 'true and fair'.

Senator WONG—But that possibility exists now; that is not a consequence of the move to international standards.

Mr Beecher—The possibility exists now. It is going to exacerbate going forward in that they have to understand what is in the accounts, what the changes are and what the meaning is.

Senator WONG—Apart from deferral, are there any other forms of relief that you would suggest the committee should look at for small and medium sized businesses?

Mr Evans—One other that we mentioned was the permission to use auditors for advice on the transition.

Senator WONG—Yes, I picked that up.

Mr Evans—But the decision was taken some time ago, as you all pointed out, and we are not trying to roll it back, only to make the transition easier for the smaller companies.

Ms BURKE—What sort of time frame is there for the deferment? Some of the other submissions are saying that if you give small and medium sized businesses a deferment they will just keep putting it off and putting it off and putting it off.

Mr Evans—Indeed they would because there is no benefit for them. But we are only suggesting a year.

Mr Service—I think there is one other advantage of the period of a year, and that is the practical availability. A couple of small companies that I know about where I do not have a direct input simply cannot find the people. They understand they have to deal with this. I think it is generally accepted now that we have got IFRS. Nobody here is saying, 'Let's ditch it,' but they just cannot get the advice they need, whereas in a few months time the big demand from the large companies will have been satisfied and lots of people with reasonable expertise will be available who can go and give advice to the small companies that you were talking about. That is where the benefit of a year's deferment comes from. It is just a matter of the sheer availability of people.

Mr Beecher—So the expertise will become available. Also, the consequences and what the standards actually mean will have been analysed and will therefore be out in the world because some companies will have implemented it. They will have understood what the consequences are and the advisers will understand what they need to look for and what the issues are.

Ms BURKE—Won't the market also dictate that some of these firms will have to do it? If they go into an acquisition mode or a purchase mode or if they are looking for other capital, they are going to be forced to do it to raise capital.

Mr Beecher—The suggestion is that it is deferred but companies can early adopt if they wish, which is the normal situation. So, if they are put in that situation or if they want to or if they feel comfortable doing it, they can early adopt and do it from the period beginning after 1 January 2005 as opposed to deferring it for 12 months.

Senator WONG—Mr Evans, I think you or someone else at the table mentioned that the issue of using auditing firms to provide advice had been flagged with ASIC by your organisation. Is that correct?

Mr Evans—I can only say that we have heard second-hand that they have some favourable disposition towards it. But I do not believe they have made a decision to allow it.

Senator WONG—No. I just wanted to see if there had been communication between the institute and ASIC.

Mr Service—I think it has certainly been put to ASIC, but I do not know whether it has been put specifically by the institute. I am aware that it has been put formally to ASIC by I think more than one organisation.

Senator WONG—I do not think any small business representatives made a submission along the lines that you are putting. Have you had dialogue with the various small business associations?

Mr Evans—We have had dialogue with our own members who are directors of smaller companies. We held a meeting in Brisbane for that purpose in November. The views were very strongly expressed. As directors they were worried about it. But I think the reason for that apparent inconsistency is that people will not focus on this until fairly late in the day and then they will find a problem.

Senator WONG—Won't that be the case even if we defer?

Mr Evans—No, or less so, for the reason that Mr Service went into, which is that the experience will be greater and the people who are now flat out working on the transition for big companies will be available.

CHAIRMAN—Thank you for your appearance before the committee and the evidence that you have given today.

[4.53 p.m.]

O'GRADY, Mr John Paul, Partner, National Accounting and Auditing Standards, Ernst and Young

CHAIRMAN—I welcome Mr John O'Grady of Ernst and Young. I invite you to make an opening statement, at the conclusion of which I am sure the committee will have some questions.

Mr O'Grady—First of all, let me state that Ernst and Young supports the endorsement of Australian accounting standards that are the Australian equivalent of the international financial reporting standards. We believe that these standards will achieve the objectives of reduced cost of capital and enhanced investor confidence; they will facilitate global comparability of financial reports; and they will also provide higher quality financial information. We believe the suite of standards represents a significant improvement on the quality of financial reporting in Australia, particularly in relation to the fact that they include standards in areas where currently none exist under Australian standards—areas such as financial instruments, share based payments and defined benefit pension arrangements.

They also provide more prescriptive recognition measurement rules. They are more specific and more detailed—and therefore are effective in achieving an objective of increased comparability across organisations. They provide greater disclosure, thereby enhancing the understandability of financial statements, although the volume of disclosures may militate against the understandability by the layperson of everything that is in those statements. We believe the increased use of fair value measurement principles from those standards actually increases the relevance of financial information presented to stakeholders. Essentially, we believe the whole suite of Australian standards and its equivalence to international standards promote comparability, understandability and relevance of financial information.

However, as we pointed out in our submission, the key to successful achievement of those objectives really lies in consistency of interpretation of the standards. We do have some concerns in that area, principally around the processes that have been set up to ensure consistency of interpretation. The International Accounting Standards Board and the International Financial Reporting Interpretations Committee, IFRIC, are somewhat overwhelmed by the volume of requests for interpretive guidance around the standards as companies and organisations are moving through implementation. We believe that further effort and resources need to be put into the interpretive side of the standards.

Because there are differences between the international financial reporting standards and the Australian equivalents of those standards, there is a need for interpretive guidance at the country level in Australia and there is a need for enhanced interpretation of the international standards. In our submission we have set out some examples of where those differences arise and where there are interpretive problems. They are just examples of many that we are coming across.

The big four firms have essentially set up their own processes internally to try and get consistency of interpretation of international standards. Within Ernst and Young we have set up global interpretive groups based around subject matter to try and get consistency of

interpretation within our own organisation. But we feel there is a need for broader interpretive bodies to be created around IFRS. We have put in our submission that we feel there is a role to be played in IFRS interpretation by the national standard setters. That should be looked at, while working in conjunction with the International Accounting Standards Board and the International Financial Interpretations Committee.

CHAIRMAN—Thank you, Mr O'Grady.

Senator BRANDIS—Just as a matter of curiosity, you say that you developed, within Ernst and Young but across your various offices around the world, certain common criteria for the interpretation of the international standard. I assume that is a practice that the other large international accounting firms would also engage in?

Mr O'Grady—Yes, I believe all the big four firms have similar types of arrangements.

Senator BRANDIS—Do you exchange that information?

Mr O'Grady—We do not exchange the information with them in terms of agreeing—

Senator BRANDIS—'Information' is perhaps an inapt word. Do you exchange with them your views or criteria about the interpretation of the standard?

Mr O'Grady—No, we do not. We generally become aware of differences in interpretation around specific transactions or, if we are the owners of a particular company and that company has been advised on its IFRS implementation by another one of the big four firms, we become aware of differences that they have in interpretation from what we have.

Senator BRANDIS—Presumably, at professional conferences where this topic is discussed, those differences would come to light and perhaps be debated among the practitioners concerned.

Mr O'Grady—Certainly that would happen in an informal capacity at conferences. I am a member of the Urgent Issues Group in Australia. At meetings of the Urgent Issues Group and other such forums, the different interpretations that different people have of the standards will come out.

Ms BURKE—Where do you go if you are looking for arbitration, as you say? Where do you go now for someone to arbitrate on what is an interpretation?

Mr O'Grady—That is a good question. If there are differences of view, we will often seek to raise the issue with the IASB staff. We seek to raise the issue and put it on the agenda of the Urgent Issues Group within the Australian context, or we may seek to have discussions on it with the International Financial Reporting Interpretations Committee. There is no formalised process for resolving these interpretative issues, except making a submission to the International Financial Reporting Interpretations Committee. Often it comes down to just a discussion around the issue and hopefully you reach some sort of resolution. If there is not a resolution at the end of the day, then there is a difference of opinion.

Ms BURKE—Do you think they will be ironed out over time once the standards are in place for a period of time and everyone is familiar with them and is using them, as they are with the current standards?

Mr O'Grady—As we move forward, I think we should see fewer differences in interpretation. We should see it coming towards a common standard, but I think, irrespective of how long the standard is around, people will always read the words differently to their own ends.

Ms BURKE—Given that some of the standards come with options, does that complicate the issue as well?

Mr O'Grady—Options do not generally tend to be the issues that create interpretative problems. I think interpretative problems generally arise more from two sources. People really read words differently and interpret them differently. In the context of international standards, what we are finding is that people from different jurisdictions are interpreting them differently depending on where they have come from and their existing standards. So in Australia we will read an international standard and we will interpret it in a particular way because we have come from an understanding that may be different from that in the UK or France or other countries.

Ms BURKE—But hopefully the international standards are actually going to iron out those interpretative issues.

Mr O'Grady—Yes, over time we hope an international accounting standards board, through guidance, will narrow those differences in interpretation.

Ms BURKE—What if I am a common or garden shareholder—and I declare now that I do not own any shares—and I have a set of accounts in front of me? Going back to the options question—and I am sorry that I am jumping all over the place—don't I want to know what option you have used so that I can read them? Isn't this as much about disclosure for me, the person on the end trying to read these accounts, as it is about firms actually coming up with audited accounts?

Mr O'Grady—Yes. If a company has adopted an option it should generally be evident from the accounts which option it has adopted. I suppose that does not help the majority of readers in actually determining how that would be different if they adopted a different option. So, even though they can tell which option has been adopted, the comparability is not enhanced by having the options.

Ms BURKE—One final thing: in your submission you note that there are a number of 'unintended tax consequences of some IFRSs'—I have to get my head around these acronyms! Are there any specific examples?

Mr O'Grady—I suppose we are referring there to the issue of the thin capitalisation problems with derecognising intangible assets. Under IFRS, derecognising intangible assets increases the debt-equity ratio and, therefore, potentially gives rise to thin capitalisation problems.

Ms BURKE—Thank you.

Senator WONG—You raised in your submission the issue of the need for an interpretive body in Australia. Obviously, one of the concerns with that is the issue you raised before: if one of the benefits is to have consistent standards across developed economies at least, having a different body exercising an interpretive function in Australia may deviate from that objective. What do you say about that intention? I think there are some reasonably cogent criticisms made of the efficacy of relying on the UIG and the IFRIC. I am interested in what you say about that.

Mr O'Grady—Our view is that, within each of the countries moving to international standards, there are existing national standard-setting arrangements and interpretive bodies which had pre-existed the move to international standards. It seems to us that the resources of those standard-setting and interpretive bodies could be better deployed by filling the vacuum around interpreting IFRS issues. That obviously would need the agreement of the International Accounting Standards Board and it would have to operate, we believe, as a network across the jurisdictions that are adopting international standards. So you could not make Australia responsible for one topic and France for another topic. You would have to have some cross-agreement between these national standard-setting bodies, under an umbrella of the oversight of the international board, for making these interpretations. We believe that more coordination between the standards setting and interpretive bodies in the different countries would lead to better consistency of interpretation.

Senator WONG—The issue of cooperatives has been raised already; has that been raised with the AASB?

Mr O'Grady—The issue of cooperatives was taken to the International Financial Reporting Interpretations Committee. Essentially, they have issued to cooperatives an interpretation about the application of the standards. I am not aware of what discussions have been had on that issue with the AASB.

Senator WONG—You may have dealt with the proposition that the adoption of IFRS will result in a lower quality of financial reporting.

Mr O'Grady—We believe it will lead to higher quality of financial reporting, mainly because it provides standards in areas where there is no current Australian standard.

Senator WONG—I am quoting from your submission.

Mr O'Grady—In individual areas we believe that in individual standards there may currently be what we would consider a higher quality accounting treatment than has been adopted in an individual standard under international financial reporting standards. But, as a package, we believe the international financial reporting standards provide higher quality financial information.

Senator WONG—What about market readiness of small and medium enterprises, given that was a focus of the previous witness?

Mr O'Grady—I believe there is an issue with the readiness of small and medium enterprises. I think there is a resource skills issue for people who are qualified in international standards to help these companies. On the other hand, for a lot of these companies the transition is not that

complex. It is not that big a move from what they are currently doing into an international standards issue.

Senator WONG—Is that point understood, do you think?

Mr O'Grady—It is probably not well enough understood.

Senator WONG—Sorry, I interrupted you.

Mr O'Grady—I think it is a bit difficult for a lot of these companies. The offset, the downside or the cost of giving them a deferral or having them adopt Australian standards is, in our view, having differential reporting between listed entities and non-listed entities or between large companies and small and medium enterprises, and we do not believe that is desirable.

Senator WONG—So what do you say about the deferral proposition?

Mr O'Grady—We would not support deferral.

Senator WONG—It seems fairly patent, but why is it not desirable to have different standards applying to different sizes of companies?

Mr O'Grady—When it comes to measurement and recognition of financial information, it seems to us that you should have consistency in how you measure and recognise assets, liabilities, revenues and expenses. We can see some argument for a differential in the detailed amount of disclosure you might have to provide but not in how you would measure the core elements of financial statements.

Ms BURKE—So if they did not have to do comparatives and go back and do something like that, that would be something that could be tolerated?

Mr O'Grady—That is right.

CHAIRMAN—As there are no further questions, thank you very much for your appearance before the committee and the evidence you have given us.

[5.11 p.m.]

AGLAND, Mr Reece Graeme, Technical Counsel, National Institute of Accountants

RAVLIC, Mr Tom, Policy Adviser, Financial Reporting and Governance, National Institute of Accountants

CHAIRMAN—Welcome. I invite you to make an opening statement, at the conclusion of which we will move to questions.

Mr Agland—The National Institute of Accountants is one of three professional accounting bodies in Australia, with approximately 13½ thousand members. We support strongly the move to IFRS and the adoption of the international standards in Australia. I defer to my colleague Mr Ravlic.

Mr Ravlic—There are several issues that we need to bring to the attention of the committee, in particular some of the issues raised by the Australian Institute of Company Directors. The National Institute of Accountants is particularly concerned with the fact that there are quite a few fugitives from the inevitable that still refuse to buckle down and get on with the work. Over the past couple of months, in preparation for this committee hearing, I have consulted with various experts in both major firms and smaller practices. Each one of those had something to do with small to medium enterprises and each one has told me categorically that there is no problem with the way their clients are managing the transition. It seems rather odd, therefore, that we have only the Institute of Company Directors raising the issue. We would have heard from our membership if there was a great concern in the small business sector about the move to international financial reporting standards. Generally speaking, people are getting on with it. The accounting bodies, for their part, in general terms have provided training to their members. That training has generally been well attended. So the members have no excuse for being unaware of all the implications of international financial reporting standards, and neither have the entities that are out there applying it.

If we were to apply the accounting literature and talk about it today, we would find that the transition date for international financial reporting standards would actually be 1 July 2004, which was the kick-off for the comparative year, so most entities that have needed to think about this have had to have been thinking about it since 1 July 2004. They ought to be well on their way to determining the balances that will appear in the comparative column—that is, the column that will denote the 2005 year end, the 30 June year end. The 31 December year end is a little bit different. For the sake of argument today, I will talk just in terms of the 30 June financial year. They should already be in the process of preparing those financial statements.

Most of the literature, contrary to what you heard earlier, has been available in some form to all of the constituents of the Australian Accounting Standards Board. The board delivered as promised on 30 June last year a whole swag of standards to its web site. Some of those were amended by 17 July 2004, when they were finally approved by the AASB, and there are only a few standards still left—one of them, as you heard earlier, being that relating to extractive

industries. The Australian Accounting Standards Board said it was waiting for the International Accounting Standards Board to finish its project.

We have heard a lot about choices in accounting standards. It disappoints me that we hear people being intellectually dishonest about this. We hear people from the corporate side as well as the professional side railing against choices in accounting standards, and it is a little bit disingenuous. If we look at one of the major areas of reform that we are seeing in financial reporting today—that is, accounting for defined benefit superannuation plans—Australia has not had a standard to date forcing companies to account for defined benefit superannuation plans, yet companies were free to account at any point in time for the gains and losses flowing through their defined benefit superannuation plans. They had the ultimate freedom. They had the ultimate choice. They had the ultimate opportunity to exercise the appropriate level of governance, on behalf of their own shareholders as well as the community they served, through their financial reporting—let us not forget the other users. They had for years the opportunity to do it themselves and to lead in corporate reporting in their own right. But what did they wait for? They waited for transition to international financial reporting standards in order to exercise corporate governance. They waited for a transition to rules before they would exercise corporate governance. What does that tell you about the state of corporate governance in this country as far as financial reporting standards go?

We are talking about the appearance of significant balances on corporate balance sheets—balances that could have appeared previously. In some cases there will be major impacts on earnings because their balances in defined benefit funds will go up or down depending on the actuarial review that takes place at any point in time. So companies have had the opportunity to account for defined benefit plans. Indeed, they have had the opportunity to account for derivatives in their own right by using literature based in the United States, even if they would have been required to modify it for the purposes of the Australian reporting environment, because there are some things in the US GAAP, as I understand it, that are not acceptable in the current crop of Australian standards, the pre 1 January 2005 crop of Australian standards. It should be quite clear by now that we are hearing about people that are rules driven and law driven, not driven by principle. They are now caught by having to report to their shareholders in an open and transparent manner.

We have heard also from the Institute of Company Directors in respect of relief for small to medium enterprises. It is extremely disappointing that we are having a discussion about relief for small to medium enterprises at the current time. First and foremost, we are well into the period in which small to medium enterprises and other entities should be preparing their comparative data, not procrastinating and waiting for somebody from the heavens to give them some relief. The single message that the National Institute of Accountants has for all those entities that are waiting for divine intervention with regard to complying with international financial reporting standard equivalents in Australia is: forget about it!

One of the concept ideas of relief was comparative relief: provision for relief from the publication of comparatives. That was an interesting idea, but it would not work because AASB 1—the first major standard that everyone ought to understand, which deals with first-time adoption—says, ‘You are not IFRS compliant or AIFRS compliant if your report is not entirely in compliance with these standards.’ Not only that, but companies would be cut out of using one-time only exemptions—which are there for practical purposes only—if they were given some

comparative relief. That would effectively delay implementation and dodge the FRC's ruling by a year, because companies that receive that relief would not be regarded as first-time adopters, and auditors could not sign off on them as being first-time adopters.

In a recent letter to the Australian Securities and Investments Commission, the National Institute of Accountants proposed a very different form of relief that may assist small to medium sized enterprises at the tail end of the process of pulling together their first set of accounts. We have asked the Australian Securities and Investments Commission to consider granting some lodgment relief to permit unlisted entities the opportunity to lodge a little later if the auditor finds that there are material errors in the first cut of their financial statements seen by the auditor for review, for the purposes of audit. To us, that is probably the most practical form of relief that would not conflict with any auditor independence rules that exist within the profession, and it would be consistent with the definition of 'independence' in the Corporations Act. The auditor would not be auditing their own work in that case.

In closing, the National Institute of Accountants believes this is a major challenge for corporate Australia because, for the first time in living memory, it has the opportunity to demonstrate that it has learned from Enron, WorldCom, HIH and OneTel. Every company, particularly those listed on the stock exchange, has the ability to make some accounting choices under these standards. Their investors ought to be able to see transparently disclosed what the company has done. A company with financial reporting courage would look at and choose the options that hit them directly in the income statement. With respect to defined benefit plans, and the three choices that exist there, an entity that is brave and trusts the market to believe in its integrity would take the choice that takes all the fluctuations in the superannuation fund to the income statement. That would be the clearest way for companies to deal with it. It would demonstrate that they are prepared to be fair dinkum about financial reporting and not using the accounting version of a multitiered car park—that is, the equity section of the balance sheet—to hide these fluctuations.

Senator WONG—Well said!

CHAIRMAN—Mr Agland, do you have anything to add to that?

Mr Agland—No.

Senator WONG—I would not want to try and follow him!

CHAIRMAN—Thank you, Mr Ravlic. A few moments ago, my colleague remarked to me that it is terrific to see someone so passionate about accounting standards; he had not observed it before.

Mr Ravlic—I started my career not as an accountant but as a journalist.

CHAIRMAN—I was aware of that, Mr Ravlic, and I explained that to him.

Senator WONG—Mr Ravlic, I am sorry but I did not get down exactly the relief you were suggesting for SMEs. I understand you have opposed a deferral and I understand the reason for

that, and I understand that you are also opposed to the deferral of the requirement to publish comparative data. What was your proposal? Could you expand on that?

Mr Ravlic—My proposal was that ASIC consider that companies be given a fortnight or a month delay from having to lodge their accounts so that any errors that they make in the process of moving to these new standards can be changed by then—give them a little bit of extra time to correct any mistakes picked up the by the auditor during the audit review process. We would argue that that is only very necessary for unlisted entities. Listed entities have other obligations. They have the ASX rules to comply with and there is also greater demand on their—

Senator WONG—Okay, let us talk about unlisted entities. How would that work in practice?

Mr Ravlic—At the moment, if a company is struggling to understand the accounts and the auditor has found errors they may work to the date as it presently stands. If there are multiple errors and it requires a company to actually work through all those issues and spend a bit of time working through them ASIC could give relief and provide the company with a bit of extra time to fix those mistakes—give them a bit of room to move. Whether ASIC would do it on an individual basis—that is, a company would have to apply for that relief—or whether ASIC would give a class order would be a matter for the commission. If you were to give individual relief, that would mean that you would not be giving people a carte blanche right to extend the period during which they report.

Senator WONG—What are the time frames we are talking about currently? What are the current time frames which would be applicable if relief were not granted?

Mr Ravlic—My understanding is that entities generally, particularly at the listed end, have a 60-day deadline. On the unlisted side, my recollection—some of colleagues who are here at the committee hearing may be able to assist—is that it is about three months from year end. So they have three months. If, as everybody from the AICD seems to be suggesting, they are struggling to find expertise, then they have a fortnight's or a month's relief to get the accounts right and get time for the auditors to come through and review them again to make sure they are right—that would perhaps be useful. In other respects, auditors are able to assist a client—they can provide educational material and they can do some training with the client but they cannot necessarily determine the accounting policies a client will take on. You have a situation there where a little bit of extra time might help.

Senator WONG—Did you hear the proposal by the AIDC to exempt small business from the prohibition against the auditing firm or the auditor from providing IFRS advice?

Mr Ravlic—We have had some preliminary discussions with ASIC on this. Our preference would be that ASIC does not give relief under the Corporations Act, because in many respects there is no way an auditor can be independent if they have been involved in the implementation task and then come along to review the work they have done. As you would all understand, when I look at myself in the morning I think I look wonderful—if you are a journalist and you have written a piece there are times when you have looked at the work so often that you cannot pick up a basic typo. The same is true for auditors.

Senator WONG—Fair enough.

Mr Ravlic—It is far more sensible for the auditor to be able to review the work, having had a fresh perspective and being able to pick up the mistakes rather than those mistakes being picked up later on down the track by the Australian Securities and Investments Commission. Having provided relief, it provided the opportunity for the auditor to be put in a position where their independence or their ability to review the accounts properly has been compromised.

Senator WONG—One of the issues that has been raised in the context of the CLERP 9—and also I think the AICD raised it—was the lack of the market for appropriate accounting advice, saying that small to medium enterprises are having difficulty accessing services from people who are suitably across the international standards to assist them. What does your organisation say about that?

Mr Ravlic—There are several responses you can give to that. The first one would involve me engaging in unparliamentary language, which would be most inappropriate. We have had this issue on the agenda since June 2002 and entities have had the opportunity to prepare. In a former life I was stating in black and white through publications such as *CFO Magazine* and the *Age* and other publications that this was coming. Those entities that have chosen to procrastinate are suffering simply because they have not sought to plan properly. At some point we are going to have to cease being a nanny state and ensure that people spend some time thinking for themselves and understanding that some of these things require more preparation on their part. Those things that are sometimes left at the feet of the profession, quite frankly, are really not the profession's problem. It is a problem for those who are resident in entities, large or small, that have not sought to think very carefully about the regulatory risks that they face not just in the next five minutes or in the next five weeks or the next five months but in the next one, two or three years.

This has been a regulatory risk. Most people would have known it was coming. It was on the horizon. They could have been preparing themselves for it. They could have been reading. They could have been learning about generic provisions in the standards. In one case, for example, there was not much that the Australian Accounting Standards Board did to a standard, the financial instruments standard—one of the most complex standards around.

If we look very carefully at the submissions—which I did over the weekend; I lead a very exciting life!—regarding the Australian Accounting Standards Board exposure draft on the financial instruments literature, we see that neither the Investment and Financial Services Association nor the dairy cooperatives appear on the list of submitters, at a time when issues to do with classification of debt and equity were being actively considered by the Accounting Standards Board—not one submission. And we are hearing a lot from people at the tail-end of the process now who want that to be slowed down because they do not like the fact that their equity is just about to have a sex change and turn into debt as a result of the adoption of the provisions of AASB 132. I very much struggle with some of the issues that the AICD bring to the table, because quite a few debates were had a very long time ago. Some of these issues could have been resolved had people been better prepared and had they thought more carefully about what was said and done in the accounting standards setting arena given that the Financial Reporting Council had made its intentions public on 3 July 2002. That was not exactly five minutes ago.

Senator WONG—I have two other issues to raise. The first is the interpretation issue, which you raise in your submission. And I am interested in your comments on how you resolve the tension between wanting consistent standards and consistent application of those standards across a number of economies and having potentially different bodies interpreting those standards. That is a bigger issue for this committee, but do you have any views about the way forward on that?

Mr Ravlic—There are several issues that you should probably be apprised of with regard to interpretation. Accountants today are facing all sorts of pressures in the international environment. We heard earlier from Ernst and Young, and you have seen submissions to this committee from two of the other major accounting firms. They are striving to ensure that they have consistent accounting practices within their firms in every jurisdiction in which they practise. It is for them a major risk management issue, particularly after the demise of an accounting firm such as Andersen. So when you are hearing talk about the retention of choices and the retention of options some of it is to do with the fact that these standards are being dealt with in many jurisdictions. They are being dealt with on the European continent, they are being dealt with in the United States, they are being dealt with in various ways in countries in South-East Asia, they are being dealt with here and they are being dealt with in New Zealand. There are various regulatory pressures on the accounting firms to ensure that the call they make is consistent. Those pressures are flowing through from the very public processes of the Public Company Accounting Oversight Board, PCAOB, in the United States and they are flowing through from pressures from the market wanting consistent information. So you have the audit firms dealing with it at that level.

If we look at it from a domestic perspective, in terms of interpretation, what we are seeing at the moment is a whole lot of people coming to terms with new literature. I guess I could best draw an analogy with pet rabbits, if I may. When you put pet rabbits out in the middle of the backyard they are struggling to find their way through, they are learning how to get to wherever they want to go through the big grass and they cannot quite see where they are heading—unless, of course, they are a very big baby rabbit, and there are a few of those around. It is a profession coming to terms with the new literature; it is the corporate sector coming to terms with the new literature. There needs to be a period of time where there is an educative emphasis from the corporate regulator and certainly some understanding from the marketplace that there will be some incompatibilities with the way things are seen. In many areas this is a major revolution in financial reporting. I spoke earlier about the governance issues with respect to financial reporting. Companies that have not thought about accounting for defined benefits superannuation plans because they could not even bother doing so now have to worry about it. It is something else they have got to learn.

Senator WONG—Sure. In the submission I think the institute suggests another standards setting body. Is that correct?

Mr Ravlic—No, we suggest a technical advisory panel.

Senator WONG—I am sorry, I should have said an interpretive body.

Mr Ravlic—Yes. We suggest a panel, not quite a standard setter itself. We would prefer a panel that does not have authoritative status but that meets regularly and provides the Australian

Accounting Standards Board with feedback on implementation and interpretation issues. Once the board has the feedback it can then make the decision itself on whether it is a matter it needs to bother the International Accounting Standards Board and its interpretative body with, or whether it is a matter that arises from a domestic issue—for example, there may be a quirk in the Corporations Act that needs to be dealt with here—and, of course, that would need to be dealt with in a domestic context. Alternatively, it could just be an educational issue—that is, the new accounting standards require you to think in a different way and, as a result, this new way of thinking is producing a different flow of numbers through the accounts.

So there are three categories of matter. You need a process to determine when, for international purposes, you want to sent them off to London because you cannot deal with them domestically. You need another one to deal with domestic issues—anything that is uniquely Australian that arises out of Australian law, be it tax law or anything else. And then, of course, there is the simple fact that some things just need to be learnt by people and they need to be taught. The professional bodies would, we envisage, be a part of that forum and take that feedback back to their professional development departments—each of us has got one—and recommend that a certain course be prepared for members that deals with a certain area of accounting in which members need some additional training, because it may be complicated or some new thinking may be involved or it would just be useful for them to have some access to better knowledge.

Ms BURKE—Extrapolating from that, is that your notion of the technical body that you would put forward?

Mr Ravlic—Where possible you would have around that table the brightest minds from the four major firms, some people from the second tier, and certainly the accounting bodies.

Ms BURKE—Given that you have had some correspondence via the *Financial Review* on this, has the AASB responded to the suggestion?

Mr Ravlic—We understand—given that David Boymal, the Chairman of the Accounting Standards Board, was quoted in the *Financial Review* that he was going to give it serious consideration—that he will give it due serious consideration.

Ms BURKE—But you have not had anything back beyond that?

Mr Ravlic—We have had some informal discussions.

Senator WONG—It is very recent.

Ms BURKE—Yes. It is only in the last couple of days.

Senator WONG—You also raise concerns about the removal of options under a number of the standards.

Mr Ravlic—Yes.

Senator WONG—I assume Professor Boymal will outline more clearly why. It seems to me that a pretty cogent argument could be made as to why you would want to remove different options under a particular standard. Why do you say that where choices are available within the standard we should retain that in the Australian standards?

Mr Ravlic—This is one area of regulatory risk to both parliament and the AASB where we need to be extremely cautious and careful. Unfortunately, I have yet to come across a well-crafted crystal ball that will tell me or anybody else what the intentions of the International Accounting Standards Board are in the medium to long term with respect to the accounting standards that they have on their books today. Some of those standards do have options in them—that is, choices. There is a risk that the standards board in Australia will pick the choice that becomes redundant when the International Accounting Standards Board amends that standard in the future.

It is probably preferable to have one accounting treatment, but if we are moving to an international framework, and we are dependent to some extent on the literature that they have, it would be unwise to tamper with it too much in order to ensure that we have the capacity to merge our literature along with theirs. It is a question of synchronisation in many respects—that is what you are looking at.

Ms BURKE—In your passionate address you talked about rule- not principle-driven accounting.

Mr Ravlic—Yes.

Ms BURKE—I am not drawing a link but, given some of the companies you were citing, is there a bit of difficulty with the lag of the US adopting some of these international standards?

Mr Ravlic—We are in an interesting situation here.

Ms BURKE—I know it is outside the terms of reference but I am just interested to hear what you think.

Mr Ravlic—The United States is, as you would know, the gorilla of the capital markets. To some degree the International Accounting Standards Board is compelled and forced to invite the gorilla to the garden party. But there is always a danger, in inviting the gorilla to the garden party, that it may decide to fall asleep and roll over on you and crush you over time, which is what we may see when the IASB deals with the US in a more intensive way during the work it is doing. I note that the submission of the Investment and Financial Services Association raises concerns about the US and the work that the IASB is doing in the engagement of the United States. My only real comment with respect to that is: if we are to expect companies that lodge in the United States to get relief from reconciling items, then politically, although it may be unpalatable to many others involved in standards setting, the International Accounting Standards Board is required to pursue or walk in step with the US on many of these projects.

That creates a problem where Australia is concerned, because we will not be at the decision-making table as a party. The IASB has said that there will be two standard setters having the discussion on the key projects: the US and the IASB. Australia and other standard-setting

countries will have an involvement on project teams. That is in order to get this process completed as quickly as possible, which in any case will take years because the US will take time to change its literature and change its financial reporting culture, which has been embedded in a legal driven focus for many years—which is why we ended up with certain aspects of Enron unfolding the way they did earlier in this decade. It will take time. The US will get there eventually; the IASB will have to make some compromises along the way. I read not long ago that there is an estimate at the current time that the US may drop its reconciliation requirements by 2007. That is what people are aiming for ultimately because when companies knock on the door of the US market and say, 'Let me in now,' they have got to prepare additional information. The objective of a lot of this is to cut out the duplication and the requirement to produce additional information.

Ms BURKE—Thank you for that.

Mr Ravlic—That is not a problem.

CHAIRMAN—Apart from the application of the standards, how do you propose that companies should make it easier for shareholders to understand the financial statements?

Mr Ravlic—It is a dangerous question you ask, Senator Chapman, because we will be here all night! I am sure my colleagues do not want to be sleeping in Canberra this evening. There are several things companies can do. Companies can take the trouble to better understand what the accounting requirements mean and translate them to shareholders across the board. Over the past few years it has become apparent to me particularly that companies have a great passion for cutting and pasting disclosures published by their audit firms in sample financial statements. While it may produce consistent disclosure across the board, and while people who look at those financial statements might say: 'Gee, Coca-Cola is doing something the same and other people are doing the same thing. Isn't it wonderful? They must be accounting the same way,' it does not enable the shareholder to understand how the accounting policy actually affects the company.

The accounting standard says one thing: it has an effect on the company. Surely there is a way the company can make that connection in the text so it is more meaningful for users of financial statements. So the first thing they can do is to think carefully about how they express things. The other thing that can be done is not essentially the responsibility of the board of directors or senior management; it is actually the responsibility of shareholders. We hear very little about this. We hear a lot about shareholder rights, which we are in favour of preserving, but we hear very little about shareholder responsibilities. If a shareholder does not understand something, as a part owner of a business they ought to complain to the company because they are entitled to a clear explanation of what it is directors and senior management are doing to the entity or for the entity in which they hold shares.

It is all very well for Tom Ravlic from the National Institute of Accountants to sit here and say, 'Companies ought to do this.' But something that can be done is for shareholders to take a more active interest—that is, for individual retail shareholders to pester companies like crazy and tell them: 'I don't understand this very complicated piece of work in the back of your accounts on derivatives. Can you please explain to me what it is you are doing?' If it is complicated, it usually means it is risky. If a shareholder does not understand what is complicated and what is risky, they probably do not understand the entity in which they have an investment. So it cuts

both ways. Companies have an obligation to report clearly to shareholders what it is that the shareholder faces with respect to the risks and rewards for holding shares in that entity. That is a given. In some cases, companies have not done that properly. I raised the instance of defined benefit superannuation plans and financial instruments earlier on in the opening address.

The other side of the coin is that shareholders have to talk to companies via email or ring the investor relations departments, or ring the Institute of Company Directors, and complain ad nauseam. They have to be a voice for themselves, individually as well as through the shareholders' association—which is very active—in order to get that clarity. Until you start to get people complaining a lot and making a noise, companies will continue to be complacent. They will continue to regard the analysts and the handful of journalists who might have some degree of importance in this world and read financial statements as their only audience for which those disclosures are really prepared. You have to have a balanced approach on both sides of the fence.

CHAIRMAN—As there are no further questions, thank you for your appearance before the committee and your contribution to our inquiry.

[5.54 p.m.]

CARROLL, Ms Naomi, Policy Adviser, Financial Reporting and Governance, CPA Australia

McBRIDE, Ms Patricia, Policy Adviser, Financial Reporting and Governance, CPA Australia

CHAIRMAN—Welcome. We have before us your written submission. I invite you to make an opening statement, at the conclusion of which we will have some questions.

Ms McBride—Thank you for the opportunity to address the committee this evening. Firstly, we would like to convey the apologies of Mr Greg Larsen, the chief executive of CPA Australia, who is attending a meeting of the International Federation of Accountants. Our comments tonight focus mainly on part (c) of the inquiry's terms of reference. In relation to part (a), CPA Australia is not aware of any existing inconsistencies with the Corporations Act. In relation to part (b), we believe that the proposed standards achieve the objectives set out for accounting standards under the Australian Securities and Investments Commission Act.

With respect to the broader issue of accounting standard setting, CPA Australia, as Australia's leading accounting body, representing the interests of more than 105,000 members working in diverse sectors such as public practice, the public sector, industry and commerce, academe and the not-for-profit sector, has long committed itself publicly to the view that Australia should be part of a global approach to the implementation of high-quality standards. We see the issuance of Australian equivalents to international financial reporting standards, IFRSs, as a major step along this road.

With regard to part (c), submissions to this inquiry have raised concerns regarding small to medium enterprises and issues relating to interpretation and guidance. We would like to offer some specific comments on these areas. We notice that many commentators and accounting standards do not define what they mean by SME. The category appears to range from mum and dad milk bars through all unlisted companies regardless of size to all companies other than the top 300 or so listed companies. Small proprietary companies are only required to apply all accounting standards if they are reporting entities, which would generally be rare. We understand that most mum and dad companies are small proprietary companies and are not reporting entities. As a result, they are not required to apply accounting standards. For entities caught within the reporting net, our discussions with preparers and auditors suggest that the majority of smaller companies have relatively simple reporting requirements and are not significantly affected by the new standards. In preparing our own organisation, CPA Australia, for the transition we have also found this to be the case.

The second area of concern raised in submissions relates to the call for interpretation and guidance on the application of accounting standards. It is clear that there is nervousness in the face of what, for some entities, is a major change in the basis of accounting. However, we support the view that professional preparers and auditors must continue to take responsibility for interpretation in the light of their individual events and transactions, as they have always done.

The only alternative is for the AASB to issue an encyclopaedia of interpretations and guidance. Even if such an encyclopaedia existed, we would expect there would continue to be calls for even more detailed guidance and interpretations. We acknowledge that this means that preparers, auditors, regulators, analysts and users need to educate themselves to understand the standards. At CPA Australia we have assisted individuals in their preparation by providing not only continuing professional development courses for our members but also a wealth of information for nonmembers on our web site to assist them in getting up to speed with the new standards.

Finally, we note that concerns have also been raised regarding the effect of specific standards on individual entities. If compliance with the new standards is the objective for all for-profit entities, standards can only be changed in ways that do not affect this. International accounting standard IAS 1 mandates that entities can only claim compliance with IFRSs if they comply with all the provisions of IFRSs. In light of this, the AASB has worked to ensure that their changes do not prevent for-profit entities from claiming compliance with IFRSs. We would ask that, if the committee considers any changes to standards within the set of Australian equivalents to IFRSs developed by the AASB, the impact on for-profit entities' ability to claim compliance with IFRSs is carefully considered.

CHAIRMAN—Can I therefore summarise your submission and your statement by saying that you do not believe that the evidence we heard before from the Institute of Company Directors has any validity?

Ms McBride—We consider that entities will be ready when they have to be. We are not saying that they are ready today; we are saying that our research indicates that when they need to be ready they will be ready. Traditionally, people have left compliance with accounting standards as late as possible. They do not find it terribly exciting. We think that the same is happening in this case.

CHAIRMAN—You comment that professional preparers and auditors must continue to take responsibility for interpretation in light of their individual events and transactions. You say that is the way it has always operated. In doing that, if they are found not to be meeting the new standards, what course of action will be taken?

Ms McBride—That is an issue for the regulator. We would expect that, if the regulator found deficiencies in their reporting, they would take appropriate regulatory action.

Ms BURKE—I have a question relating to SMEs. It seems to me that it is a bit like the millennium bug, where everyone went into this massive panic that this terrible thing was going to happen and we had to find this big expert. The companies that did nothing saved themselves a fortune because nothing actually eventuated with the millennium bug. Do you think a lot of these people have gone into this massive panic about something that is not going to happen?

Ms McBride—I think that a lot of our standards are already consistent with the new standards that are coming in, so we have a good base. We can clearly see areas where there are going to be changes. You have heard the list—financial instruments, impairment of intangibles and defined benefits plans. So there are clearly going to be changes. I think people are very often not looking at the reality but asking, 'What do we do?' Until they sit down and ask how it affects them—

Ms BURKE—So any deferral is just going to create this sense of panic, if we tell them, 'This is the date—do it.'

Ms McBride—We have a long history in Australia where, if you do not have to apply an accounting standard early, you do not. There is the classic case of the revisions to the tax standard, which was put out in 1999 with voluntary early adoption. I think the number of companies that have adopted it in 2005 is very small. It is not mandatory yet.

Ms BURKE—Do you also agree that perhaps there is a lack of expertise or advice out there or do you think that the various institutions are providing courses and information? Is there a lack of skills available for these people to get hold of?

Ms McBride—I think there is the ability to get the skills out there. The courses are in place and the education is available. Whether everybody has yet availed themselves of what they need is a different question, but for most of them we still have a lot of time.

Ms BURKE—Is there a notion about reconciliation and backdating records for compliance? Some have also brought up the fact that yes, you could get up to standard, but crunching numbers to go back for comparative purposes may be onerous. It is said that you could have a deferral of that or you do not need to comply with that standard to be compliant.

Ms McBride—I'm sorry, I am going to have to get a little technical here.

Ms BURKE—That's okay. I will just nod and pretend I understand what is going on!

Ms McBride—We have a real technical problem with this. In order to get everybody over the barrier the International Accounting Standards Board developed and our own AASB brought in a first-time adoption standard. What that says is that with a lot of things it is going to be too hard to go backwards, so you have the opportunity to take the status quo. But you only have that when you move to the new standards. If we say, 'Don't worry about your comparatives,' then we are saying that you are not moving to the new standards, so we are not going to give you all the let-outs to make it possible. So it is not as simple as saying you do not have to do comparatives, because in doing that you are going to have to make a lot of changes to a lot of standards; otherwise, you are going to be saying that you cannot have all the other things that have been put in place to ease the process through. So we have technical problems with it. We also have problems from the practical perspective that shareholders should have the ability to know, if the profit has gone from 100 to 120, what proportion is performance and what proportion is accounting.

Ms BURKE—What is the new standard versus—

Ms Carroll—That is right. You are not comparing like with like.

Ms BURKE—Exactly. Going to the interpretation, if you are having some difficulty arbitrating that interpretation, do you think there is a need, as one of the other submissions said, for an arbiter?

Ms McBride—We are looking at putting one in after the event—that is, the financial reporting panel. At the moment we do not have an arbiter before the event. But very often the interpretation issue comes down to really understanding the transaction. If you understand the body of standards, if you understand the transaction, for smaller entities the answer is usually pretty obvious. If you have some esoteric piece of financial engineering, no it is not. But at the sort of level where companies are going to need to do more themselves and have mid-tier advisers, then very often the transactions are not that complicated.

Ms BURKE—But there could be a fairly complicated one for very large firms.

Ms Carroll—Yes, and they have got massive teams and they are spending megabucks working on their issues.

Ms BURKE—Have you got a comment to make in respect of this notion of having options within the standards?

Ms McBride—People talk as if we have never had options in the standards before. We have options within our existing suite of standards. So it is not something new; what we are getting is more of them. There are two issues here. One is that in a perfect world we would know the absolutely right way to account for everything, we would not have an issue and we would not have any options, and that would be our preference; but the world is not perfect. So while we are working out what to do and we have got technical arguments pulling us both ways and people feel very passionately that both ways are right, or neither way is right, then we are going to have options. Hopefully, time will eventually remove them. We are concerned that if there is an option in an international standard it should also be in the Australian standard; otherwise, you have notionally got the possibility that an Australian company has to use option A for Australian reporting but its overseas parent requires it to use option B for overseas reporting. So it is effectively preparing two IFRS reports with different results.

Ms BURKE—Which nullifies the whole reason for going towards a global set of standards.

Ms McBride—Yes, exactly.

Ms BURKE—Do we or do we not need a technical advisory body in this transition phase 1?

Ms McBride—Can we do MBA 101: first of all, work out what you want to and then work out a structure to do it. I do not think we have firstly worked out what we want to do. The AASB has been frantically busy getting its standards out. It is now at the stage of working out how we go forward. We know it is putting its mind to that, and it seems a bit premature to try to put in other facilities or structures before we know what we are trying to achieve, what the AASB's total remit is and what is the best way to achieve that.

Senator WONG—I would like to ask about the issue you have just raised. I am not an expert on all the standards but, as I understand the submissions, there are at least three international standards which enable various options where the Australian equivalent does not enable them. Would your position be the same as some of the other accounting bodies, that if the international standard has more than one accounting treatment available within it then that should be reflected in the Australian standard?

Ms McBride—That would have been our preference, but that does not mean to say that that is where we are today. What we have now got is a body of standards which mostly includes the international options.

Senator WONG—Where they do not, is it your organisation's view that they should or that the committee should just say, 'It is a call for the AASB and we're not going to make any recommendation'?

Ms McBride—I think we are at the stage now where as a nation we have the standards on the table and we need to pick them up and move forward, and that is a fight for another day when the standards come up. I do not think that is today's fight.

CHAIRMAN—There being no further questions, Ms Carroll and Ms McBride, thank you very much for your appearance before the committee and for your assistance with our inquiry.

[6.10 p.m.]

PALMER, Mr Bill, General Manager, Standards and Public Affairs, Institute of Chartered Accountants in Australia

REILLY, Mr Keith, Technical Standards Advisor, Institute of Chartered Accountants in Australia

CHAIRMAN—I now welcome Mr Palmer and Mr Reilly, the representatives of the Institute of Chartered Accountants in Australia. We have before us your written submission. I invite you to make an opening statement, at the conclusion of which we will move to questions.

Mr Palmer—Thank you. Very briefly, the institute represents 40,000 members in commerce and the profession. We have a strong constituency representing auditors of a variety of listed and non-listed companies and we also have a membership which represents the significant number of people involved in the preparation of financial accounts. The institute supports the introduction of international accounting standards as planned. With respect to the problem that has been alluded to regarding the SME sector, our view is that further research needs to be done on the extent of any problem, and if that research confirms that a problem does exist then the appropriate way to deal with that would be for the FRC in conjunction with ASIC, APRA, AASB and other constituents to consider the options available to deal with it, as opposed to perhaps individual constituents arriving at their own solutions. I am more than happy to take questions.

CHAIRMAN—From your written submission, am I right in concluding that you take a bit more of a flexible approach to the issue of small to medium enterprises being ready to meet the standards, compared with the earlier witnesses we heard from in the accounting profession?

Mr Palmer—Our view is that a number of comments have been made but we still have not seen a study or detailed evidence that would suggest that there is a problem and, if there is a problem, the extent of the problem.

Mr Reilly—My comment would be that the evidence given to date, and certainly the submissions that we have gone through and analysed, would suggest that, anecdotally, smaller companies are not going to have the same level of resources as the larger companies. In conjunction with the Australian Stock Exchange, we have done a survey of listed company annual reports. Those listed companies are required to report, for their 30 June 2004 financial statements, on their preparedness to meet the 2005 international accounting standards. ASIC has done a similar survey, and the survey results broadly are saying that, whilst a number of accounting standards—financial instruments and impairment of assets in particular—are proving challenging, the companies by and large believe that they will be prepared in time to meet their 2005 obligations. We will see further disclosures for the period to 30 June 2005, when the companies are required to detail the financial impact of moving from the current series of Australian accounting standards to international standards.

It would be useful, I think, to have a look at the filings with ASIC by the non-listed reporting entities that are required to comply with Australian accounting standards to see their level of

preparedness currently. Anecdotally, my personal feeling is that a lot of them really have not done a lot of work so far. It would be useful to see some of that evidence. We are also in the process of looking at the cost of regulation to organisations generally, so we may have some more evidence there.

We are in agreement that it is important to make the transition to the Australian equivalents of international financial reporting standards. We, like the other accounting bodies in other organisations, have provided significant education to our members. There is quite a lot of material up on our web site but, at the end of the day, it is still because there are a new suite of standards. Even though a lot of them are very similar to our existing standards, it will be somewhat of a big bang approach. Whether it is quite a Y2K analogy or not, I am not so sure.

Mr Palmer—But one would not be surprised at the comments to date and there is still some way to go.

Senator MURRAY—Mr Reilly, my experience with difficult issues like this and their implementation is that the difficulties are most often highlighted post facto. If that occurs you then have to say what the consequence would be to those companies if something were highlighted post facto. If you look at the three regulators concerned, ATO, ASIC and ASX, and, I suppose, APRA could come into play for the financial institutions, ASX and APRA would definitely have their eye on the bigger lads, the publicly listed companies. ASIC is unlikely to pay much attention to small or medium sized enterprises, so that would only leave the ATO which would have an eye as to whether the new standards have affected the declaration of profit and whether it affects their revenue, I suppose. What is your view on the aftermath? Do you think simply that the regulators will have a period of leniency and submissions will come in for matters to be adjusted by AASB and others and it will work its way out over time?

Mr Palmer—I think on income tax, for example, the applications of the tax rules will not change. We have always had a reconciliation between accounting and taxable profit. We will continue to have a reconciliation. There have been some comments made about the impact on thin capitalisation and the Treasurer recently announced that there would be a three-year window to review the impact of that particular problem. But, apart from that, I do not envisage that the introduction of IFRS is going to present significant problems in terms of calculation of taxable income for the vast majority of enterprises in this country.

Senator MURRAY—In your submission you have suggested that the committee should look at at least doubling the threshold levels under which the company is classified as small and therefore excluded from preparing financial reports in accordance with part 2M.3. Without prejudging our report or our recommendations, my own attitude would normally be that I would like to see that that is needed first. In your remarks just now you said that you did not actually have that much evidence that that is a necessary remedy right at this moment.

Mr Palmer—I think that issue is addressed by financial reporting generally as opposed to IFRS. In terms of the application of the international accounting standards, I would concur with your comment, as we have just said, that there is still a lack of hard evidence. What is happening in this debate is that there is confusion. Costs are quoted quite often as being one of the impediments to the introduction of international standards. If you are looking at the question of cost and the burden on SMEs generally then we think that you are really looking at the whole

ambit of responsibility for financial reporting generally as opposed to whether it be on the left-hand or the right-hand side of the road.

Senator MURRAY—Let me return to my earlier scenario. I have had the impression, from reading what has been said about this by market participants from companies, that they are not so much concerned with enforcement. I have rarely seen them remark about worries about what ASIC, the ASX, APRA or the ATO will do. They are much more worried about the market and about how shareholder value will be either positively or—most commonly the argument from those people is this—detrimentally affected. In other words, it is not a matter of regulators and enforcement; it is market concern. Is that a right judgment of mine?

Mr Palmer—We as a professional body have undertaken, amongst other things, some training of the media to give them a better idea of the implications of the changes, in order to help in this education process. When one goes through a lot of the impacts, one sees that many of them do not have any cash flow impact at all. So although a reported profit may change, a gearing race ratio may change and there may be some short-term implications in terms of a company's financial structure, in the longer term it is not having an impact on their cash flow, so the underlying nature of their business is not changing at all. I think that is one of the things that people lose sight of in the debate in that, if, for example, international accounting standards require you to derecognise a $500 million intangible from your balance sheet, the business you are in stays exactly the same and the shareholders' cash flow and other things are in no way inhibited or affected.

Mr Reilly—There is an education factor as well. Accounting standard AASB 1047 of the Australian Accounting Standards Board requires for 30 June 2004 disclosure of preparedness towards meeting the Australian equivalents of international standards, and for 30 June 2005 what the financial impact will be, so that, if you take a typical June-year-end company, the market should be reasonably educated as to what those differences are. As Mr Palmer has said, the basic business has not changed; some of the numbers will be different.

From a banking perspective, the bank might suddenly find that some of the debt to equity covenant ratios have changed—and some of the companies may well be in breach of that—hence the reason why it is important for those directors to talk to their constituents, their shareholders, by their annual reports or by their briefings, and have their financiers explain what the impact of a move to a new basis or a changed basis of accounting will be.

Senator MURRAY—From a market perspective, although changes such as those you have just given examples of are likely to be classified in the accounts as abnormals, they will not be abnormal specific to a company. It will be happening across all the companies in that particular industry or sector and therefore the market is unlikely to react negatively to a particular share price. Is that a right judgment?

Mr Reilly—I think I would agree with that. Earlier on there was some comment made about cooperatives and the particular difficulty they may well have with the financial instruments standard. A comment was made that they did not make any submissions at the time that the International Accounting Standards Board or the Australian Accounting Standards Board were debating financial instruments. I think one of the difficulties is that, until you start to actually apply a standard, you may not realise that it may have adverse implications for your financials.

In that particular instance, my understanding is that the cooperatives only became alarmed or aware once the International Accounting Standards Board's interpretation committee started to say, 'In this particular situation, your equity will no longer be equity; it will be debt.' So if you have a cooperative that has quite a strong equity base and overnight that is changed into liabilities and there is little equity left, then the conveying of that information needs to be handled with a great deal of care, particularly as the business has not changed at all.

Mr Palmer—That is probably the main emphasis. When we have any change, communication of the impact is a vital part of the process. The AASB has led the way by having the requirement that initially, certainly in terms of the market, companies be required to report on how it would impact their accounting policies. The second phase of that is how it is going to actually impact their numbers.

Senator MURRAY—My inclination is that if there were remedial requirements relating to this issue they would be better addressed post facto, because only then will you be able to see what is happening. What sort of time frame do you think the parliament and the government should be looking at to see whether any adjustment in policy or approach should be taken in this area—whether AASB would be, for instance, requested to examine or re-examine a particular issue; that sort of approach? How soon will it emerge whether there are significant market or accounting problems?

Mr Reilly—I would argue that the first application of the international accounting standards will be for the 31 December 2005 balances. We will see disclosure of those companies' half-yearly results in the half-year to the end of June 2005, so you are probably going to see some market activity around about July-August this year. I would see it in a couple of different stages. I would like to see some work done to see just what impact those results have had.

Senator MURRAY—By whom?

Mr Reilly—I think by the key constituents. Ultimately, I guess, it is by the Financial Reporting Council, because it is the Financial Reporting Council that has been entrusted with overseeing the financial reporting system and the work of the AASB from a strategic direction point of view. We, being one of the professional bodies—and others, no doubt, also—will do some analysis of that work as well. I would see it starting from there. Then you will have the December-year-end companies reporting their results for the full year in February next year. You will probably see a fair amount of market comment later this year.

Senator MURRAY—Thank you. I will leave it there.

Senator WONG—First I would like to address this issue of the proposition of doubling the threshold for exemption. It is a fairly dramatic response to some equivocal evidence about the capacity at least of SMEs to respond to IFRS, let alone the broader issue of non-listed entities being able to handle the reporting standards.

Mr Reilly—I am happy to offer a comment on that. This particular committee under another name actually asked for a review of the impact of the move to small and large and the tests that were put in place. If my memory serves me correctly, the view at the time was that there should be indexation of those particular tests because, if it was deemed appropriate in 1995 that a small

proprietary company be one which had revenue less than $10 million, assets less than $5 million and less than 50 employees, over time with inflation you would pick up a lot of small companies that were not caught in 1995. So the doubling was our pretty rough way of saying that indexation really should have applied each year. ASIC certainly applies indexation in terms of collection of fees, so it would have seemed appropriate—

Senator WONG—It is a bit different to whether or not one is required to report in accordance with that part of the Corporations Law. I do not think that is an appropriate analogy, but I take your point. Has this been raised by you with the FRC?

Mr Palmer—Not to date.

Senator WONG—You talked about—and I agree with you, Mr Palmer—some sort of evidence based approach as to the difficulties that are asserted for SMEs of the move to IFRS. What evidence do you point to that the relevant group who would be affected by your proposed change are having significant difficulty in complying with the current reporting framework?

Mr Palmer—We do not have firm empirical data on that point ourselves. What Mr Reilly earlier referred to is the fact that this question of no indexation leads us to believe that there were certainly companies initially that might not have been affected but in the interim have come to be required to prepare financial reports by virtue of the growth in their business, as opposed to any other factor.

Senator WONG—But those thresholds are transparent. Isn't that a known threshold?

Mr Reilly—It certainly is, but I recall the argument in the debate at the time being that those thresholds were appropriate. They were linked directly back to similar thresholds that applied in the United Kingdom. Our view is that there is not just the cost of implementing IFRS but the cost of producing audited financial statements in 2005 for companies that would have been considered small in 1995. Ten years later they are not considered small. We saw that as relevant in terms of IFRS because there would perhaps be some additional cost to those companies, but there are also the additional costs of reporting. Back in 1995 parliament deemed that there was no benefit.

Senator WONG—But this is a broader issue than IFRS. What you are proposing is quite a substantial change to the reporting framework.

Mr Reilly—Yes, it is.

Mr Palmer—Exactly.

CHAIRMAN—My recollection is that the committee has an outstanding report on this matter which is still awaiting a government response after two years or more.

Senator WONG—I am sure you will deal with that, Chairman. Mr Reilly, I do not want to have a long discussion about your CLERP 9 proposal, but let me be clear about what you are proposing—are you actually suggesting that ASIC put in place a class order which would grant exemption from the requirements which are applicable under the Corporations Law?

Mr Reilly—We have been in discussions with ASIC on a number of issues, as we have been with a number of key constituents, to try and ensure that implementation of the Australian equivalents of IFRS is as painless as possible. One of the issues is the amount of work that an auditor can do in assisting the company that they are auditing. We believe that the auditor can provide quite a lot of information. In fact, some of the earlier evidence today made it quite clear that the major firms have already been providing significant resources both to the companies that they are auditing and to companies they are not auditing. We have issued a reasonable amount of guidance on auditor independence. We are happy that the CLERP 9 provisions which we have supported are in place. We would want to look a bit more carefully at any proposals that ASIC have in that regard.

Senator WONG—Are you supportive of the AICD's suggestion of an exemption?

Mr Palmer—No, the independence framework which we now have was put in place after a long debate and consideration. As people have said for some time, independence is not something one can turn on and off. When you start looking at exemptions for specific issues, you get into the whole problem of self-review and all the underlying issues surrounding independence.

Senator WONG—Which are not removed simply because it is a small or medium enterprise.

Mr Palmer—Exactly—that is our point.

Senator WONG—Regarding 1046—are you suggesting a classic class order to get exemption from the requirements in the act? I was not clear from that paragraph in your submission precisely what you were proposing.

Mr Reilly—I think our longstanding position is that we would prefer the accounting rules to be in one place or, if not, that they be consistent. Therefore, if it is the wish of parliament that there be certain disclosures of directors' and executives' remuneration, we would like to think that the AASB would be in a position to be able to incorporate those provisions in the standard.

Ms BURKE—Going back to some of the things that other people have commented on in respect of interpretation—I know you have not gone into it, but everybody else has commented on the need for an arbiter.

Mr Reilly—I probably have a conflict of interest here because I am conscious of CLERP 9 and auditors' independence because I am actually the accounting bodies' representative on the Urgent Issues Group. My view, and certainly the view of the institute at this stage, is that the Urgent Issues Group is the appropriate group to handle interpretation type issues. You will be hearing evidence from David Boymal, the Chairman of the AASB, and no doubt Professor Boymal would concur with my view that the UIG has had some challenges in the interpretations area for a number of reasons. These include the fact that the international standards are principle based and, therefore, we have got the very clear impression that the International Financial Reporting Interpretations Committee is not keen to issue a vast number of rulings or interpretations. It does not want to go down the prescriptive route, which was criticised as the approach that the US had used. At the same time, if there are particular issues that need to be resolved here then the UIG should be able to do that.

The challenge is communicating our views with the International Accounting Standards Board and its interpretation arm because it would be silly for Australia to issue an interpretation and then have the international interpretation committee say, 'You've got it wrong'. The UIG and the AASB chairman at the moment are working through a mechanism to make sure that can work as quickly and as efficiently as possible. Put very simply: if we are feeling constrained by the international process, then the UIG will, in my view, continue to do what it has always done—that is, issue prompt interpretations.

Mr Palmer—Certainly we feel our role as a professional body is to monitor problems that people are experiencing, to collate where there is a common set of issues and to relay them to the appropriate people such as the AASB.

Mr Reilly—On our web site, which we are continuing to develop, we have a series of questions and answers on each particular accounting standard or on each topic because a number of the questions are not detailed or complex interpretations of the standard. They have been considered by a number of groups before, so we are working with the major auditing firms, with ASIC and also with our international colleagues to try and put up some kind of database. In an ideal world I guess the UIG would probably do that, and that might happen in time. We have taken that initiative to attempt to get that database together today.

CHAIRMAN—Mr Palmer and Mr Reilly, thank you for your appearance before our committee and your assistance with our inquiry.

[6.38 p.m.]

BOYMAL, Professor David, Chairman, Australian Accounting Standards Board

THOMSON, Mr Angus, Technical Director, Australian Accounting Standards Board

CHAIRMAN—Welcome. I invite you to make an opening statement at the conclusion of which we will move to questions.

Prof. Boymal—Needless to say, a great number, if not all, of the issues that have been discussed today have been considered over time by the AASB and, therefore, all of these matters have already been given a considerable amount of thought in arriving at the decisions that we did in relation to the accounting standards. But perhaps what I should do is provide a little background to assist the committee. Australian accounting standards were commenced to be harmonised with international accounting standards from 1996. In the first place the approach to harmonising these standards was that the AASB would write accounting standards in its own language, using its own words, which conveyed the same messages and the same requirements as the international standards.

This process was going on from 1996 until 2002. In 2002, the Financial Reporting Council issued a different directive. Rather than harmonise with international standards in our own way and in our own language and words, the directive was to take up the international standards, in effect, verbatim. That is quite important because the AASB was not sitting on its hands doing nothing between 1996 and 2002. It was progressively, in its own way, making the Australian accounting standards require the same thing as did the international accounting standards.

I provide that background because even though that task was not completed—and there were what I call holes in the Australian accounting standards where the AASB had not got around to the harmonisation process—in the main, we already had accounting standards that were at least intended to be the same as the international standards. That is quite important to know because one then asks: 'What sort of change are we now confronted with?' In some of the areas where we had holes in the standards the changes can be quite dramatic. But, for the bulk of the accounting standards, we were already well and truly on the way and the differences that have arisen from picking up the international standards verbatim are reasonably minor. Therefore, when we look at the questions about small and medium enterprises, we must recognise that it is not an absolute change of rules where every rule is utterly different—far from it. It has been a progressive change over time but since 1996 it has been done in this different way.

As I have said, there were holes in the standards. There were about four standards that were missing in the Australian suite. The changes are somewhat dramatic. Perhaps I should put a point bluntly: there have been discussions this afternoon about suggestions for changing the Corporations Law. Our job, as the Australian Accounting Standards Board, was not to be involved in suggested changes to Corporations Law but rather to get about the task of harmonising verbatim with the international standards. I am certainly most happy to answer questions in relation to the Corporations Law but that was not our main focus.

At the present time, there remain some sitting days of both houses before the standards have gone through the entirety of the process. As you probably know, as soon as the AASB makes the standards they are Australian law, so, as of today, they already are Australian law. But the parliaments, as with all delegated legislation, have the opportunity to intervene by the disallowance process. Because of the intervention of the federal election, the number of sitting days for the disallowance process happen not to have expired yet. At this late stage, if either house was to disallow the standards when they have been presented in their entirety, you can see that that would make for an awfully thick book of standards. We would have utter chaos. I cannot even really contemplate an overall disallowance.

If either house saw fit to amend those standards, I would not go so far as to say there would be utter chaos—and there is a limit, I think, to how either house can take paragraphs out but cannot put them in—but, if parliament in its wisdom wanted to do that, we would be running the risk that the whole purpose of the exercise would be defeated. If any change to this suite of standards meant that those standards were no longer internationally compliant then the whole purpose of the exercise would be defeated. We would then have a suite of standards but would not have satisfied the first objective. As chair of the AASB, I probably need to make those points, because that really is the major point at issue as we wait for those remaining sitting days to arrive. Maybe the others who presented were not in a position to put it is bluntly as I would, but I think we have to realise what would happen if, potentially, there was disallowance.

Senator WONG—I think we are very aware of that, Professor Boymal. That has been made clear to us, and it was something that the committee discussed when we drafted the terms of reference. As you correctly point out, the delay in referring the matter for inquiry was caused primarily by the federal election and then the delay in the constitution of the committee. Those are matters beyond our control, obviously.

Prof. Boymal—Let me address a couple of issues before you ask me whatever. Contentious areas appear to be our removal of some of the options in the standards, the question of interpretations, and small-medium enterprises, so let me attempt to address those three issues. So far as the options are concerned, the international standards in some spots have a number of choices of treatment. The AASB established a quite complicated policy in relation to those. I think you would understand that, if there were a country embracing the international standards that did not have rules or had very loose rules, maybe two or even three ways of doing things could well be acceptable—much better than literally dozens or hundreds of different ways. But if there were a country that had prided itself on having one approach to doing things then the idea of there being just straight out choices would not be such a good idea. The International Accounting Standards Board itself is not all that keen on choices, but some of the standards are quite old, and they were written to get the UK and the US to agree, so both of their methods were included. Basically, many of the choices are rather old compromises.

The AASB adopted the policy that, if more than one method was allowed in the international standards, and one of those methods was a method that we had already been applying in Australia, and that was the only method that we had been applying in Australia, we thought it appropriate not to introduce the alternative but to leave things as they were. Our reason for that rests in our enabling legislation, because the ASIC Act basically says that our job in developing accounting standards is to produce accounting standards that are relevant and reliable, facilitate

comparability, are readily understandable, reduce the cost of capital and enable companies to compete effectively overseas. That is really just a precis of section 224 of the ASIC Act.

The piece about facilitating comparability troubled us because, if there was only one way in the past of accounting for a particular transaction in Australia and that was one of the ways prescribed in the international standards, how possibly could introducing two ways, where the companies could then choose, facilitate the comparability of accounting in Australia? Our conclusion was that that seemed to be outside the requirements of our enabling legislation.

On the other hand, if nothing had been prescribed in Australia—let us say it was in one of the missing standards that we had not got around to—and there were two methods in the international standard, or perhaps three as there are in one instance, then we adopted the view that, although one method is better than two in relation to comparability, since we had not specified only one way to do it in the past we would accept that there was more than one method as the starting point. That produced quite a complicated policy and an appearance of inconsistency on our part, because we allowed some of the options and disallowed some of the others, but there was a reasoning behind the way in which we went about it. The whole thing is to make financial reports in Australia comparable from one company to another. Therefore, I hope you can see that the idea of choices of treatment appears to run counter to that.

There is a difficulty internationally with us removing choices. There is absolutely no doubt that it is within our prerogative to do that because we are the standards setter in Australia at the end of the day. We would like to have as much comparability between different companies' accounts in Australia as possible. But, if an overseas company incorporated somewhere else has the choice of two ways of doing things and in Australia we limit that to only one way, then for some companies, and in particular overseas owned companies—and I think that point was identified by the deputy chair earlier—or companies that lodge their accounts in more than one country, that causes them some possible difficulty.

Mind you, those problems of restating accounts for those purposes have always been there and we are not talking about large numbers of companies that are thus affected. Really, we stand by the decisions we made about our removal of the options. When you read some of the letters it sounds like we did that willy-nilly. We did it in two instances, so we are not really talking about a widespread removal of options. It was done in two standards. And we changed the scope limitation which had the effect of bringing one situation into the rules rather than excluding it from the rules. So we are talking about three instances in total. Often when one reads the responses from a particular company that has been affected by that, of course they are not happy. But it is only three instances and there are not a great number of companies involved.

Regarding the SME issue, the AASB has had experience with one accounting standard where, because of its complexity, it was decided to defer the application date. It actually did that twice because, after the first deferral date arrived, there was still an indication that companies were not ready; therefore a second deferral date was chosen. Having now converted to the international standards, we will no longer have this particular tax standard which was the topic dealt with under the old Australian standards. We will pick up the new. But the very interesting thing from that experience was that the longer one defers the application, the longer it enables the—let us say—recalcitrants to continue to not address the issue. Therefore, our experience was that deferring as a means of dealing with the non-dealing with an issue is not a good answer and that

it just enables companies to take even more time to get on and do other things rather than address the issue.

I gave the background about how we first went about harmonising standards because there are potentially little or no effects for small companies. Small companies do not typically deal in financial derivatives. They do not typically get involved in takeovers. Those sorts of transactions have the real bite in terms of international standards. The sooner small enterprises analyse how these new rules will affect them, the sooner they will discover that for the bulk of them the effects will not be significant. Our view is that there should be no deferral for them. In addition, the idea of deferral appears to go across the original purpose, which was that there should be a complete change in Australia, that we should go international and the credibility of our reporting would be enhanced as a result. If it does not apply to all, the credibility of those who have adjusted to the new system will be enhanced but the credibility of those continuing with the old reporting will not have been improved. I have a feeling that that cuts across the FRC's original intention.

Finally, I want to talk about interpretations. We have flagged that there is an issue relating to interpretations. In moving to principles based standards there is potentially more than one answer to some of the treatments concerning certain transactions. That concerns us because, as I said before, part of our enabling legislation requires us to facilitate comparability in financial reports. If there is more than one possible way—and this is outside the options that the standards specify—to read the standards so that they provide more than one possible answer there is an inherent problem with principles based standards that needs to be addressed. That is not to say that you need a specific rule about everything because if you did they would not be principles based. However, there are serious dilemmas in relation to what some of these standards mean.

An interpretative body already exists. It is a subcommittee of the AASB and, as a consequence of being a subcommittee of the AASB, its pronouncements are authoritative. Anybody can make an announcement about an interpretation, but it needs to be authoritative. Likewise, the international standards setter has a subcommittee that makes interpretations. That subcommittee is IFRIC—the International Financial Reporting Interpretations Committee.

It is absolutely obvious that the most desirable sort of interpretation is one that would apply throughout the world. Therefore ideally IFRIC should be making the interpretation. Unfortunately IFRIC is reluctant to do that. It is a matter of resources and of the chairman of the IASB saying, 'We've introduced principles based standards; work it out for yourselves.' IFRIC is very slow and has a very drawn out process in relation to making interpretations.

If international interpretations are not forthcoming then it appears to us that it would be desirable to have an Australian interpretation, because, if there is no international interpretation, we are not achieving comparability world wide. But rather than just giving up, it is better to have comparability within Australia if you cannot get it world wide. So we would defer to the international interpretations all the time—they are the most desirable—but if they are not forthcoming within a reasonable time frame then we believe there is a role for the Australian authoritative interpreter to provide interpretation. But, very clearly, we do not want to go out on a limb with these interpretations. We certainly do not want to be non-international compliant; again, that will destroy the whole object of the exercise. If we get involved in the interpretations, it will be done with the full knowledge of the International Accounting Standards Board,

hopefully in a cooperative manner. So far this appears to be working, although it is early days; in fact, at the moment we are working on interpretations for the international body. There are some issues that have an Australian twist, because Australian law comes into play. Internationally they are not interested so we have to do those within Australia.

You can see from what I say that, whilst we see a need for Australian interpretations, they need to be dealt with responsibly and not in isolation or in an ivory tower. Again, it is early days, but we believe that this is a situation which we can control. We have good relationships with the International Accounting Standards Board. We would not do something without their understanding why we needed to do it differently or apart from them, but so far it seems to be working very well. The problem is that there may be a great rush for the need for interpretations as companies buckle down, particularly the smaller ones that cannot turn to international firms for solutions, and we may be swamped with these requests. But we are not swamped yet, by any means, and at the present time we think it is a situation that is under control. But one hears of views ranging from, 'We must get involved,' through to, 'Keep your noses right out of it.' Again, we have considered all these views and we believe that the approach that we have decided to take is a responsible one in the circumstances. Unfortunately, a lot of implications that come through from people who have different points of view from us—and, of course, some of them will—is that it gives the appearance that we have not thought about this, or we have just been completely recalcitrant or absolutely stubborn and will not budge. But it really is not the case; we have given these things a lot of thought and believe at this stage that we are coming up with what are the most appropriate solutions for Australia, again keeping in mind what our enabling legislation requires of us. I have probably said enough now. I will throw it over to you.

CHAIRMAN—Thank you, Professor Boymal. Do you have anything to add, Mr Thomson?

Mr Thomson—No, thank you.

CHAIRMAN—You referred to the subcommittee of the board that deals with interpretations. Is that the Urgent Issues Group?

Prof. Boymal—That is the Urgent Issues Group.

CHAIRMAN—There have been calls recently in the media for the establishment of an interpretations authority. Are you aware of that?

Prof. Boymal—Yes, but this came from the National Institute of Accountants, and the National Institute of Accountants were really saying that they think there needs to be a better mechanism to pass the problem issues on to the AASB and/or its interpretative arm. I believe their suggestion was that, if there was a group that met regularly and decided, yes, there are disagreements in interpretation between the various large accounting firms or middle-tier firms or through the accounting bodies, even the smaller practitioners, then such a group meeting regularly would represent a means whereby we would be informed of the difficulties in interpretation. I believe that the intention of the NIA was that we would then deal with it. So they were not talking about a new structure; they were taking, rather, about how the information should be better fed to us to work on.

Senator WONG—And is there any merit in that process?

Prof. Boymal—I believe there is quite a deal of merit in that. I was asked by the media the day after the NIA's media release was put out, and I said at that time that I thought the suggestion had merit and that we would seriously consider it. It has only been a few days—

Senator WONG—True.

Prof. Boymal—so we have not as yet seriously considered it, but I really do believe it is a suggestion that has merit.

Senator WONG—So that would be something you would envisage the AASB looking at?

Prof. Boymal—Yes. We already have consultative groups, so it does not really represent anything very different to the way in which we consult already. But it would focus especially on questions of interpretation, so I see a lot of merit in that idea.

CHAIRMAN—You might be aware of calls for the board standard 101 to include a 'true and fair view' override, similar to the one contained in the equivalent IASB standard. Can you explain to the committee the rationale for this particular departure from IASB standards?

Prof. Boymal—Yes. The international standard, in actual fact, has a provision that, if the accounts are required to give a true and fair view and that appears to be contrary to the accounting standards, then the true and fair view will prevail. That is a true and fair view override. But that standard actually goes on to say 'unless the legislation of a particular country does not allow this'. So it is not just sitting as an open thing in the international standard; it actually defers to whatever the local legislation might say.

Our local legislation at the present time has what you might call twin requirements, but I would say they do not relate to an override. The twin requirements, as one of the other speakers indicated, are to both comply with the accounting standards and give a true and fair view. The Corporations Law says you must comply with the accounting standards as the first initial requirement. If the directors believe that complying with the standards does not produce a true and fair view, then the directors must give as much additional information as is required in order that a true and fair view is also given. So there is an acknowledgement in the law that these are not necessarily exactly the same thing, but it is not an override.

I am afraid I cannot tell you exactly when but in previous Corporations Law in Australia we did have a true and fair view override. The law said something like, 'You must comply with the accounting standards unless this does not give a true and fair view, at which time you do not have to comply with the standards.' The companies made improper use of that, blatantly saying, 'We're not going to comply with the accounting standard because it does not give a true and fair view.' They really were not even giving good reasons; they were just saying: 'That's our view. There you are.' The law was changed to prevent that from happening, and I would fear that, if consideration were given again to a true and fair view override, we would suffer the same problems again. We have already been bitten once with that experience, and I think it would be a retrograde step. But the international standard definitely defers to local legislation in relation to that, and our legislation has a point of view about it.

Senator MURRAY—I would describe our law now as allowing a qualification where there is a different opinion, rather than an override.

Prof. Boymal—Yes, but that would not be the way an auditor would look at it.

Senator MURRAY—I am talking with respect to the directors. The directors qualify the accounts where they think there is—

Prof. Boymal—Indeed. But the auditor would therefore say that in his view the accounts comply with the accounting standards and that the accounts either do or do not give a true and fair view. So yes, it would be a director's qualification, but not necessarily an auditor's qualification unless the auditor disagreed with the director.

Senator MURRAY—Which is why it works well now.

Prof. Boymal—Yes, I believe it does work well. And although the gentleman from the Institute of Directors said that he sits on the board of a company where he does have that situation, my previous experience as the technical standards partner in one of the big four firms was that, as soon as the legislation was changed, the company stopped playing that and they no longer were maintaining that compliance with the accounting standards did not give a true and fair view. In fact, my experience after that legislative change was that I did not see the companies wanting to argue that way anymore. So I believe that the current legislation works well in relation to the way that it has two arms: complying with the accounting standards and the requirement for a true and fair view.

Senator MURRAY—They were using it as an option to the accounting standards.

Prof. Boymal—They were.

CHAIRMAN—Mr Ian Langerfield-Smith from the Department of Accounting and Finance at Monash University made a submission to this committee in which he described the documentation of the standards as an 'exemplar of worst drafting possible'. I was wondering whether you would like to respond to that claim.

Prof. Boymal—My first response is that the drafting was done by the International Accounting Standards Board, so I could say: don't blame me! But to answer that reasonably, I think it is a gross overstatement. We have been speaking about interpretative problems, and how therefore not everything can be perfectly understood and have one meaning, but I do not think others have really been complaining along those lines. I think Ian has a particular point about that, but it is really not a common point that anyone else has made.

CHAIRMAN—Have you made representations to the IASB to try to have the $44 annual charge for support materials removed? If so, with what success?

Prof. Boymal—This is the whole copyright issue, which is quite complex. We obtain the international standards themselves from the IASB free of copyright. It is government policy that legislation should be freely available on web sites so that it is available for anybody to read. Because the IASB does not charge us a royalty for the standards themselves, we are therefore

able to make them available freely on our web site and no charge gets passed on. Unfortunately, the IASB has not been prepared to give—they regard it as a gift to us—this same freedom of royalty in relation to their other material. Therefore, we have to charge in relation to the printed material because we pay a royalty. Likewise, there is account taken of how many hits there are on this area of our web site and we are obliged to pay a royalty to the IASB. I need to be clear that the IASB is not charging us $44. Built into the $44 is the fact that we have to introduce a charging system for what otherwise would be entirely free, and $4 of the $44 is GST.

Ms BURKE—I am glad you added that!

Prof. Boymal—Part of the $40 is a recoupment of our costs for the trouble we have to go to to introduce a complete charging system. It is most unfortunate. We have tried very hard, not only at AASB level but at other levels and at Financial Reporting Council level too, but they have not budged yet to make the other stuff available to us free of charge.

Senator WONG—What is the process in terms of reviewing the standards?

Prof. Boymal—Perhaps Mr Thomson could deal with that one.

Mr Thomson—Can I clarify: is this reviewing the IASB's?

Senator WONG—Presumably there will come a point, let us say through the implementation phase or process, where you determine there might be a problem with one of the standards or you might relook at one. What process does the board envisage with regard to monitoring the implementation and any problems associated with the actual detail of the standards, which might only arise after they have been complied with?

Mr Thomson—Obviously our work program now is quite closely tied with that of the IASB. So, indeed, if they decide to revise something or review an issue, we would also do that. In terms of implementation experience, there have already been a number of issues that have come to our attention through constituents contacting us about problems they have had either with interpretation or potential corrections they think need to be made to the standards. In those cases where we believe there is a good case, we approach the IASB. Indeed, this recently happened with the standard on extractive activities. The IASB agreed with us that there was a problem in that standard and they asked us to draft a correction, which will be put before the IASB and also before our board.

Senator WONG—Did that come up through the UIG or was that directly to the board?

Mr Thomson—It came directly through the staff from constituent questions. I guess there are a number of means by which this might come up, official or otherwise, but we have open phone lines and open email so constituents are free to ask us any question they like. That is the basis on which we learn what is happening at the coalface, effectively, and whether there are issues. Our first reaction is to think about those issues ourselves and then refer them on to the IASB and encourage them to deal with those problems. They often come back to us and say, 'Could you please come up with a solution and put it before our board and also your own board.'

Prof. Boymal—If we tried to solve it ourselves and thus changed one of the accounting standards, there would then be a big risk—we have tried to minimise this risk—that the accounts would not be IFRS compliant, which again would defeat the purpose of the exercise.

Senator WONG—I appreciate that. I was actually more interested in the process whereby issues might be fed back, which probably comes back to the NIA proposal. We might have a situation like the extractive industry issue that you just raised in relation to one or more of the standards which are in place. How do you envisage handling feeding that back to the IASB and/or suggesting options for how they might deal with the problem?

Prof. Boymal—One of the reasons for the NIA suggestions is that historically our Urgent Issues Group has never been flooded with requests for interpretations. A large number of requests for interpretations in fact come from the public sector rather than the private sector. So one might well ask: why has the private sector been reluctant for us to produce interpretations? Possibly the answer is that they like the flexibility of there not being interpretations.

Senator WONG—That is a nice, polite way of putting it.

Prof. Boymal—The idea of there being a more formal structure in order to let these problems bubble to the surface is a good idea because our experience has been that there is this reluctance for some of the issues to be presented to us. But we feel that once we get the issue we know exactly what to do with it and how to deal with the IASB in relation to it. It does not mean we will be successful with the IASB every time because every country wants to do the same thing. But we have processes in place and we will not do things unilaterally; we will always deal with the IASB. Only if we get nowhere with the IASB would we contemplate taking a step unilaterally. So we feel it is well in hand.

Senator WONG—That is the issue. Is the need for that kind of interaction with the IASB going to increase through the next 18 months and, if so, are you set up—sufficiently resourced—to manage that process?

Prof. Boymal—I think we are sufficiently resourced to deal with it. It is really a matter of how the IASB deals with it if so many of its constituent countries all flood it with these same sorts of things. It was interesting to see the Ernst and Young recommendation that countries should start to work together. That also deserves some serious consideration, although we would obviously have to get other countries to work with us. What I fear is not our problem with resources but the IASB being absolutely flooded with these types of requests coming at it from all directions, and it may not be able to cope. An alternative way of dealing with it at an international level might well be a great idea if only we can get countries to agree, which is a very hard thing to achieve. But it is worthy of putting to David Tweedie, the Chairman of the IASB, to see what he thinks about trying to spread the load but get some international agreement nonetheless.

Senator WONG—The process for doing that would be through the FRC or directly through—

Prof. Boymal—Through us, I think.

Senator WONG—You have dealt with a number of the issues I was going to raise: the true and fair override and the deferral of the requirement for the publication of comparative data for SMEs. I presume your response would be the same as you indicated in your opening comments: let us have everyone complying with the same standards.

Prof. Boymal—There is one other thing: take a small business and let us assume that when it gets around to it it discovers that it is not such a big job. Everybody is basically saying, '1 January 2005; hey, that's now. We've passed it.' Yes, they should be addressing it now but let us look at the end date rather than the start date. These small companies normally will have a June year end. If they are that small they will not be listed so they will not have half-year published reporting. That means that the first set of accounts that they produce under IFRS will be for 30 June 2006. Let us say they produce them two months after that, say, 31 August 2006. At that time they will have to have restated their comparatives for 2005. Yes, everybody agrees they should be thinking about that now but they do not actually have to produce or come public with that until about August 2006. They have all of the time from now until then to continue to work on it. When people tell you the starting date for the period it tends to put more urgency on it than talking about the deadline date, which is 2006—the June 2005 balances are not due yet, much less 2006.

Senator WONG—What do you say to the suggestion that, I think, the NIA made to retain the current start date but to give some relief in terms of the date by which the accounts of the SMEs would have to be reported or finalised?

Prof. Boymal—I think that has merit. One could say, 'What would one month do?' It struck me, as I heard that suggestion, that one thing that even one month would do is that when the accountants have finished with the big end of town they will then have another month to service the small end.

Senator WONG—They could then move on to the small end. That is a good answer.

Prof. Boymal—One month is a short period of time and may not be long enough, but if lodgments with ASIC, just for the transition year, were delayed a month for that end of the market I cannot see that any great harm would be done, and it might produce a benefit. The question is: just how much of a benefit? It is a bit hard to measure, but it is a suggestion with merit.

Senator WONG—You might have raised the impact on cooperatives in your opening statement.

Prof. Boymal—Yes, there is impact on more than just cooperatives. This same problem—I will explain the problem in a moment—would apply to any entity that has an undertaking to repay the shareholders. If there is an obligation to pay then by definition in the international standards it is a liability. If you have created an obligation to repay your shares or your units then it is not equity; it is a liability. That is the fundamental definition of what a liability is and therefore it is hard to find a way of getting around that rule. With both the cooperatives and unit trusts, particularly the unlisted ones, if you put your money in a cash management trust, the trust undertakes to buy the units back from you. That is a liability and although we in Australia have been treating that as equity, strictly it is not equity. But the earth is not going to fall in. Those

entities are exactly the same entities they were before. There is going to need to be an educational program so that this is understood by all, but they are identical to the organisations that they were before.

We have been warning them about debt covenants or other contracts that are inappropriately worded for a while and they had better get on with fixing them. Yes, their accounts will look different, but the earth will not fall in. I think the sooner they get on with it and realise that as entities they are completely the same as they were before, the better. What I am really saying is that it is very hard to work out how they can be given relief if they have created a situation where instead of having residual equity they are legally obliged to pay, because an obligation to pay is a liability under the international rules.

Senator WONG—Yes. I appreciate the point you are making.

Prof. Boymal—It is fundamental, I guess.

Senator WONG—Yes. I understand that. Do you think the affected sector has an understanding of the effect on it of IFRS and that the earth is not going to fall in?

Prof. Boymal—They certainly have been slow in coming to grips with that. The agitation is occurring right now and it should have occurred earlier. But even if it had occurred earlier, because this is one of the fundamentals, it is very difficult to know how else one might deal with it other than us not going international at all—but those days are over. So I think at this point in time these entities are going to have to bear the detriment. This will be a trouble in that their accounts will need new explanations. In the same way, some other companies are going to have to reverse the revaluations of their intangibles. They are not happy about that either, but it is a fundamental rule. I think the benefits overall are the credibility of Australian financial reporting. The costs or the detriments are borne by different companies depending upon their situations. All I can say is that in our judgment the overall benefits to adopting international standards are greater than these detriments. It is not denied that some entities will suffer some sort of detriment but, as I said before, the entities are the same; it is that they have some explaining to do so that people will understand.

Ms BURKE—Just on that one: in the worst-case scenario, a cooperative credit union, say, might not meet its APRA requirements for funds under management. That is the absolute worst-case scenario that I can think of off the top of my head.

Prof. Boymal—Yes, but APRA would be understanding. APRA has already said to quite a number of the companies that come under its control that, until it, APRA, can come to grips with that, the old rules will prevail whilst they work out how to deal with these issues. Again, the earth will not fall in as a result of that.

Senator WONG—Has AASB had any discussions with APRA regarding these issues and the implications of them?

Prof. Boymal—We have had discussions with APRA all the way along, so we are very aware of many of the issues that will be affecting financial institutions that come under APRA control. At this stage APRA has not asked for any exceptions to arise in the international standards.

APRA understands that it is up to APRA to change its requirements; it is not up to the international standards to change. Again, it is I think a problem area, but it is under control.

Senator WONG—Is AAS 1046A part of this?

Prof. Boymal—Yes, 1046 is about the disclosure of the executive remuneration.

Senator WONG—Is 1046A also part of the tabled standards?

Prof. Boymal—1046A was only a minor amendment to 1046.

Senator WONG—But it is part of this bundle or bunch of—

Prof. Boymal—Yes. But the main problem there is that section 300A—

Senator WONG—I am about to raise that. I know you wrote to the then parliamentary secretary about the issue between 300A and 1046. As I recall, 1046A was the IFRS alteration.

Prof. Boymal—Yes, that is right.

Senator WONG—You are aware that parliament determined, for various reasons—and it was obviously a fairly hotly debated issue—to put certain requirements into the Corporations Law, so that one might envisage some reluctance to alter it just because the—

Prof. Boymal—Perfectly understood.

Senator WONG—Is there a way forward to harmonise?

Prof. Boymal—Yes. We are currently dealing with Treasury on this. AAS 1046 came first and then parliament introduced section 300A. We tried at the time to make the section 300A requirements the same as our 1046 but that did not eventuate, so there are differences. There are two problems. One is that these two requirements are not exactly the same. Whilst they are calling generally for executive remuneration information, they do not deal with exactly the same people. The accounting standard deals with those who are regarded as being the most senior people in the hierarchy. Section 300A deals with the most highly paid. We did not particularly like that because you could have a person who is highly paid just in the year—perhaps the year of leaving—and it would produce a different piece of information to that about the most senior executives. However, parliament decided that these were the people about whom they wanted the information to be disclosed.

The second thing, apart from the differences in the people, is that parliament decided that 300A information would be for publicly listed companies. There are other entities who have to provide the 1046 information. There are some publicly listed entities that are not companies and there are other important but non-listed entities. So, as well as there being different disclosure for different people, not exactly the same entities are covered. You might well say that 1046 covers a wider range of entities than 300A. Companies have been complaining because the amount of detail is quite significant. It takes a number of pages of an annual report to provide the data. If

you have to provide it twice and it is slightly different, three pages of annual report now doubles up to six or the like. So the pure cost of the paper and the printing is a problem.

We are working hard with Treasury to find a resolution. We will defer to parliament so that if parliament wants these certain people we will alter our standard to cover those people. But our information is required to be audited because it is in the accounts and the directors' reports are not audited. In addition, we cover additional entities. So we cannot just wipe our standard; that would let some off the hook. We are working with Treasury to find a way that the information in section 300A, by a means of cross-referencing, can also be the information for 1046. Since it is the information for 1046 which is part of the accounts, that piece of the directors' report will need to be audited. At the moment, Treasury is working on a set of regulations to try to have the information consistent and provided only once. The benefit of 300A is that it has to be certified by officers of the company and the benefit of 1046 is that it is required to be audited by a cross-referencing system. We may be able to get the benefits of both without duplication. We in Treasury are working on that at the moment.

Senator WONG—I am pleased to hear that. Is there an inconsistency between 300A and IFRS?

Prof. Boymal—Interestingly, this information is not called for internationally. This is an Australian decision. There are some really strange things. I will give you another example. You know all the fuss about auditor's remuneration, independence and what auditors are being paid for other services. The international standards do not ask for any disclosure about what auditors get paid at all. We have always had that information and we have left that information requirement because in our minds it is regarded as being essential. People have complained that we have gone beyond the international standards—again, few and far between—but there are some areas, for instance in both the executive remuneration and the auditor remuneration, where we considered it quite appropriate to go beyond what is in the international standard. So you do not worry about the international standard; it is a local requirement.

Senator WONG—It does not prevent us from having additional requirements, does it?

Prof. Boymal—No, not at all.

Senator WONG—Thank you very much, Professor.

Senator MURRAY—In a number of ways, Professor Boymal, you are a passive agency in that you do not have the resources to go out and be an active enforcer, monitor or analyst of what is happening in the marketplace. Do you propose to have a formal memorandum of understanding with ASIC to assess how the implementation is going, perhaps with other professional organisations as well as other regulators, so that you get early warnings of any problems of implementation that you might otherwise not get? Before you answer, in my mind already is Greg Pound's work for ASIC, where he and his staff have done an appraisal of a number of annual reports and their compliance with existing standards. So they are getting a lot more experience in this area than they used to have.

Prof. Boymal—We have never discussed the formal memorandum of understanding, I think primarily because it is an issue that has never crossed our mind. We work closely with ASIC. I

say to Greg Pound, the chief accountant of ASIC, that it is rather more our function to interpret the standards than the regulator's, although if there is no other interpretation forthcoming then the regulator has to work it for himself. That is probably not the most advised thing; it is better to have the standard setter do that in the first instance. There is a dividing line between us and ASIC. As you would appreciate, we are in effect the law-makers and they are the enforcers.

Senator MURRAY—The regulators; that is right.

Prof. Boymal—We are on very friendly and cooperative terms, but we try not to encroach on each other's territory—one being law-making, the other being enforcing. But you are absolutely right in that their experiences are quite important in terms of whether the laws ultimately need to be changed. We do cooperate, but, quite frankly, a formal memorandum of understanding had not crossed my mind.

Senator MURRAY—My mind is this. This is a relatively unique circumstance. They do have resources which you do not. They are more in the field than you are. I would have thought that formal conveying of information to you to see how it was going would be all to the good, frankly.

Prof. Boymal—Yes, I am inclined to agree. I can see no downside in relation to that. It happens informally already, but it is not a formal—

Ms BURKE—ASIC has one with the RBA; APRA has one with ASIC; ASIC has one with APRA. One of the other requirements for it is the privacy provisions. Technically, in some of these instances, they are not allowed to give you this information.

Senator MURRAY—We may or may not decide to put that in as a recommendation. If you are keen, that will help.

Prof. Boymal—I have no problems with it.

Senator MURRAY—Good. Most matters have been dealt with, but I want to return to the issue of small and medium enterprises. In defence of the Institute of Chartered Accountants, they did indicate that the evidence for their request was fairly loose, if I can paraphrase what they were saying. But they have obviously been asked to bring the issue forward, and they have done so in their submission. But they were looking for some kind of relief, exemption or higher threshold for small and medium enterprises. You would be aware that, on page 2 of their submission, they said:

Consequently, the Institute would encourage the Committee to consider the existing definition of a small company under the Corporations Act 2001 with a view to at least doubling the threshold levels under which a company is classified as small and therefore excluded from preparing financial reports in accordance with Part 2M.3.

The Chairman reminded me, and we have called it up, that in March 2001 this committee had a report on the aspects of the regulation of proprietary companies. At page 35, it said:

The PJSC believes that it would not be appropriate to relieve all proprietary companies of the audit requirement for several reasons. This option would not be consistent with the reporting entity concept in the Accounting Standards, as

some proprietary companies, particularly those that seek to raise equity or loan capital, will almost always exhibit the characteristics of a reporting entity. Users of financial reports, who are unable to access financial information about the entity, depend on high quality financial reports from the company in making their resource allocation decisions. For reporting entities that have dependent users of those reports the need for audited financial statements will always outweigh other considerations. But, as submissions noted, for some proprietary companies the issue is more complex. The PJSC nevertheless concluded—

and this is what I thought was an interesting part of our approach—

that the ownership of the company is a better indicator of the need to impose an audit requirement under the Law than the arbitrary test of a company's economic significance.

The law at present just focuses on economic significance. It says, 'This is the amount of money,' and, as you heard, the ICA are saying we should consider raising it. I must say I am not immediately attracted to that. But the alternative proposition put by the PJSC some time ago was that you should look at aspects other than the economic significance. What is your view of both those propositions?

Prof. Boymal—If I could explain to begin with that this whole area is extremely complex, and the reason for that is that both the legislation and the accounting standards buy into it. They do it as follows. The legislation distinguishes between small proprietaries and large proprietaries, and it sets three criteria: the amount of sales, the amount of fixed assets and the number of people employed. I think the rules are that if you satisfy two of those criteria you flip into the large proprietary category. That is the legislative distinction. At the bottom end, at the small proprietary, unless shareholders require it you do not have to have an annual meeting, you do not have to lodge accounts—you do not even have to prepare accounts, so it is absolutely nothing.

In the legislation the next level is what is called a disclosing entity, and that covers both listed companies and those who have gone to the market, raised debentures and the like. So they do not have to just be listed; they also have to have gone to the public market. The accounting standard then has a distinction between a reporting entity and a non-reporting entity. A reporting entity is defined in very general terms: is the public interested in the accounts or not? If the public is interested then it is a reporting entity; if the public is not, it is not. So that is a very judgmental area.

When you take all of those requirements, some introduced by legislation and some by the accounting standard, you have a really complex set of dividers. I think what happens when legislators consider it is that they look at the part that is in the legislation and when we standard-setters look at it we look at the part that is in the accounting standard. But I really think the best way to look at it is in total, because in a way it does not matter who drew these different lines; the lines are there. Because they come from both a legislative source and an accounting standard source there are overlaps and inconsistencies between them. I am inclined to think that the whole thing needs to be looked at—not just the legislative rules, which are the small versus large proprietary, but the totality of the different levels of reporting requirements, irrespective of where those rules come from. I am not sure I have quite answered the question you asked, but you can see that it is a very complex area.

Senator MURRAY—Let me take it a little further: I think the matter is more complicated. I do not have any statistics, but there have always been small companies that have constructed their accounts as if they were a reporting entity, because the nature of the professionals involved is such that they want to keep their books in that manner. In my view that choice was accelerated when the GST was introduced, because companies then had to report in a different manner for taxation purposes. Many of them also began to operate as we would describe reporting entities operating—or much more closely to reporting entities than non-reporting entities. So, when I am faced with a proposition such as that put rather diffidently by the Institute of Chartered Accountants in Australia, I return to our view, which is essentially that economics should not be the entire determinant of a reporting entity structure. My question to you really was: is this the opportunity, now that the international accounting standards are being introduced, to review this whole area and get more consistency and rationality than I think is apparent at present?

Prof. Boymal—My view on that is that the issue of the international accounting standards—this massive book of them—is complicated itself without overlaying these other issues. What we are talking about here is a Corporations Law issue that has little to do with accounting standards other than the fact that companies are facing a new set of rules, so the question is which ones should face them. But we are looking at a quite significant Corporations Law change to address it. In my mind, if we overlay the introduction of the new accounting standards with too many other issues, it starts to get even more complicated. Probably it is an area that I think needs to be revisited, but as a serious and perhaps longer term Corporations Law issue. I think that linking it with the international standards, whilst it may be a matter of convenience because everyone has to face this new set of rules, just ends up blaming the new standards for everything. It is hard to see the real connection.

Senator MURRAY—Let us go back to your earlier remarks. You said: 'Look, for most small and medium enterprises, the way in which the standards have shifted is relatively minor and modest. It is not going to affect them.'

Prof. Boymal—Yes.

Senator MURRAY—That is my interpretation of what you said: it is not going to affect them that much.

Prof. Boymal—Yes, indeed.

Senator MURRAY—But the essential proposition made by the ICA—even if it was diffidently, as I put it—is: 'Enlarge the number of exceptions anyway to keep people out of the complexity and out of the potential difficulties, even if they cannot identify them in advance.' I am really asking whether that is necessary. So many more companies have entered into full reporting and compliance with full accounting standards because their accountant said that that was a natural consequence of upgrading their accounting systems when they were faced with the GST. They came onto a standard set of reporting, because they were improving their company operations.

Prof. Boymal—I think one of the earlier people giving evidence drew a distinction between the measurement and recognition rules and the disclosure rules. To my way of thinking, if you are saying, 'My profit is so much,' it needs to be determined on the same basis whether you are

large or small, international or local. You cannot have different versions of what your profit is. But the extent to which you go into the detailed disclosures is another thing. If you are a small company, the disclosures are horrendous and over the top. So I think that there is the possibility for relief in relation to the amount of disclosures that are made, but the idea of having more than one way of measuring profit—so that, if this small company finally lists, it has to change the profit because it is now in a different category—does not make sense to me. I would be very wary of there being any rules or ability for companies to produce a different set of numbers to say: 'This is my financial position, because I am large or because I am small.'

Senator MURRAY—That is the answer for which I was searching. I personally have no time for a view that small and medium enterprises should be relieved from accounting for their books in a manner which is consistent and common to all companies. I have a great deal of time for the idea that they should be relieved from the disclosure which is more applicable to large entities.

Prof. Boymal—Yes, and I would concur with that view.

Senator MURRAY—I must confess that I have not read enough of the reports closely enough, but I do not see that principle as having been developed anywhere in the material put before us. I am not sure whether our existing corporate law arrangement and our existing accounting standards recognise those—

Prof. Boymal—No, because our existing Corporations Law is an all-or-nothing type of approach.

Senator MURRAY—That is right; I am not sure whether they recognise that distinction. It is the disclosure that is onerous, not the compliance with having a common approach to verifying your costs, sales and profits.

Prof. Boymal—Yes. Interestingly the International Accounting Standards Board has just started to ask these same questions. It has a project in its very early stages to determine whether there should be a lower level of accounting standards and particularly disclosure requirements for SMEs. It has done a survey up to this point in time and the survey results indicate that there is a deal of enthusiasm for a lower level of disclosure. However, some people want a lower level of measurement as well but others are very strongly against lower levels of measurement. The project is in its very early stages but I believe that ultimately there will be an international accounting standard specially designed for SMEs that will contain some sorts of relief. However, that is a way off yet.

Senator MURRAY—Perhaps I am making a misjudgment, but my instinct is that the authorities underestimate the amount of international interest in small companies. By that I mean that the assumption is that small companies are geographically local to the country concerned. However, the number of small business people who move to another country and buy a small business and have experience of one type of accounting behaviour in their original country and then have to adopt and understand a new type of accounting behaviour—particularly with regard to sale conditions and what they are actually buying—is extensive.

Prof. Boymal—You are quite right, Senator. One of the speakers for the AICD said something that made me shake my head because I thought he was wrong. It was the presumption that going

into international accounting standards only benefits those companies in the international marketplace. That is not the case, because the whole idea is to enhance the credibility of reporting for all organisations in Australia. Going into the international marketplace to raise money is one decided benefit but, if a small business man wants to sell his business and his accounts are more credible than they were, that provides him a benefit. The benefits are a lot wider than this 'I'm not raising any shares overseas, so what's in it for me?'

Senator MURRAY—That is right.

Prof. Boymal—There is a deal of misunderstanding about the breadth of the overall benefits. Everybody perceives it from their own point of view.

Senator MURRAY—It is the way in which the numbers are configured; that is the important point for buyers and sellers of businesses from different countries.

Prof. Boymal—Yes.

Senator MURRAY—That goes on all the time. Butchers in England are buying property in South Africa because they know that the relationship of the rand to the English pound gives them an advantage. The butcher in England who understands how his little business operates and how his numbers are configured faces a situation where the way in which the numbers are configured and how the assets are expressed in South Africa may be quite different. The same applies to someone in Australia buying a place in France.

Prof. Boymal—Think of the benefits if it was one language.

Senator MURRAY—A huge amount of this type of transaction is going on.

Prof. Boymal—Absolutely.

Senator MURRAY—I conclude by asking you to confirm that this is an area that the AASB is now starting to examine.

Prof. Boymal—Yes. In confirming that it is an area that we are examining, the IASB is about to turn its mind to it and we will contribute to its deliberations. Yes, it is happening, but it is not just happening locally; these thoughts are happening worldwide.

Senator WONG—How do you envisage that the consultation or input process from small or medium enterprises could be made through this examination?

Prof. Boymal—Small and medium enterprises are not good contributors to the process, unfortunately, even if it affects them. My greatest hope is that the accountants who service those be encouraged to respond on behalf of their clients. If you are running a small business, all of this esoteric stuff is way beyond your day-to-day interests. But the accountants who service this end of the market ought to show an interest. Typically they have not been good respondents either, but in many respects I think it is fair to say that the accounting bodies speak on behalf of that level of practitioner. The idea is to encourage the accounting bodies to present views with

that end of the market in mind. I cannot think of a better way other than asking it of the accounting bodies.

CHAIRMAN—Thank you very much for appearing before the committee and for your contributions to our deliberations.

Committee adjourned at 8.01 p.m.