PricewaterhouseCoopers
ABN 52 780 433 757

333 Collins Street
MELBOURNE VIC 3000
GPO Box 1331L
MELBOURNE VIC 3001
DX 77 Melbourne
Australia
www.pwc.com/au
Telephone +61 3 8603 1000
Facsimile +61 3 8603 1999
Direct Phone +61 3 8603 3868
Direct Fax +61 3 8613 2308

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

28 January 2005

Dear Ms Bachelard

Re: Inquiry into Australian Accounting Standards

Thank you for the invitation to make a written submission to the Committee on its inquiry into Australian Accounting Standards. PricewaterhouseCoopers would like to make a short submission to the Committee to assist in its inquiry.

Our submission is attached. We would be pleased to appear before the Committee to elaborate on our submission. Please contact Jan McCahey on 03 8603 3868 (jan.mccahey@au.pwc.com) or Mark Johnson on 02 8266 2824 (mark.johnson@au.pwc.com) should you have any questions.

Yours sincerely

PricewaterhouseCoopers

PricewaterhouseCoopers

Jan McCahey

Jan McCahey
Partner

PRICEWATERHOUSECOOPERS

28 January 2005

Submission to Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Australian Accounting Standards

PricewaterhouseCoopers has closely reviewed the provisions of all Australian equivalents to International Financial Reporting Standards (AIFRS) in the course of making numerous submissions to the Australian Accounting Standards Board (AASB) on the exposure drafts of those standards. We do not believe these standards introduce inconsistencies with the provisions of the Corporations Act 2001 or its regulations (the Act).

It is our submission that the proposed standards will act in furtherance of the objectives of the Act as set out in Part 12, Section 224 – in particular by:
- benefiting the Australian economy
- maintaining investor confidence in the Australian economy
- facilitating higher quality financial information.

Benefits to the Australian economy

To meet the demands of global businesses and capital markets, financial reporting must be based on globally acceptable accounting standards. The Australian Parliament recognised this when it required (in Section 225 of the Act) the Financial Reporting Council to:
- further the development of a single set of accounting standards for world-wide use, and
- promote the adoption of international best practice standards in the Australian standard setting process.

The benefits of AIFRS for the Australian economy are clear. Globally accepted standards will bring increased availability of capital at lower cost. Investment is facilitated when financial comparisons can readily be made between companies in different parts of the world. Common standards also facilitate direct cross-border investment, since multinational companies have significant efficiency gains and lower compliance costs when subsidiaries in different countries report on the same accounting basis and there is no longer a need to reconcile off-shore accounting with local standards.

IFRS-compliant reports are also expected to reduce the barriers to entry to the US markets. The IASB is committed to reducing differences with US generally accepted accounting principles (GAAP) where those changes are consistent with improving the quality of financial statements. This is likely to lead to the removal of the requirement to reconcile financial statements to US

GAAP in the longer term. In the short term, the greater similarities between IFRS and US GAAP will mean that the number of reconciliation points for Australian companies listed in the US will decrease once AIFRS are adopted.

The importance of consistency with international practice

On this point, we do have some concerns about the present divergences between AIFRS and IFRS. In the Australian equivalents as they stand, there are a number of areas where there is potential for Australian practice to differ from the way IFRS is implemented globally. This may result in AIFRS being perceived as being inferior to IFRS, particularly if they cause the financial reports of Australian entities to be non-IFRS compliant.

This also poses some risk to the SEC's acceptance of IFRS-compliant statements without reconciliation. The US regulator has made it clear that it will not support the use of IFRS without reconciliation to US GAAP unless the International Accounting Standards Board (IASB), and those countries using IFRS, can show consistent application of the standards. Australia's support for the goal of a globally accepted set of accounting standards must be demonstrated by a strong practical commitment to avoiding divergence from international practice.

We do not believe that these concerns provide grounds for disallowing AIFRS as they stand, but would encourage the careful monitoring of the application of the standards to ensure consistency with international practice. We would also support a process that ensures IASB standards are adopted in Australia without modification, other than in exceptional circumstances.

Preparedness for adoption

In terms of the preparedness of Australian businesses for adopting AIFRS, our experience is that the vast majority of companies will be able to comply with AIFRS in their 31 December 2005 and 30 June 2006 annual reports and half-yearly financial reports, as required. It is now more than two years since the FRC announced the adoption of IFRS, and many companies are now well advanced in their transition programs. There are some areas where implementation issues have been identified. However, the IASB, AASB, preparers and auditors are expending considerable effort to address these issues and achieve consistent and practical implementation of the standards within the required time frame.

There have been particular concerns raised about the burden for small to medium sized entities (SMEs) complying with the new regime, as many of these entities are not operating in global markets and therefore see less benefit in having internationally comparable standards. We acknowledge these concerns. However, we would not support any proposal to retain existing Australian GAAP for SMEs.

Established Australian regulatory policy is to apply a single set of accounting standards to all Australian reporting entities. The use of consistent recognition and measurement rules increases the comparability and reliability of financial information. We do not believe it is appropriate to apply different rules to particular entities, based on arbitrary size criteria: many SMEs would prefer to use the same GAAP as their larger counterparts, and those that did not, would need to keep records in order to change to AIFRS if they ceased to be SMEs or needed to report to overseas investors.

Furthermore, the IASB and AASB are currently working on a project to address accounting for SMEs. Attention should be focused on ensuring that this project addresses the needs of SMEs, rather than introducing unnecessary complexity by allowing two sets of GAAP at this stage.

Maintaining investor confidence in the Australian economy

Public trust in capital markets has yet to be restored, despite the progress that has been made over the past couple of years toward raising governance and financial reporting standards.

The adoption of IFRS is critical to the trust-building program, internationally and in Australia. Global markets are aware that Australian standards need to be brought into line with international standards – otherwise they compromise the quality and trustworthiness of our financial reporting. The markets have been expecting this international consistency to be achieved as part of the transition to IFRS in 2005. Participants in those markets will be operating within the context of accepted international practice and divergent practices are likely to be viewed as detracting from the quality of Australian financial reporting.

Higher quality financial information

Some sectors of the business community have argued against specific requirements or standards – in particular, the rules on recognition and measurement of intangibles, hedging and financial instruments – on the grounds that the application of these rules will not provide the best picture of a company's financial position.

We do not agree that these rules will result in lower-quality reporting than present Australian practice. In our opinion, these standards provide for a greater level of disclosure, more rigorous methodologies and more accurate valuations than existing AGAAP. We acknowledge that some information on the fair value of certain types of intangibles will no longer be presented; however, companies are still able to disclose that information in the notes to the financial statements.

While there are some aspects of AIFRS which could be improved, these concerns are minor compared to the improvements that adoption of international standards will bring. The introduction of AIFRS will significantly strengthen financial reporting and corporate governance in Australia. The IASB's standards are widely recognised as a global best practice financial reporting framework, delivering high quality, relevant and comparable financial information.

In contrast, existing Australian standards have significant shortcomings. There are several important areas which are not addressed or where the prescribed treatment falls short of recognised best practice. This has the potential to allow for financial reports which do not reflect a company's true financial position. International standards provide a solution to these concerns (see Table 1 for more detail).

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Table 1: Comparison of AGAAP and IFRS in key areas

Topic	**Concern**	**IASB solution**
Financial instruments	No standard – companies are not required to recognise the impact of derivatives on their balance sheet, or may record them at amounts which don't reflect their market values.	Comprehensive standards on accounting for financial instruments require recognition at fair value.
Superannuation accounting	No standard – accounting does not always accurately reflect real exposure to defined benefit funds	Standard requires liabilities for future superannuation contributions to be recognised.
Intangible assets	No specific standard – entities may recognise and revalue intangible assets, even if there is no active market to measure the fair value against.	Standard sets out clear rules for recognition or revaluation of intangible assets
Investment property	No standard – changes in values are accounted for differently depending on the type of entity that owns the asset. Depreciation is not uniform.	Standard sets out clear rules for accounting for changes in value and for depreciation of investment property.
Income tax accounting	Deferred tax liabilities are likely to be understated.	Deferred tax balances must always be recognised for future tax consequences of past transactions or events.
Impairment of assets	Discounting of future cash flows is not required when assessing the recoverable amount of an asset. Assets may be recorded at amounts which exceed their values.	Discounted cash flows must be used.
Restoration obligations	Liabilities for restoration obligations by mining companies can be understated as they are not recognised in full at the time they arise, but spread out over a number of years.	Must be recognised up front.