

# CHAPTER TWO

## Background to the Proposed Standards

2.1 This Chapter discusses the policy reasons for the harmonisation of international accounting standards, and the process which has been undertaken in order to produce the current standards.

### Key Institutions

#### *Financial Reporting Council*

2.2 The Financial Reporting Council (FRC) was established under the *ASIC Act 1989* and continues in its operations under the *ASIC Act 2001*. It is an advisory board, whose members are appointed by the Treasurer, and which reports directly to the Treasurer. The *ASIC Act 2001* gives the FRC a number of broad functions, including "broad oversight of the processes for setting accounting standards in Australia."<sup>1</sup>

2.3 The FRC is also given functions relating specifically to the formulation of accounting standards. These include:

- (c) determining the AASB's broad strategic direction; and
- (d) giving the AASB directions, advice or feedback on matters of general policy and on the AASB's procedures; and
- (e) monitoring the development of international accounting standards and the accounting standards that apply in major international financial centres; and
- (f) furthering the development of a single set of accounting standards for world-wide use with appropriate regard to international developments; and
- (g) promoting the continued adoption of international best practice accounting standards in the Australian accounting standard setting processes if doing so would be in the best interests of both the private and public sectors in the Australian economy<sup>2</sup>.

2.4 The limits of the FRC's capacity to direct the AASB are provided in the same section:

- (5) The FRC does not have power to direct the AASB in relation to the development, or making, of a particular standard.

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1 *ASIC Act 2001*, s.225(1)(a)

2 *ASIC Act 2001*, s.225(2)

(6) The FRC does not have power to veto a standard made, formulated or recommended by the AASB.<sup>3</sup>

### ***Australian Accounting Standards Board***

2.5 Like the FRC, the Australian Accounting Standards Board (AASB) was established under the *ASIC Act 1989* and continues in its operations under the *ASIC Act 2001*. The Board comprises a full time Chairman (currently Mr. David Boymal) and nine part-time Board members. The Commonwealth Government is directly represented on the AASB by an officer from the Department of Finance and Administration.

2.6 The functions of the AASB are outlined in s. 227(1) of the *ASIC Act 2001*, and include:

(b) to make accounting standards under section 334 of the *Corporations Act* for the purposes of the corporations legislation ... ; and

(d) to participate in and contribute to the development of a single set of accounting standards for world wide use.

2.7 Section 334(1) of the *Corporations Act*, which is referred to above, states:

**334(1) AASB's power to make accounting standards.** The AASB may make accounting standards for the purposes of this Act. The standards must be in writing and must not be inconsistent with this Act or the regulations.

### ***International Accounting Standards Board***

2.8 The International Accounting Standards Board (IASB) is an international body responsible for setting authoritative International Financial Reporting Standards (IAFRs). It has been in place in its current form since 2001, prior to which the standards setting work was undertaken by a predecessor body called the International Accounting Standards Committee (IASC). Australia has participated in both the IASB and the IASC since the formation of the IASC in 1973.

2.9 The IASB is comprised of 14 board members, appointed from the member nations of the IASB, on the basis of merit (they are not, for instance, appointed on a national basis and do not represent either their national profession, national government or national standards-setting organisation). An Australian, Mr Warren McGregor, is on the IASB and has been heavily involved in the international standards setting process since the early 1980s.

2.10 The IASB has no independent authority to impose accounting standards. For the IASB's standards to become mandatory within any national jurisdiction, they must be adopted by that jurisdiction (usually by a national standards setting body). Currently, Australia, Germany and the UK have moved closest to adoption of the

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3 *ASIC Act 2001*, s.225

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IASB standards. The European Union is moving closer to adoption, and the United States, while less advanced in this process, still appears to be moving in a direction consistent with harmonisation. The IASB's internet site gives an account of the current level of acceptance of its standards:

International Financial Reporting Standards (IFRSs) have achieved recognition universally as a highly influential set of accounting standards, with over 90 countries claiming that they will be following IFRSs in 2005.

In many countries, stock exchange listing requirements or national securities legislation permits foreign companies that issue securities in those countries to prepare their consolidated financial statements using IFRSs. The principal capital markets in this category are Australia, Germany and the United Kingdom. From 1 January 2005, all publicly listed companies in the European Union will be required to prepare their financial statements in conformity with IFRSs. From the same date, Australia will adopt IFRSs as its national accounting standards. New Zealand will require IFRSs from 2007.

Certain countries do not permit companies to use IFRSs without a reconciliation to domestic generally accepted accounting principles (GAAP). Most notable among these countries are Canada, Japan and the United States. In the US the Securities and Exchange Commission has indicated that it will probably have to review the need for reconciliation after 2005. It has also expressed strong support for moves to achieve convergence between US GAAP and IFRSs.

Furthermore, in April 2004 the US standard-setter, the Financial Accounting Standards Board, and the IASB agreed to align their future agendas.<sup>4</sup>

## **The process of harmonisation**

2.11 Harmonisation of accounting standards has been recognised as a worthwhile goal since at least the time of the formation of the IASC in 1973. However for several decades, the role of international bodies such as the IASC and the less formal G4+1 group (comprised of Australia, Canada, New Zealand, the USA and the UK) was more as a forum for liaison between national standard setting bodies who could, through such liaison, work towards increasing the extent to which their national accounting standards were concordant.

2.12 Concerted action on a harmonised set of international accounting standards did not properly commence until 2001, after the reconstitution of the IASC as the IASB. The IASB almost immediately commenced work towards harmonised standards, with Australia as a participant in the process. In the FRC's 2000/01 Annual Report, then-Chairman Jeffrey Lucy wrote:

The AASB will now be working closely with the IASB, aligning its work program (to the extent possible) with the IASB's, leading certain projects on

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4 www.iasb.org, accessed 7 December 2004.

the IASB agenda and providing support on others. We should begin to see within a few years whether the work of the IASB, in collaboration with national standard setters, is producing quality international standards capable of wide acceptance in major international capital markets and eventual adoption for world-wide use. The FRC and AASB are committed to the international effort to assist this outcome.

2.13 In 2002, the process of international harmonisation received a substantial boost when the European Union adopted Regulation (EC) No. 1606/2002 (19 July 2002) which required the adoption of IASB standards throughout the EU, provided those standards:

- are conducive to the European public good; and
- meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.<sup>5</sup>

2.14 These standards became effective throughout Europe on 1 January 2005. It should be noted, however, that Regulation No. 1606/2002 only applies to international standards adopted by the European Commission. Not all of the standards have been adopted. A current list of those standards which have been adopted, and those which are in the process of consideration, is available from the European Commission Internal Markets Directorate at the following internet address:

[http://europa.eu.int/comm/internal\\_market/accounting/index\\_en.htm](http://europa.eu.int/comm/internal_market/accounting/index_en.htm)

2.15 In Australia, observation of the European regulatory process contributed to the FRC's decision to formally support the adoption of the international accounting standards in Australia from 1 January 2005. In announcing this decision, then-FRC Chairman Jeffrey Lucy stated:

The FRC fully supports the Government's view that a single set of high quality accounting standards which are accepted in major international capital markets will greatly facilitate cross-border comparisons by investors, reduce the cost of capital, and assist Australian companies wishing to raise capital or list overseas.

Mr Lucy said he understood that the 1 January 2005 timing is somewhat later than the Government would have liked. However, it is determined by the decision of the European Union to require EU listed companies to prepare their consolidated accounts in accordance with IASB standards from that date, in support of the EU single market objective. Australia certainly cannot afford to lag Europe in this regard, Mr Lucy said. He also expressed his support for efforts to encourage the United States to further

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converge its standards with IASB standards with a view to eventual adoption.<sup>6</sup>

2.16 In February 2004, the AASB sought from the FRC advice as to whether exemptions or exceptions to the IASB standards could be included in the Australian standards. "The FRC responded that it did not contemplate that there would be any exceptions or exemptions allowed to companies reporting under the Corporations Act."<sup>7</sup>

2.17 In March 2004, following stakeholder concerns about the timeline for implementing the standards, the FRC imposed a deadline of 31 March 2004 for the IASB to produce its platform of demands, and 30 June 2004 for the AASB to produce the Australian equivalents. Failure to meet those deadlines would have resulted in the standards commencing later than 1 January 2005. Both deadlines were met.<sup>8</sup>

2.18 The regulations currently before the parliament would give legal effect to Australia's adoption of the IASB standards.

### ***International consultation process***

2.19 The process by which the IASB establishes standards is set out as article 18 of the IASB's *Preface to International Reporting Standards*. The process includes extensive opportunities for comment both by members of the public and by the standard-setting bodies in IASB member nations. International consensus on all but two of the proposed standards was achieved fairly readily. The two contentious standards were IAS 32 (*Financial Instruments: Disclosure and Presentation*) and IAS 39 (*Financial Instruments: Recognition and Measurement*). The equivalent Australian standards are AASB 132 and AASB 139.<sup>9</sup>

### ***Australian consultation process***

2.20 The AASB conducted a consultation process in parallel with the IASB process. Regardless of whether the IASB proposed the implementation of a pre-existing IASB standard, an amended standard, or an entirely new standard, the AASB issued an exposure draft for public comment. Where the IASB standard was to be an amended or new standard, the AASB consultation process operated concurrently with the IASB consultation process.

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6 *Bulletin of the Financial Reporting Council*, 2002/4, 3 July 2002.

7 Submission 3, AASB, p. 1.

8 Submission 3, AASB, p. 2.

9 Senate Economics Legislation Committee, *transcript of evidence*, 2 June 2004, p. E96.

2.21 In addition, the AASB itself made comments to the IASB on amended and new standards where appropriate.<sup>10</sup> Those comments were made public on the AASB and IASB websites.

2.22 In all, the AASB issued 32 Exposure drafts and three invitations to comment. These generated hundred of submissions, which were made publicly available (unless specifically marked confidential) and were considered by the AASB in developing the standards which are the subject of this inquiry.

2.23 The AASB submission stated:

The AASB has addressed a range [of] issues raised by industry groups. In some cases, the concerns have been accommodated in the standards, for example, concerns about the application of financial instrument disclosures to parent entities. In other cases, the AASB has thoroughly investigated the issues and determined that the change needed to accommodate the concerns would jeopardise the greater effort to achieve consistency with IASB standards, for example, in relation to the recognition of internally generated intangible assets.<sup>11</sup>

2.24 When the IASB standards were issued, the AASB finalised its own standards, amending the IASB standards where appropriate (but ensuring that these standards did not jeopardise the ability of for-profit entities, complying with the AASB standards, to also comply with the IASB standards). Consequently, while the AASB did not simply adopt the IASB standards in full, amendments were only made where they did not threaten the fundamental rationale for harmonising international accounting standards.

2.25 Those AASB standards have now been tabled in both houses of parliament, and will operate from the first annual reporting period which commences on or after 1 January 2005 (unless the standards are disallowed by either house).

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10 It should be recalled that there is also an Australian member of the IASB itself.

11 Submission 3, AASB, p. 5.