

## CHAPTER 5

### ACCOUNTING STANDARDS

#### Outline of proposed changes to accounting standards

5.1 The Bill establishes a new Financial Reporting Council (FRC) which will have broad oversight of the accounting standard-setting process. The FRC's statutory functions will include:

- responsibility for the operations of the Australian Accounting Standards Board (AASB); and
- monitoring the operation of accounting standards.<sup>1</sup>

5.2 The FRC will also be required to report to the Minister on the effectiveness of the standard-setting process and, in particular, the progress towards harmonisation of Australian accounting standards with international standards.

5.3 In addition, the Bill provides for the establishment of the AASB, the standard setter, as a body corporate and, in making and formulating accounting standards, requires that the AASB must have regard to certain set criteria.<sup>2</sup>

#### Adoption of International Accounting Standards

5.4 The Bill introduces a new provision giving the Minister the power to give a direction to the AASB about the role of international accounting standards. The Bill says that:

##### **233 International accounting standards**

The Minister may give the AASB a direction about the role of international accounting standards in the Australian accounting standard setting system. Before giving a direction under this section, the Minister must receive and consider a report from the FRC about the desirability of giving the direction. The AASB must comply with the direction.

5.5 The Explanatory Memorandum to the Bill provides the following outlines of the objective and operation of the provision:

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<sup>1</sup> Sections 225(1), (2).

<sup>2</sup> Under sections 229 and 231 of the accounting standards provisions of the Bill, any standard made or formulated by the AASB must have been developed with regard to its suitability for different types of entities and must have been the subject of a prior cost/benefit analysis by the AASB of the likely effect on the entity to which it applies.

This provision therefore provides a mechanism for the Minister, upon the advice of the FRC, to require the AASB to move towards greater adoption of international standards if that is considered appropriate and the AASB has not moved in that direction of its own accord.

Issues that the FRC would be expected to have regard to when it is preparing a report for the purposes of this provision include:

- whether the standards made by the international standard setter had been endorsed by the International Organisation of Securities Commissions for cross-border raisings and listings;
- the level of acceptance of international accounting standards in the world's major capital markets (including the United Kingdom, France, Germany, the United States and Japan); and
- whether the adoption of international accounting standards would be in Australia's best interests.

5.6 The Committee received evidence from a number of witnesses who were concerned about the effects of this provision. They put the view to the Committee that international accounting standards have not been developed to a point where their adoption in Australia would necessarily lead to an improvement either in the standards of financial reporting in this country, or in the ability of Australian companies to raise capital on international markets.

5.7 Both the AASB and Accounting Bodies were concerned that effect of section 233 of the Bill would be to commit Australia to the adoption of IASC standards. According to Mr Boymal any move to adopt IASC standards without amendment would be premature. He cautioned against the automatic adoption of IASC standards.

5.8 Speaking on behalf of both Accounting bodies Mr Boymal explained the current stage of development of accounting standards:

International accounting standards contain choices. That is because they are written based upon international compromise. If two powerful countries sitting on the international accounting standards disagree, then you will find both of their approaches often appearing in the international accounting standard, saying, 'You can either do it by method A, or you can do it by method B,' because that was the way of getting both country A and country B to agree at that forum to let the document through.

So we have some quite different treatments for single transactions allowed in international accounting standards. Just to give you an example so that you have a feeling for it, if one incurs interest expense on borrowing money to develop or build big plant, the international accounting standard says that you can either expense the interest or you can capitalise it to the asset.

In Australian accounting standards we have never allowed this sort of wide range of choices. In Australia we chose one of those two methods.<sup>3</sup>

5.9 Mr Boymal emphasised that IASC standards do not contain the detail, which would adequately prescribe accounting policies or disclosures because they reflect the fact that they are generic. In contrast, Australian standards, which are enforceable under the Corporations Law, are developed to be implemented as “black letter” law. There is, therefore, less uncertainty about the required treatment under the standard. In addition, the IASC standards do not take account of the particular business environment of a country like Australia and the development of standards:

The problem with the international standards at the moment is that you have got a set of words there but it is hard to know what they mean. You have no-one to turn to, to ask what it means or to ask what the drafters intended. You cannot get answers to any of these basic questions. The IASC needs to have a structure which provides answers.<sup>4</sup>

5.10 These views were reflected by other witnesses. In its submission the Securities Institute said that it is undesirable for Australia to adopt international accounting standards issued by the International Accounting Standards Committee before they have been accepted by the major overseas capital markets. Several other witnesses emphasised to the Committee that acceptance of international standards by the US market was crucial to the universal acceptance of the those standards.<sup>5</sup>

5.11 In evidence to the Committee, the AASB indicated that Australian accounting standards could no longer be developed in national isolation. For this reason, it had developed and issued its International Harmonisation Policy in 1996.<sup>6</sup> The objective of that Policy is to move ultimately to the adoption of an internationally accepted set of accounting standards. According to Mr Boymal, Australia has done more than any other country in working with the IASC and harmonising with the IASC’s standards.

5.12 As part of that Policy the AASB is undertaking a Harmonisation Program to make Australian standards consistent with IASC standards. However, it was acknowledged that some Australian standards fall short of IASC standards but are being improved as part of the Harmonisation Program.

5.13 The Group of 100 supported the process of harmonisation with international standards but recommended that adoption of IASC standards should depend on three criteria:

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3 Mr David Boymal, Committee Hansard, 13 July 1998, p 22

4 Mr David Boymal, Committee Hansard, 13 July 1998, p 31

5 Mr David Boymal, Committee Hansard, 13 July 1998, p 23.

6 See AASB, Policy Statement 6 – ‘International Harmonisation Policy’. The recent Wallis Inquiry reaffirmed the view that the AASB should, where practicable, harmonise Australia’s accounting standards with international standards (Recommendation 12 of the Financial System Inquiry, Final Report, March 1997).

- acceptance of the international accounting standards by the major capital markets;
- an effective role for Australia within the IASC; and
- substantial support for these standards by Australian users.

5.14 The Committee fully endorses the policy objective of ensuring that Australian accounting standards are brought into line with any generally accepted international standards. However, the Committee is not convinced that the adoption of international standards is desirable at this time. The evidence presented to the Committee strongly suggests that international accounting standards have not yet been developed to the point where their automatic adoption in Australia would necessarily enhance the standard of financial reporting by Australian companies, or improve the ability of Australian companies to access major overseas capital markets. The Committee is not persuaded that the AASB should be directed to automatically adopt international accounting standards without there being some opportunity for public examination of the issues.

5.15 In considering the legislation before the Parliament the Committee notes that Bill does not in fact require such adoption. It merely allows the Minister to give a direction to the AASB on the role of international accounting standards in the Australian accounting standard setting system. Some of the concerns about this issue appear to stem from the early drafts of the legislation and do not appear to be justified in light of what the Bill actually says.

5.16 Similarly it appears to the Committee that the guidance given to the FRC in the Explanatory Memorandum presented with the Bill is very wide reaching. It appears to the Committee that the FRC would have the opportunity to incorporate in its report to the Minister consideration of the matters raised in evidence before the Committee.

5.17 In considering this matter the Committee also took into account the provisions of section 334 of the Corporations Law. This section allows the AASB to make accounting standards for the purposes of the Corporations Law. The section goes on to state that:

334(2) Section 46A of the Acts Interpretation Act 1901 of the Commonwealth applies to a standard made under subsection (1) as if it were a disallowable instrument for the purposes of that section.

5.18 Accounting Standards are therefore disallowable instruments which must be tabled in Parliament. This process will provide an opportunity for the Parliament to scrutinise and debate the appropriateness of any accounting standards developed as a result of a direction by the Minister under proposed section 233 of the ASIC Act. The standards can be disallowed by either House as a result of this process.

5.19 The Committee has therefore concluded that there is no need to change the provisions contained in the Bill.

## Independence of the AASB

5.20 Under the new arrangements, the Financial Reporting Council (FRC) will oversee the accounting standard-setting process and have the power to set policy directions for the AASB. The Bill also empowers the FRC to “give the AASB directions, advice or feedback on matters of general policy and the AASB’s procedures.”<sup>7</sup>

5.21 The AASB, however, expressed concern that the FRC as the oversight body may impede the operational independence of the AASB. Mr David Boymal, Deputy Chairman of the AASB, told the Committee that:

The AASB certainly agrees that there should be a financial reporting council because there is a need for broad oversight and there is a need to separate the detailed standard-setting process from the broad objectives. But there is at the same time a concern that the specific wording of the bill fails to ensure the technical independence of the AASB. The concern is that, if there are technical proposals being developed by the AASB that are a worry to the FRC, in the guise of setting priorities or allocating the funds the FRC will have the opportunity to have a greater technical influence than appears to be the intention. Therefore, the AASB believes that the specific terms of reference of the FRC need to be further addressed to further ensure that the technical independence of the AASB is not too greatly influenced by the FRC.<sup>8</sup>

5.22 Similarly, the Accounting Bodies advocated more operational independence for the AASB. They recommended that the independence of the AASB, as a technical board, should be strengthened by the appointment of experts from both the private and public sectors. Pointing to overseas examples of standard-setting structures, the Accounting Bodies stated that “the functions prescribed for the FRC vis-à-vis the AASB are unique. The standard-setting arrangements in all other jurisdictions including the UK, US and within the International Accounting Standards Committee and other standard –setters, provide more operational independence for the standard-setting board.”<sup>9</sup>

5.23 As part of the new arrangements, the AASB will be established as a body corporate and have a range of powers; for example, it will have the power to engage staff and establish advisory panels and consultative groups. The Accounting Bodies noted that these powers could give rise to a potential for conflict with the FRC, given that it will oversee the operations of the AASB and approve the AASB’s budget.<sup>10</sup>

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7 Subsection 225(2)(e).

8 Mr David Boymal, Australian Accounting Standards Board, Committee Hansard, 13 July 1998, p 64.

9 Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, Submission 6, p 11.

10 Frank Micallef, Committee Hansard, 13 July 1998, p 74-75.

5.24 The Committee notes that since the release of the exposure draft of the Bill the issue of the independence of the AASB, as a technical body, has been addressed directly in the Explanatory Memorandum to the Bill. The Explanatory Memorandum refers to two important safeguards in the context of the FRC's powers and the membership of the AASB which are designed preserve the independence of the AASB.

5.25 First, the Explanatory Memorandum places great emphasis on the transparency and accountability of the FRC's decision-making process and its reporting obligations to the Minister and to the Parliament:

The provisions [section 225 of the Bill] have been designed to ensure that the FRC is in a position to provide broad oversight over the standard setting process without being able to determine the content of particular standards. In particular, the FRC will not have any influence over the technical deliberations of the standard setter and will not be able to veto, either in whole or in part, any accounting standard made by the standard setter. In performing its functions and exercising its powers, it is expected that the FRC will operate in a manner that is open and consultative in nature.<sup>11</sup>

Further:

The FRC does not have the power to direct the AASB in relation to the development, or making, of a particular standard.<sup>12</sup>

Proposed subsection 235B(1) provides that, before 31 October in each calendar year, the FRC must give the Minister a report on the operations of the FRC, the AASB and their respective committees and groups during the 12 months that ended on 30 June in that calendar year and the achievement of the objectives listed in proposed section 224...Proposed subsection 235(3) requires the Minister to table the FRC's report in each House of the Parliament as soon as practicable after it has been received.<sup>13</sup>

5.26 Secondly, the Explanatory Memorandum makes clear that the AASB will have a broad membership and will include individuals from the private and public sectors with technical expertise:

Under proposed subsection 236B(3), a person must not be appointed to the AASB unless they have appropriate knowledge of, or experience in, business, accounting, law or government.<sup>14</sup>

5.27 While the Committee considered whether to recommend the inclusion of similar safeguards in the provisions of the Bill, as an alternative to their reference in

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11 Explanatory Memorandum, para 9.6.

12 Explanatory Memorandum, para 9.31.

13 Explanatory Memorandum, paras 9.42-43.

14 Explanatory Memorandum, para 9.51.

the Explanatory Memorandum, it believes there are appropriate checks and balances between the roles and powers of the FRC and the AASB to ensure the operational independence of the AASB. The processes of the FRC should be transparent and accountable, and the Committee envisages the FRC holding its meetings in public session.