

20 January 2005

Our ref: RME/CM

Ms Sarah Bachelard  
Secretary  
Parliamentary Joint Committee  
on Corporations and Financial Services  
Suite SG.64  
Parliament House  
CANBERRA, ACT, 2600

By Mail and by email  
corporations.joint@aph.gov.au

Dear Ms Bachelard,

Inquiry into Australian Accounting Standards (Inquiry)

I refer to your letter of 10 December 2004 inviting the Australian Institute of Company Directors' (AICD) to make a submission to the Inquiry in relation to the Australian Accounting Standards tabled in the Senate on 30 August 2004 and 16 November 2004 (the Standards).

The AICD is concerned that the short time available for consultation means that the AICD has not had the opportunity of considering the detail of the proposed Standards and their consistency with the Corporations Act. The transition to international accounting standards is one of the most significant changes to financial reporting in Australia in a generation. For this reason it is regrettable that the Committee has such a short time within which to conduct the Inquiry.

The AICD appreciates that the Inquiry does not intend to revisit the decision to harmonise Australian accounting standards with international accounting standards. However, the AICD has been concerned for some time at the impact the transition to international accounting standards will have on smaller companies especially the 20, 000 - 25,000 unlisted reporting entities which will be required to implement international accounting standards. Unlike European countries implementing the international standards smaller Australian companies are at a disadvantage compared to their international competitors because the new international standards will apply to all listed companies and unlisted reporting entities in Australia - in Europe IFRS will only apply to listed companies. It is these smaller companies, which will bear the greatest relative burden on transition to IFRS.

The AICD has prepared material outlining the specific difficulties of smaller companies. Copies of the AICD's September 2004 Discussion Paper "Transitional arrangements for smaller companies in relation to International Financial Reporting Standards" and the AICD's letter dated 23 December 2004 to Treasury setting out responses from accounting firms to an informal AICD questionnaire are enclosed.

The AICD believes the responses to our questions justify the AICD's position that there is a need for some form of relief in relation to the transition to international accounting standards for smaller companies.

The form of relief that would most help smaller, especially unlisted companies is more problematic. The feedback we received indicates that

exempting these companies from the requirement to provide comparatives, a solution previously explored by the AICD, will be of limited assistance in that the bulk of the work required will take place before the production of comparative figures. However the AICD believes that Treasury and regulators should work with industry to alleviate the genuine concerns of smaller companies about the transition to international accounting standards.

The AICD would be pleased to appear before the Committee to answer any questions on its Submission.

Please do not hesitate to contact me or Rob Elliott should you have any questions about the submission.

Yours sincerely,

Ralph Evans  
Chief Executive Officer



AUSTRALIAN  
INSTITUTE OF  
COMPANY  
DIRECTORS

ABN 11 008 484 197

*Professionalism in Directorship*

## **Discussion Paper**

# **Transitional arrangements for smaller companies in relation to International Financial Reporting Standards**

**8 September 2004**

## **Australian Institute of Company Directors**

Australian Institute of Company Directors (AICD) is the peak organisation representing the interests of company directors in Australia. Current membership is over 19,000, drawn from large and small organisations, across all industries, and from private, public and the not-for-profit sectors. Membership is on an individual, as opposed to a corporate basis.

Australian Institute of Company Directors has several national policy committees and task forces, focusing on issues such as law, reporting, corporate governance and national education.

The key functions of AICD are:

- to promote excellence in director's performance through education and professional development
- to initiate research and formulate policies that facilitate improved director performance
- to provide timely, relevant and targeted information and support services to members and, where appropriate, government and the community
- to maintain a member's code of professional and ethical conduct
- to uphold the free enterprise system
- to represent the views and interests of directors to government, regulatory bodies and the community
- to develop strategic alliances with relevant organisations domestically and internationally to further the objectives of AICD.

## **Background to the issue**

Australian Institute of Company Directors has historically supported the introduction of International Financial Reporting Standards (IFRS). This has always been on the proviso that their introduction is in the best interests of the Australian economy and that introducing IFRS does not result in Australia having accounting standards of lesser quality. Australian Institute of Company Directors remains supportive of the transition to IFRS but is concerned to ensure that the transition to IFRS occurs in a manner that does not discredit the process or disrupt the orderliness of the Australian capital markets.

Australian Institute of Company Directors believes that larger companies, especially those who raise or plan to raise capital in overseas markets are well on the way to making the transition to IFRS on 1 January 2005. However, anecdotal evidence from AICD's membership and recent evidence from surveys conducted by the Institute of Chartered Accountants in Australia (ICAA) and the Australian Prudential Regulation Authority indicates that smaller listed companies and unlisted reporting entities are less well prepared for the transition. For the range of reasons discussed below AICD believes it is appropriate to find some method of relieving the burden of transition to IFRS for smaller listed companies and unlisted reporting entities. Australian Institute of Company Directors further believes that other stakeholders would support this proposal.

Australia is unusual in that while there are a comparatively large number of listed companies for the size of the market the companies at the lower end of the market have relatively low capitalisation. There are also somewhere between 20,000 and 25,000 unlisted reporting entities in the Australian market which are affected by the transition to IFRS. It is these smaller companies, who will bear the greatest relative burden on transition to IFRS. Anything that can be done to ease this burden without endangering the integrity of the markets or the acceptance of IFRS will minimise criticism of the process from this highly vocal and influential group.

Australian Institute of Company Directors has prepared this Discussion Paper to canvass the issues involved and to suggest possible solutions.

## **Specific difficulties for smaller companies**

Smaller companies are at a greater disadvantage in moving to IFRS than larger companies because:

- Smaller companies do not usually have the internal resources available to manage the implementation and will have to seek outside advice at a time when the larger accounting firms, which have significant expertise in this area, are deluged with requests for assistance
- Recent ASIC announcements suggest that companies will not be able to use their audit firm for IFRS implementation which will force these companies to enter into a relationship with another firm of advisers involving delay and

inconvenience – this significantly disadvantages companies in rural and regional Australia

- If smaller companies are able to find appropriate professional advice they will still need to find the financial resources to pay for this advice which will be a drain on their already limited resources
- Smaller Australian companies are at a disadvantage compared to their international competitors because IFRS will apply to all listed companies and unlisted reporting entities in Australia – in Europe IFRS will only apply to listed companies. New Zealand which is a comparable market to Australia in size and character is not making the transition to IFRS until 2007
- Recent surveys conducted by the Institute of Chartered Accountants in Australia and the Australian Prudential Regulation Authority show that whilst larger Australian companies are well prepared for IFRS smaller companies are not – practically speaking there is a risk that large companies will manage the transition to IFRS well and small companies will manage the transition poorly. This is not a good situation for corporate Australia, given that Australia is one of the first countries in the world to make the transition to IFRS
- Historically Australian companies have not been required to implement new standards in the year they are introduced – Australian companies are now faced with the dual pressure of the introduction and implementation of new standards in the same year. This is unprecedented. What is different on this occasion is that for a number of the IFRS standards the past has to be re-stated as if the new standards had always applied. It is the cost of “restatement of the past” that will fall heaviest on smaller companies
- In addition to the transition to IFRS Australian listed companies are in the process of completing the first year of their implementation of the Australian Stock Exchange Corporate Governance Council’s “Principles of Good Corporate Governance and Best Practice Recommendations” (ASX Principles) as well as the enhanced auditor independence and other requirements under the CLERP 9 legislation. Anecdotal evidence indicates that smaller companies have not yet made disclosures under AASB 1047 “Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards” (AASB 1047) because they have been pre-occupied by the ASX Principles and the current year’s reporting. The degree of “regulatory shock” for Australian companies at the current time is considerable
- One of the stated benefits of implementing IFRS is giving Australian companies easier access to international capital markets – this is not a benefit flowing to the majority of smaller Australian companies, especially unlisted reporting entities who will be involved in significant expense and trouble for no corresponding benefit
- The practical difficulties of implementing IFRS for smaller companies are only emerging as these companies begin the work involved in moving to IFRS. The key difficulties will revolved around the level of companies understanding of the intricacies of the standards, particularly relating to financial instruments and impairment, for example, the impairment requirements of IAS “Financial Instruments” (IAS 39) apply to trade receivables and provisions for doubtful debts. A further example of an issue that has emerged is that of dividends. Under the current Australian law companies are only permitted to pay dividends out of profits, or retained profits. The introduction of IFRS may require some companies to make large

write downs of assets such as intangible assets. These write downs could potentially eliminate any retained profits, or indeed result in negative retained profits without any change to the fundamental performance of the underlying business, or the company's cash position, because the write downs are not "cash" transactions but are book entries. Under the existing Australian law, companies that fall into this category would then be severely restricted in their ability to pay dividends. This could potentially apply to well run, profitable Australian companies, with a track record of dividend payments

- Despite the best efforts of the Australian Accounting Standards Board (AASB) there have been significant delays with the issue of the final versions of IFRS. The final version of the "stable platform" was only available on 27 July 2004
- Despite the fact that the "stable platform" is now in place there are a number of outstanding issues regarding some of the new international standards, for example, IAS 39 on financial instruments and the basis of "grandfathering" of exploration costs for mining companies on which the International Accounting Standards Board is currently consulting
- The first time adoption date for IAS 39 and 32 will be for financial years commencing on or after 1 January 2005. Accordingly, the IFRS comparative financial statements may not be meaningful where IAS 39 and 32 have a significant impact on the measurement and reporting of financial assets and liabilities. IAS 39 is relevant to a much wider group of companies than financial institutions. Examples of companies to whom it is relevant include mining companies with hedging arrangements in place
- The Urgent Issues Group is still in the process of updating a number of its interpretations and is unlikely to complete to process before that transition date of 1 January 2005

## **Suggested solutions**

### **Relief for smaller listed companies and unlisted reporting entities from the requirement to provide comparatives under IFRS**

- Allowing the transition date to IFRS to be moved 12 months could provide relief for this group. For example, for a December balancing company the date of transition to IFRS would be 1 January 2005 rather than 1 January 2004. The previous AGAAP comparative information for 2004 would be disclosed
- This solution would dispense with the need for companies to run two systems, to prepare accounts under both the Australian and international standards and the need for companies to prepare and audit the comparatives. A reconciliation of the adjustments required on first time adoption would be required to be prepared and audited
- Alternatively, relief for this group could be provided by an exemption for these companies from the requirement to provide comparatives in the first year of the introduction of IFRS
- Whilst this may mean that those companies would not be IFRS compliant in the first year, companies for whom this is an issue are highly likely to prepare comparatives
- This solution has the benefit of "self correcting" after the first year in that companies will provide comparatives one year later than previously

contemplated. December balancing companies will have “caught up” by 1 January 2006 and June balancing companies by 30 June 2006

- Investors will still be able to make comparisons between pre and post IFRS numbers because of AASB 1047 and AASB 1 which requires companies to make a detailed reconciliation between pre and post IFRS numbers. The AASB 1047 disclosures require companies to make estimates based on materiality whilst AASB 1 requires the detailed comparison between the two sets of financials
- This solution would dispense with the need for companies to have an audit of the numbers prepared under the current system, the comparatives and the reconciliation between the two sets of numbers
- Under this proposal companies would prepare accounts for 2004/2005 under Australian GAAP and would then prepare a reconciliation to the opening IFRS numbers. The companies’ auditors would then audit the reconciliation to the opening IFRS numbers. This would be less involved process than that currently contemplated which would involve an audit of the comparatives
- Relief should be extended to listed companies below the Top 300 listed companies which would mirror the requirement for audit committees under the ASX Principles
- The relief should also extend to the large number of unlisted reporting entities
- IAS 39 which has dispensed with the requirement for comparatives provides a precedent for the relief being sought
- There is increasing international recognition of the burden that recent legislative and other changes are placing on smaller companies. For example, recent press reports indicate that the United States Securities and Exchange Commission (SEC) is taking note of the increased burden on smaller public companies of rules stemming from the 2002 Sarbanes-Oxley Act. Donald Nicolaisen, the SEC Chief Accountant has been quoted as supporting giving smaller companies another year to prepare for expensing stock options and the requirement that involves companies reviewing the effectiveness of their internal controls over financial reporting
- The proposed relief proposed would not disadvantage users of financial reports.

### **Introduce a standard form reporting template for complying with AASB 1047 for smaller listed companies for IFRS changes**

- Another measure that would assist smaller listed companies would be some form of template for companies to report under AASB 1047 on the changes to their actual numbers on moving to IFRS, as opposed to a narrative description of the material changes to the numbers
- This template is suggested on the basis that companies will need to determine their opening balances and the presentation of the numbers is likely to as, if not more, time consuming than preparing the actual calculations
- Arguably smaller listed companies will be able to provide financial reports in accordance with IFRS, however the one-off reporting of transitional issues in accordance with AASB 1047 has practical difficulties, as these entities need a specific reporting template in 2005 to describe and quantify the changes and then a completely new template in 2006



- Given the auditor independence issues discussed above considerable time and resources are required to determine the presentation format
- A separate standard form or template to quantify IFRS changes at 30 June 2005 would resolve many of the reporting issues for small listed companies in 2005 who would be able to leave their accounts in the AASB trilogy format, and reduce the quantification of IFRS to a simple form filling exercise

Australian Institute of Company Directors believes that extending assistance to smaller Australian companies would not put Australia out of step internationally or prejudice Australia's position as a world leader in the implementation of IFRS. Providing relief to these companies will minimise disruption to Australian business, maintain the credibility of Australian financial reporting and ensure that the Australian markets remain orderly.

23 December 2004

Ms Kerstin Wijeyewardene  
The Treasury  
Corporations and Financial Services Division  
PARKES ACT 2600

Fax 02 6263 2770

Dear Kerstin,

## **Transition to International Financial Reporting Standards (IFRS) - Issues for smaller companies**

I refer to your recent request that AICD provide some feedback from the major 4 accounting firms and some mid-tier accounting firms on the level of preparedness of smaller companies for the transition to IFRS. The aim of obtaining this feedback was to try and “flesh out” the concerns expressed by a number of our members regarding smaller companies’ transition to IFRS.

The AICD emailed the following questions to 8 mid-tier accounting firms and the four major accounting firms:

- 1. Your assessment of the level of preparedness of smaller companies for the transition to IFRS*
- 2. A rough guide to what it is costing these companies to make this transition over and above the amount they normally spend on preparing annual financial statements – either a percentage over and above their normal spend would suffice or a rough figure. For example, one Top 50 company has said it is spending A\$10million on advisers*
- 3. Whether these companies are experiencing difficulties in obtaining professional advice relating to the transition*
- 4. What are the major areas of change for these companies?*
- 5. Would it assist these companies if they did not have to provide comparatives in the first year?*
- 6. A rough guide to the costs that would be saved by granting an exemption from the requirement to provide comparatives in the first year*

7. *Anything else that might be relevant or helpful.*

Whilst it is not a good time of year to conduct this type of enquiry two of the mid-tier accounting firms and one of the “Big 4” accounting firms provided specific responses to each of the questions. A summary of these responses is enclosed. We believe the responses to our questions justify the AICD’s position that there is a need for some form of relief in relation to the transition to IFRS for smaller companies.

As you will see from the enclosed material other evidence suggests that:

- the level of preparedness of smaller companies especially unlisted companies is not high
- these companies are likely to experience difficulties as the transition date draws closer
- smaller companies will struggle to obtain the resources they need as the larger accounting firms are involved in implementing Sarbanes-Oxley, CLERP 9 and IFRS and the smaller companies may not have sought advice yet and will be “at the back of the queue” when they do seek advice.

The form of relief that would most help smaller, especially unlisted companies is more problematic. The feedback we received indicates that exempting these companies from the requirement to provide comparatives will be of limited assistance in that the bulk of the work required will take place before the production of comparative figures. However we believe that Treasury and ASIC should work with industry to alleviate what we believe are genuine concerns for smaller companies about the transition to IFRS. The AICD would be happy to be involved in this process.

The AICD believes that extending assistance to smaller Australian companies would not put Australia out of step internationally or prejudice Australia’s position as a world leader in the implementation of IFRS. Providing relief to these companies will minimise disruption to Australian business, maintain the credibility of Australian financial reporting and ensure that the Australian markets remain orderly.

If you have any questions in connection with this letter please contact Rob Elliott or Catherine Maxwell.

Yours faithfully,

**Ralph Evans**  
**Chief Executive Officer**

cc. Michael Coleman Chairman, AICD Reporting Committee