

Keith Alfredson

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The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Suite SG.64
Parliament House
CANBERRA ACT 2600

Dear Madam

Inquiry into Australian Accounting Standards

I wish to make the following submission to the Parliamentary Joint Committee on Corporations and Financial Services in connection with its current inquiry into Australian Accounting Standards tabled in compliance with the *Corporations Act 2001* in the Senate on 30 August 2004 and 16 November 2004. This is a personal submission.

Summary of my opinion

In my opinion:

- (a) the standards referred to above are consistent with the *Corporations Act 2001* and its regulations and will act in furtherance of the objectives of the Act; and
- (b) while there has been much media publicity concerning certain issues that may arise out of the adoption of the standards, there are no strong reasons why the standards should not be allowed to operate as intended by the Australian Accounting Standards Board.

Detailed comments

The *Australian Securities and Investments Commission Act 2001* sets out the core objectives of accounting standard setting in Australia. These objectives are:

- (1) Accounting standards should require the provision of information that:
 - allows users to make and evaluate decisions about allocating scarce resources;
 - assists directors to discharge their obligations in relation to financial reporting;
 - is relevant to assessing performance, financial position, financing and investment;
 - facilitates comparability; and
 - is readily understandable.
- (2) Accounting standards should facilitate the Australian economy by reducing the cost of capital and enabling Australian entities to compete overseas.
- (3) Accounting standards should facilitate the Australian economy by having accounting standards that are clearly stated and easy to understand.
- (4) Accounting standards should maintain investor confidence in the Australian economy, including its capital markets.

In my opinion, the Australian Accounting Standards tabled in the Senate on 30 August 2004 and 16 November 2004 are in accordance with the above core objectives. I especially note that in my opinion they will lead to the preparation of accounts which will undoubtedly give a “true and fair view” as required by the *Corporations Act 2001*.

Much media comment has been focused on certain changes that will result from the adoption of the standards, including the derecognition of internally developed intangibles, where there is no active market on which to base a revaluation (which will ordinarily be the case). In my opinion, the derecognition of internally developed intangibles is an inevitable outcome of Australia’s strategy to achieve international comparability through the adoption of accounting standards equivalent to International Financial Reporting

Standards. Given the fact that most countries (including UK, USA, Canada and continental European countries) do not permit the revaluation of internally generated intangibles, it is obvious that international comparability cannot be achieved if this practice is allowed to continue in Australia. Some have argued that past revaluations should be “grand-fathered”. However, it is worth noting that the UK Accounting Standards Board under the then leadership of Sir David Tweedie (now Chairman of the International Accounting Standards Board) placed a prohibition on revaluations of internally generated intangibles approximately ten or so years ago, and at the same time required the derecognition of any such intangibles then carried on the balance sheets of UK entities. Given that UK entities were able to cope with such derecognitions, it is somewhat difficult to see why Australian entities will not similarly be able to cope.

Some publicity has also been given to possible “thin capitalisation” issues that may arise from the derecognition of intangibles under the income tax legislation. In my opinion, any such issue is irrelevant to accounting standard setting. Indeed Treasury was advised by the AASB that such potential issues could arise from Australia’s adoption of International Financial Reporting Standards some two or so years ago. In my view it is up to Treasury to address such issues through amendments to the tax legislation, if unintended tax consequences arise through the changes to accounting standards.

Some commentators have also argued that the timetable for adoption of the standards should be delayed for certain entities. I do not support any such delay. In my opinion, the move to international accounting standards has been well publicised ever since the Financial Reporting Council made the strategy decision in June 2002. To now delay the process will favour those entities that have deliberately failed to take the necessary steps to make the changes. This would be a most unfortunate outcome. Further, in my opinion, the extent of change by smaller entities that do not enter into complex financial instruments has, in my opinion, been grossly exaggerated. For many such entities, there will be few changes in recognition and measurement practices, with the changes in presentation and disclosure being relatively easy to cope with. For example, there is little effort involved to make the change from mandatory amortisation of goodwill to mandatory non-amortisation of goodwill, coupled with impairment testing of intangibles.

In my opinion, the adoption of the standards will considerably enhance the quality of financial reporting in Australia, as well as assisting in international comparability. Of particular significance is the fact that Australia will for the first time have comprehensive standards dealing with:

- the accounting for share –based payments (including executive options);
- the recognition and measurement of financial instruments, including derivatives;
- the recognition and measurement of intangibles;
- the recognition and measurement of the cost of defined benefit superannuation schemes; and
- the recognition and measurement of the impairment of assets.

These topics are all significant omissions from the previous suite of accounting standards existing in Australia. The filling of these gaps is in itself strong ground why no impediment should be placed on the implementation of these standards in accordance with the timetable established by the Financial Reporting Council and implemented by the AASB. For example, in my opinion, Australia can not afford to continue not to have a comprehensive standard dealing with the accounting for derivatives. In my opinion, the Pasmenco and Sons of Gwalia corporate failures highlight the urgent need for a comprehensive standard dealing with the recognition and measurement of derivatives and other financial instruments.

I also note that some media publicity has recently been given to purported problems relating to the interpretation of international financial reporting standards. In my opinion, as I stated in a recent letter to the Australian Financial Review (14 January 2005), it is extremely naïve to believe that the International Accounting Standards Board or its very much part-time Interpretations Committee (IFRIC) will be in a position to make interpretations that will cover all the issues that will routinely arise in a set of relatively complex accounts of a listed entity. The Australian Urgent Issues Group never did that in the past and it is unrealistic to believe that the AASB or the UIG or the IASB or IFRIC will do so in the future.

In my opinion, the onus of responsibility for interpreting and applying accounting standards firmly sits with those who have the legal responsibility: boards of directors and auditors. In my opinion, while improvements to accounting standards can always be made and will undoubtedly be made in the future by

the IASB and the AASB, the proposed standards under current consideration by the Committee are generally of high standard and are sufficiently principles-based to permit their appropriate interpretation and implementation. Of course, those applying the standards will need to have the desire to live by principles and have the fortitude to apply them in the manner intended, if high quality transparent financial reporting is to be achieved. To oversee that this eventuates is, of course, one of the responsibilities of the Australian Securities and Investments Commission.

I shall be pleased to discuss this submission with the Committee.

Yours sincerely

Keith Alfredson