21 January 2005

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

e-mail: corporations.joint@aph.gov.au

Dear Ms Bachelard,

Re: Inquiry into the Australian Accounting Standards tabled in compliance with the *Corporations Act 2001* on 30 August and 16 November 2004

The National Institute of Accountants (NIA) is pleased to provide some remarks to the Parliamentary Joint Committee on the above inquiry. We hope that our contribution will assist the Committee members to make recommendations about this important area of law affecting capital markets. We would also be pleased to present before the Committee at any hearings it is holding on the matter.

It should be stated from the outset that our submission is confined to an analysis of aspects of implementing Australian accounting standards that have been defined as being local equivalents of International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) rather than debating the technical merits of the standards that are being implemented. The pursuit of one set of accounting standards with which companies and other entities must comply irrespective of the jurisdiction those entities reside, is a laudable objective and one supported by the NIA. Our submission will include an analysis of some emerging trends in the implementation of the new standards that are being brought to our attention by various groups within the accounting profession and the general business community that are of concern to us.

Market readiness and adopting standards

Implementation is being delayed in some cases because companies have failed to invest early enough in training and alteration of systems. This has gradually emerged over the past 12 months as it became apparent to directors and senior officers of companies outside of listed entities that changes to accounting standards are just as much a part of the regulatory "furniture" as changes that flow through from government alterations to tax law. It appears some directors and senior managers in corporations give greater weighting to changes in tax law than they do to accounting standards and as a result their ability to cope with the change. This may explain the lobbying from some groups for a delay or deferral in implementing all or part of the 2005 suite of standards for certain types of companies.

While some commentators are calling for the suspension of the deadline of adoption for all entities other than listed entities there are those that argue for relief from certain requirements in the accounting standards. One suggested form of relief is for the standard setter or some other authority to defer a requirement for the publication of comparative data in the first sets of financial statements that companies are required to do under the new standards. The NIA opposes calls for such relief for the following reasons:

- The accounting standard regulating first time adoption of Australian equivalents to International Financial Reporting Standards (IFRS) requires entities to publish both their current year and comparative figures in accordance with those new standards. The standard, which is known as AASB 1, permits companies to take advantage of some exemptions to the accounting standards in the first year of transition to IFRS equivalents in this country. It is unlikely that companies would be able to receive the benefits of those exemptions in a situation where relief from the publication of comparatives is provided. It is also unlikely the AASB would consider amending the standard because this would mean the accounting pronouncements would be out of syncronisation with those operating at the international arena.

- Provision of relief in the publication of comparatives would also mean that the deadline confirmed by the Financial Reporting Council (FRC) would be effectively meaningless for entities of a certain type. The granting of comparative relief would extend by one year the period companies that are defined as SMEs would sit outside the new accounting regime. This would appear to be inconsistent with the directive initially issued by the FRC in July 2002 and reconfirmed at FRC meetings in March and April 2004.

- It is also argued by some commentators that listed companies outside the top 300 companies on the Australian Stock Exchange and other non-listed reporting entities should be given relief from the publication of comparatives. The fact that an entity is a reporting entity under the accounting framework creates an obligation upon it to prepare general purpose financial reports that are consistent with the accounting standards of the day. A reporting entity by definition is required to comply with accounting standards for the preparation of general purpose financial reports in the public interest. It would be a breach of the accounting framework in the first instance to grant relief from certain requirements to all but those in the top tier of listed companies. Furthermore, it is unclear why those outside the top 300 listed companies should have a lesser level of accountability and transparency in relation to financial reporting than those within the top 300. Those in the larger portion of the listed market are just as much reporting entities as the top 300 and all requirements of accounting standards should be applied to them.

- Small to medium enterprises are always going to be under-resourced and will seek to delay the inevitable. In this context it is probably prudent to ensure the deadline is firmly stuck to in order to ensure companies of all sizes comply with the new body of accounting literature. It is a truism that entrepreneurs will react to emergencies rather than plan too far ahead. There is little point in delaying the implementation of IFRS at that level.

- It is argued by some commentators that the provision of relief with regard to comparatives would minimise disruption to Australian business. It would also be correct to say that the so-called disruption to business would only be transferred from the current period time to a future date and as such the argument about minimization of disruption to Australian business should be rejected.

- Contrary to the views put by some commentators the standards issued by the International Accounting Standards Board apply to all for-profit entities. The IASB does not distinguish between the size of for-profit entity. It is therefore appropriate that the deadline and the reporting requirements be supported by the NIA in this light. The European Commission, for example, is requiring listed entities to use IFRS as endorsed for European application and it is left up to individual jurisdictions to decide whether other for-profit entities should be required to apply the standards issued by the IASB for the preparation of their financial statements. The party that makes the decision is not the IASB, but the standard setters and parliamentary institutions in individual countries that are contemplating or have moved to adoption.

- A further comment has been made by commentators in relation to suggestions Australian companies that are unlisted not being required to apply the new standard on recognition and measurement of financial instruments before 2007 on the grounds that some other jurisdictions might not be doing so. It would be less than prudent to not apply a standard that fills a long-term gap in Australian accounting literature to all entities that are required to comply with the standards under the law. This approach also fails to acknowledge that all for-profit entities will have financial instruments of one description or another to account for. Just because an entity is small, unlisted or even small and listed does not mean it has any right to not account for something a large company is required to book on balance sheet or through the income statement.

- Small to medium enterprises will generally have fewer complex accounting issues when compared with larger listed entities. There are circumstances where companies will have to reshape some of their information systems to capture data for compliance with the domestic equivalents of international financial reporting standards. Feedback from practitioners appears to suggest that most SMEs will have no more than two to five adjustments to make in order to bring themselves into line with the new framework. This leads to the inevitable conclusion that the work to bring such entities into compliance with the new regime will be considerably less than for large business.

The NIA believes there are more effective ways of dealing with any problems related to the transition to Australian equivalents of IFRS. Corporate regulators such as the Australian Securities and Investments Commission (ASIC) could adopt an educative approach in the first year of implementation of the new standards and alert companies to any application errors spotted by ASIC’s reviewers. The NIA, however, would be concerned if some entities misinterpret this approach and seek to flout the spirit of the standards so ASIC should reserve the right to take any breaches of the standards that reflect aggressive accounting through its usual enforcement processes. We should expect there to be interesting interpretations of accounting standards that will need stern action on ASIC’s part.

Interpretation of accounting standards

A further implementation problem is the interpretation of accounting standards and achieving consistency in the way accounting is practiced in Australia in the first instance. There is little point in having a single set of accounting standards if the application of those standards is going to vary from entity to entity and from jurisdiction to jurisdiction because the interpretation process is flawed.

The challenges in achieving consistency should never be underestimated because of the way in which the accounting profession works in this country and others. What we are seeing develop at present is a clear stratification between the “knowledge rich” and the “knowledge poor” in the financial reporting arena and this has clear implications for the quality of service provided by the accounting profession as a whole to the Australian community. We may face inconsistencies in the application of standards and thereforfe market place uncertainty unless some action is taken to ensure that the dissemination of current accounting thought is brought about in a more efficient and timely manner. This would be an unfortunate outcome in a jurisdiction that makes accounting standards and related interpretations law that is passed by the Federal Parliament.

The Australian standard setter has no effective means to bring out all of the practical problems people face in practice. It does have a subcommittee that meets monthly to decide on appropriate interpretations known as the Urgent Issues Group (UIG). The UIG is fast losing relevance because most decisions relating to interpretations will know be dealt with by the IASB’s interpretation body, the International Financial Reporting Issues Committee (IFRIC). There is little point for the maintenance of an Australian interpretative body that has to have its work approved formally by the domestic standard setter before it is given legal status via its incorporation into what is known as a ‘service standard’. The ‘service standard’, known as AASB 1048, lists all of the interpretations and gives them legal force by reference. What we are in effect talking about is a system that makes a virtue out of double handling rather than dealing with interpretations with a ‘one-stop shop’. Any interpretations the domestic standard setter deals with should only be in circumstances that are uniquely Australian as opposed to the taking of a different view on a technical standard that would result in substantive differences between the international and domestic bodies of literature.

The standard setter must give urgent consideration to whether the UIG is the best mechanism to deal with issues emerging in the current environment. One option for the AASB is it may replace it with a new body with a charter that encourages constituents on that committee to focus on implementation challenges in a productive and co-operative manner. It should not have decision making powers, but it should serve as a consultative and early warning mechanism for practitioners and companies.

The AASB could use such a committee for advice and feedback on technical implementation as well as identifying interpretation difficulties. This would give a greater number of individuals from varying backgrounds an opportunity to identify issues as a part of ensuring an effective transition to the new body of standards is achieved. It would also allow organisations such as the accounting bodies to have more open access to the kinds of thinking the major firms are engaging in at the moment and that can only be to the benefit of the broader accounting profession and, indeed, the Australian community as a whole because there would be less risk that the interpretations would be different. Everyone would benefit through a more open discussion of these issues.

The NIA has already suggested the AASB must give consideration to establishing a body to help it identify implementation and interpretation issues. This body was advocated by the NIA in a recent media release and we are pleased that the AASB chairman, David Boymal, has agreed to strongly consider establishing such a body. The NIA stands ready to participate in any such process because we believe it is the best means to achieve cooperation between the accounting standard setter and practitioners.

Disclosure of IFRS impacts

While we have not conducted a comprehensive review of the disclosures of the impact of new accounting standards on financial statements, the examples we have read through indicate that many companies are yet to feel comfortable explaining the impacts of the standards with specific reference to the kinds of transactions or balance sheet items the changes will affect. There appears to be an unwillingness on the part of many entities to break down what are sometimes complex ideas and simplify them for shareholders and other readers of financial statements in order to make this more meaningful.

Disclosure of the impacts of the new standards on the financial statements of entities is important but corporate disclosures that are clothed in the mystique of the language of finance fail to communicate with the users of financial statements for whom it is assumed that the material is actually prepared. Shareholders deserve simpler explanations of what the changes will do to the financial statements of their companies.

Disclosure that copies the wording of accounting standards without incorporating specific descriptions of the kinds of items or transactions the company has on its books that will be affected is ineffective stakeholder communication. It is encouraging to see companies such as Telstra, ANZ Bank and Insurance Australia Group, for example, making an effort to more fully explain the impacts of the accounting standards on their balance sheet, income statement and cash flow statements to those using their financial statements and corresponding notes. More effort needs to be made by all of the participants in the capital markets to ensure companies recognise and act on the demands from stakeholder groups for material that is easily comprehended by users of varying knowledge levels.

Some of these objectives of informing shareholders about the financial position and financial performance of an entity can be achieved by a company engaging in a discourse with its stakeholders using descriptive management discussion and analysis. An accounting standard that sets down some key requirements so that there is a general consistency of approach to discussion and analysis prepared by companies would add to the effecient operation of the capital market. We note that the UK Accounting Standards Board has recently issued an exposure draft of an accounting standard on the topic and we would encourage our domestic standard setter to do the same.

Shareholders must also play a role in holding companies accountable for the quality and understandability of disclosures in financial statements and annual reports. One of the core qualitative characteristics of financial reports stated in the framework for the preparation and presentation of general purpose financial reports is understandability, which is in our view just as important for the material that lies outside the province of the audited financial statements. Financial reports might comply with accounting standards but the disclosures may well be useless to the stakeholders of a company if little time is put into simplifying the complex so a broad range of stakeholders are able to comprehend what the impact of the new accounting standards is on a company's financial reports. We would encourage shareholders to take action and demand clear explanations of disclosure in company reports if they find it difficult to understand. They are unable to adequately perform their role as a part-owner of a business if the information is presented to them in a complicated, convoluted manner. Increased pressure from shareholders and other stakeholder groups may well produce better disclosure outcomes.

Principles-based accounting standards

The NIA is concerned that there is a push in some quarters to make the international accounting standards more prescriptive and less oriented towards the contents being principle-based. We believe standard setters should be discouraged from placing detailed rules in accounting standards as such pronouncements will create the opportunity for the creation of new instruments of corporate finance that find ways around reporting the substance of transactions. Standards based on generic principles are also more likely to lead to a more faithful representation of the economics of businesses over time. Accounting standards based on principles are a better means of achieving this than are a greater body of rules or even a "true and fair" override. We are concerned that some individuals still believe a "true and fair" override is an appropriate device with which to achieve quality financial reporting.

Removal of choices available under the IFRS by the AASB

Australia's policy of tampering with IFRS by removing choices may endanger the ultimate objective of adoption of IFRS in the South East Asian region. Australia is seen as a world leader in accounting standard setting, and any domestic tampering - even for reasons that are well-intentioned, will serve as an example to countries that have a less developed accounting infrastructure.

The AASB has a stated policy of deleting options in IFRS where it believes such a deletion is in the interests of the Australian community. To date, the AASB state that there has been three instances where choices available under IFRS have been removed. These standards are:

- AASB 3 *Business Combinations*, where a scope limitation option relating to internal reconstructions was deleted;

- AASB 107 *Cash Flow Statements* where only the direct method is allowed by the AASB; and

- AASB 131 *Interests in Joint Ventures* where only the equity method is allowed to account for joint ventures.

The NIA supports and respects the right of the AASB to act as a sovereign standard setter but it has an obligation not only to this country but also to lead the region in moving to a single global set of accounting standards.

It would not serve the interests of the region if individual jurisdictions decide to follow Australia's lead and edit IFRS by removing options or making additions that affect the measurement and recognition criteria. This includes filling what are purported to be gaps in guidance where the international standard setter has scoped an area out of a standard.

The NIA understands the reasons the standard setter has made its decisions but believe it is inconsistent with the general objective of leading this region to adopting a single body of accounting standards.

There could be no worse an outcome than if other countries debating how best to implement IFRS point to Australia and take this country and its standard setter as an example of what constitutes adoption. It also runs counter to the general push by the accounting profession world wide and coordinated by the International Federation of Accountants (IFAC) to have a single body of accounting standards apply across the globe.

The IASB has an objective of removing options over a period of time and it is probably more important to allow for this natural evolution to take place for the benefit of all in the long run.

We would be pleased to answer any queries that relate to the issues raised in the correspondence above. Please feel free to contact our policy adviser – financial reporting and governance, Tom Ravlic, on 0407 408 000 for further information on issues raised in this submission. We would be happy to assist the committee in any way possible.

Kind Regards

Gavan Ord
Technical Policy Manager
National Institute of Accountants

Encl. Recent NIA Media Releases on IFRS

MEDIA RELEASE

Embargoed until 12am Monday 17 January 2005

Better disclosure on IFRS for shareholders

The National Institute of Accountants encourages all Australian listed companies to clearly explain the impact of adopting International Financial Reporting Standards (IFRS) to their shareholders.

Australian accounting standards require companies to explain the impact of moving to IFRS. While the disclosures prepared by listed companies for their accounts last year generally complied with the relevant standard (*AASB 1047)*, the NIA believes most shareholders would have some difficulty understanding what the changes mean.

It is important that listed companies remember their financial statements are general purpose financial reports.

"A primary characteristic of general purpose financial reports must be that the users for which they are intended understand what a company has done in financial terms," NIA Technical Policy Manager Gavan Ord said.

"We urge companies to make it easier for shareholders to comprehend the impact of such important changes in accounting regulation and this means providing a more shareholder-friendly disclosure document than those written by the external audit firms.

"Customising disclosure for the specific circumstances of an entity helps investors and other readers of financial statements to understand the company's operations."

Companies such as Telstra, ANZ, Insurance Australia Group and Coca Cola Amatil have already illustrated the impact of IFRS by providing examples of the kinds of balance sheet and income statement items that will be affected.

The NIA, one of three professionally recognised accounting bodies in Australia, also encourages companies that have not yet analysed the impact of IFRS to review this issue as soon as possible.

Small to medium-sized enterprises should take particular note of the accounting standards on impairment and property, plant and equipment. In some cases, they will need to create new asset registers to cope with the various accounting requirements emerging from those two standards.

About the NIA

Representing more than 13,000 members, the NIA is recognised as a leading voice for the profession through its representation on a number of peak bodies including the Financial Reporting Council, the National Tax Liaison Group, the Superannuation Industry Liaison Group and the Small Business Forum.

MEDIA RELEASE

11 January 2005

Advisory body to help implementation of new rules

The Australian Accounting Standards Board (AASB) should consider creating a technical advisory panel to help identify implementation and interpretation problems emerging out of the move to International Financial Reporting Standards (IFRS), according to the National Institute of Accountants (NIA).

The NIA, one of three professionally recognised accounting bodies in Australia, believes a technical advisory panel could provide the standard setter regular feedback on implementation concerns and emerging trends.

The advisory panel should include members from the three accounting bodies, the major accounting firms, representatives of the second tier practices, business, regulators and other interested parties to help resolve areas of uncertainty.

“We are aware that industry groups have formed discussion forums and some accounting firms are liaising with each other on interpretation and implementation matters,” NIA Technical Policy Manager Gavan Ord said.

“This is understandable in the absence of a body that could help practitioners and the AASB better communicate the concerns we have seen being articulated in the press over the past few years.

“What is needed is a forum that can provide the standard setter with an effective source of feedback on what a broad range of practitioners believe is less than clear.”

Mr Ord said it may be that the concerns are genuine interpretation problems that emerge from the accounting standards. It is also clear the new standards are also forcing people to relearn aspects of their accounting with the help of professional accounting bodies such as the NIA through professional development programs.

He said a mechanism to determine whether concerns raised by people are merely educational issues or matters requiring legislative action from a standard setter is needed.

“The challenge for practitioners is not just reading the standards but also understanding the nuances that exist within the literature,” Mr Ord said.

"Those outside the major accounting firms will not have access to that kind of thinking and a forum at which more challenging areas of implementation can be discussed by thought leaders in the accounting profession will provide a clearer idea of where the standard setter and the professional accounting bodies need to focus their efforts on education."

About the NIA

Representing more than 13,000 members, the NIA is recognised as a leading voice for the profession through its representation on a number of peak bodies including the Financial Reporting Council, the National Tax Liaison Group, the Superannuation Industry Liaison Group and the Small Business Forum.

MEDIA RELEASE

21 January 2005

Some small businesses face big challenges with new rules

The National Institute of Accountants (NIA), one of three professional bodies in Australia, has issued a warning to small businesses to ensure they become aware of the move to the International Financial Reporting Standards (IFRS) and prepare for changes when necessary.

Anecdotal evidence suggests that many companies have failed to invest early enough in training and alteration of systems which has caused delays in implementing the new rules.

This follows an online poll conducted by the NIA which revealed the majority of respondents believed companies were not ready for the introduction of IFRS on January 1, 2005. Of the 128 responses to the poll, conducted from the 15 December 2004 to 5 January 2005, 43 agreed that companies were ready and 85 believed they were not.

“Time is running out to do the work,” said NIA Chief Executive Officer Roger Cotton.

Acknowledging that resources are scarce for many small businesses, Mr Cotton urged companies to seek the advice of an accountant over their IFRS requirements. He also said providing the appropriate training for staff members will reduce the amount businesses rely on an external accountant for advice on this issue.

“Ask your accountant to explain if the new standards apply to you and if necessary, ensure you update your computer systems to cope with the changes in reporting,” he said.

“Small businesses on the acquisition trail need to understand the new requirements for accounting for goodwill. Talk to your accountants about how the new requirements for goodwill impact on the way the company will present its financial picture to the marketplace.”

19 January 2004

To the editor
Letters section
Australian Financial Review
Email: edletters@afr.com.au

To the Editor,

We note the letter by Keith Alfredson published in the Australian Financial Review on 14 January 2005 (see page 74) about the adoption of International Financial Reporting Standards. Mr Alfedson's letter raises the issue of disbanding the Urgent Issues Group on the grounds that interpretations relevant to practitioners and corporates will be developed as a general rule by the International Financial Reporting Interpretations Committee.

The National Institute of Accountants has some sympathy with the notion that is has less relevance in an environment where the accounting standards requiring interpretation, particularly with reference to for-profit entities, are being developed by the International Accounting Standards Board.

We would encourage the Australian Accounting Standards Board to review whether there are more effective ways of generating interpretations for specific domestic issues the international body is either unwilling or unable to address as a part of its upcoming review of the Board's structure and strategy.

Yours sincerely,

Roger Cotton
Chief Executive Officer