Investment & Financial Services Association Ltd
ACN 080 744 163

31 January 2005

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
CANBERRA ACT 2600

Dear Dr Bachelard

Inquiry into Australian Accounting Standards

We refer to the request by the Parliamentary Joint Committee on Corporations and Financial Services for written submissions on implementation problems with the harmonisation of Australian accounting standards with International Financial Reporting Standards (**IFRS**).

Australia's funds management industry manages more than $760 billion for over nine million Australian investors, in superannuation and non-superannuation managed investments (unit trusts) and life insurance products ('**managed funds**'). IFSA represents the retail and wholesale funds management industry and has over 100 members that manage approximately 95% of the industry's funds under management.

Introduction

This submission is limited to the impact of harmonised Australian standards on the operation of managed funds. It should be noted that Australia operates the 4th largest managed funds market in the world and, in terms of funds under management, is exceeded only by the US, France and Luxemburg[1]. The US, the largest market, has not adopted IFRS[2].

IFSA members generally support the Government commitment to comparable financial reporting through the adoption and Australianisation of International Financial Reporting Standards (**IFRS**). However that commitment is given in the context of the development of a globally competitive market.

The decision to harmonise Australian standards with IFRS effectively means the adoption of IFRS as Australian law. In relation to future implementation problems, the concern of our industry is:

1. Scope of Application; and
2. Australian input and control in the formulation of IFRS.

[1] See Attachment A.

[2] The IASB and the US Financial Accounting Standards Board (FASB) issued a Memorandum of Understanding on 29 October 2002 as part of its project aimed at reducing the differences between IFRSs and US GAAP – see Attachment B.

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1. SCOPE OF APPLICATION

Given the differences in the scope of application of Australian accounting standards that have a broad application, and IFRS which applies only to listed entities, there is a need for the Australian Accounting Standards Board (**AASB**) to undertake a thorough cost-benefit analysis of proposed changes before they become part of Australian law. We note that the requirement for a cost-benefit analysis is a requirement under the current law – section 231 of the *Australian Securities and Investments Commission Act 2001* (**ASIC Act**). Australian authorities need to adopt harmonised IFRS with 'open eyes'.

As part of Australia's new harmonisation agenda, there needs to be an appropriate statutory process to ensure accountability of the standards-setters. While the main statutory objects of accounting standards[3], and the responsibilities of the AASB in formulating such standards[4], are set out in Part 12 of the ASIC Act, section 234 of the ASIC Act operates to excuse failure in the standard setting process. Section 234 provides that "a failure to comply with this Division (Division 2 of Part 12) in relation to the making of an accounting standard does not affect the validity of the standard."

While IFSA members generally support the concept of the harmonisation of accounting standards internationally, Australia should alone not be a 'testing ground' for international standards given the potential for damage to Australian industry. Australian accounting standards are broader in their application to business entities than is IFRS in European Community (**EU**) Member States. It is, therefore, essential that a thorough domestic review and cost-benefit analysis be undertaken before any particular IFRS requirements are applied to particular Australian industry sectors not likewise subject to IFRS in EU Member States.

Following the announcement that Australia would adopt Australianised IFRS from 1 January 2005, IFSA members identified a number of issues with the application of certain of the new standards[5] to unlisted managed funds. IFSA members determined that they would be faced with the introduction of measures that are deficient and would, rather than harmonise, put Australian practice at odds with that of our major international competitors. The European Funds Industry Association, FEFSI, had also identified similar difficulties to those identified in Australia. However, it was noted that IFRS would not be applied to unlisted managed funds of EU Member States until 2007, at the earliest. This we submit may explain the lack of urgency of EU Member States in determining the issues identified.

Following consultation with Government, ASIC and the AASB, the issue of ASIC Class Order relief on 22 December 2004 avoided the immediate risk of damage to the industry. However, while the relief avoided the immediate operational difficulties it has required unlisted managed funds to now maintain dual books of account - for statutory financial reporting on the one hand and, on the other hand, for operational accounting purposes in relation to asset valuation, unit pricing and other fund calculations. This, however, has resulted in Australian unlisted managed funds incurring additional costs to introduce IFRS compliant processes and systems for

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3 section 224 of the *Australian Securities and Investments Commission Act 2001*

4 Section 229 of the *Australian Securities and Investments Commission Act 2001*

5 AASB 139: *Financial Instruments: Recognition and Measurement* and AASB 132: *Financial Instrument Disclosure and Presentation*

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apparently no benefit in terms of global harmonisation. Additionally, it makes our industry less transparent to unitholders because under the new arrangement unit prices and financial statements will be determined using different pricing criteria. The use of two books, one for unit pricing and another for financial reporting, has the potential to cause investor confusion, particularly given that net assets of funds will fall to nil, and that the implied unit price in a set of financial statements will be different to the actual price investors transact at. This is exacerbated by the fact that superannuation funds will continue to account for members' funds as equity.

Although ASIC has given relief, the implementation of IFRS equivalent standards will continue to present some immediate difficulties for funds mangers and industry. The following matters have been identified:

1. It is a major problem for most fund managers to have to review every single scheme constitution for existing funds to determine whether amendments are required.
2. The decision to treat units in unlisted funds as a liability will result in the official financial statements showing net tangible assets (**NTA**) as zero. The default provisions of associated legal documents, such as mortgages or debenture trust deeds, are likely to be effected where consequences NTA is zero.
3. In some cases, the new standards interact with scheme constitutions in such a way as to affect distributions, where these are based on net accounting income, because of the requirement in Australian Accounting Standard 140 to carry revaluation gains and losses into profit and loss. Again it is a matter of finding and amending the relevant provisions.
4. There will inevitably be problems arising from having two sets of accounts. For some purposes figures in official financial statements will need to be adopted, for example, where there is inter-fund investing.

While the managed funds industry considers that there are real benefits to be gained through harmonised international standards, it considers that there can be significant competitive disadvantages in being the first to adopt and apply international standards. Particularly, where they have not been thoroughly considered in either the international or Australian domestic context. It is noteworthy in this regard that the key standards affecting managed funds (IAS 32 and 39) are currently the subject of much debate and proposed amendment, largely because listed entities in the UK and Europe are now in the process of transition and are lobbying heavily for change. Indeed, we understand that there are currently proposals with the IASB to reverse the IAS 32 requirement to reclassify unitholder funds as liabilities, and conjecture that the eventual transition of the US to IFRS will result in reverting to valuing assets at last sale rather than bid price. This means that the Australian industry (and ultimately the consumer) is currently incurring costs to comply with requirements that may revert to rules similar to existing Australian GAAP within 5 years or even less.

It is the position of industry that the structure for mandating accounting standards in Australia must require thorough analysis, consultation, consideration and review by the AASB with industry before any recommendation is made to the Parliament. This will require amendment to the law.

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2. AUSTRALIAN INPUT AND CONTROL IN THE FORMULATION OF IFRS

Commencement of IFRS in Australia is, of course, only a first step in the bedding down of Australian IFRS. Industry needs direction from Government and a greater understanding of:

- Australian involvement in the development of future accounting standards before they are introduced into Parliament; and
- the consultation process for the development of Australian/IFRS standards.

Industry must have confidence in the accounting standard setting process and, must have effective avenues of redress if accounting standards developed by the International Accounting Standards Board (**IASB**) do not satisfy aims and objectives of Australian standards as set out in Part 12 of the ASIC Act.

It is not satisfactory, as has been stated by the AASB representatives on numerous occasions in the recent past, that all problems and issues should be referred to the IASB for consideration and determination. If that be the case, the question arises as to what the future role of the AASB is if it has effectively been replaced by the IASB, a body that is not answerable to the Australian Parliament. Additionally, there are obvious difficulties in terms of distance, time zones and cost in Australian industry making effective representation to the IASB.

The IASB is described in its Mission Statement as:

> "... an independent, privately funded accounting standard-setter based in London, UK. The Board members come from nine countries and have a variety of functional backgrounds. The IASB is committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. In addition, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world."[6]

The status of the IASB as an "independent, privately funded accounting standard-setter" has given rise to concerns about its power and lack of accountability. As long as the adoption and implementation of IFRS in Australia also satisfies a domestic Australian process for accounting standards, Australia's national interest will be served. But this should not mean the slavish acceptance of IFRS.

Given the size of the Australian funds management industry, we should expect Australia to be significantly and influentially involved in the making of accounting standards that impact the managed funds industry. The move to IFRS and the growth of the global funds management industry should provide an opportunity for the development of specific funds management industry standards.

Conclusion

There are benefits for Australia in participating in the development of international financial reporting standards. However, such benefits must be assessed against costs to Australia. The single biggest issue facing the funds management industry in terms

[6] www.iasb.org/about/index.asp

of applicable accounting standards is to ensure that the standards facilitate the Australian economy by:

1) reducing the cost of capital;
2) enabling Australian entities to compete effectively overseas;
3) having accounting standards that are clearly stated and easy to understand; and
4) maintaining investor confidence.[7]

Yours sincerely

Richard Gilbert
Chief Executive Officer

[7] see section 224 of the *Australian Securities and Investments Commission Act 2001*

ATTACHMENT A

Australia passed Italy in terms of funds under management in the quarter ending 30 June 2003 to become the 4th largest Managed Funds Market in the World.

Managed Funds Net Asset by Country as at 30 June 2004	**Millions of U.S. Dollars**
US	**7,586,404**
France	**1,194,350**
Luxembourg	**1,179,035**
Australia	**531,518**
Italy	**450,463**

Domestic sources: ABS, APRA, ASSIRT and Morningstar.
International sources: Investment Company Institute (ICI) on behalf of the International Investment Funds Association.

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ATTACHMENT B

FINANCIAL ACCOUNTING STANDARDS BOARD

International Accounting Standards Board®

NEWS RELEASE 10/29/02

FASB and IASB Agree to Work Together toward Convergence of Global Accounting Standards

LONDON, United Kingdom, October 29, 2002—The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) have issued a **memorandum of understanding** marking a significant step toward formalizing their commitment to the convergence of U.S. and international accounting standards. The FASB and IASB presented the agreement to the chairs of leading national standard setters at a two-day meeting being held in London. The agreement between the FASB and IASB represents their latest commitment, following their September joint meeting, to adopt compatible, high-quality solutions to existing and future accounting issues.

The agreement follows the decisions recently reached by both Boards to add a joint short-term convergence project to their active agendas. The joint short-term convergence project will require both Boards to use their best efforts to propose changes to U.S. and international accounting standards that reflect common solutions to certain specifically identified differences. Working within each Board's due process procedures, the FASB and IASB expect to issue an Exposure Draft to address some, and perhaps all, of those identified differences by the latter part of 2003. The elimination of those differences, together with the commitment by both Boards to eliminate or reduce remaining differences through continued progress on joint projects and coordination of future work programs, will improve comparability of financial statements across national jurisdictions.

Robert H. Herz, Chairman of the FASB, commented, "The FASB is committed to working toward the goal of producing high-quality reporting standards worldwide to support healthy global capital markets. By working with the IASB on the short-term convergence project—as well as on longer-term issues—the chances of success are greatly improved. Our agreement provides a clear path forward for working together to achieve our common goal."

Hailing the agreement, Sir David Tweedie, Chairman of the IASB, remarked, "This underscores another significant step in our partnership with national standard setters to reach a truly global set of accounting standards. While we recognize that there are many challenges ahead, I am extremely confident now that we can eliminate major differences between national and international standards, and by drawing on the best of U.S. GAAP, IFRSs and other national standards, the world's capital markets will have a set of global accounting standards that investors can trust."

About the Financial Accounting Standards Board

Since 1973, the Financial Accounting Standards Board has been the designated organization in the private sector for establishing standards of financial accounting and reporting in the United States. Those standards govern the preparation of financial reports and are officially recognized as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants. Such standards are essential to the efficient functioning of the economy because investors, creditors, auditors and others rely on credible, transparent and comparable financial information. For more information about the FASB, visit its website at www.fasb.org.

About the International Accounting Standards Board

The International Accounting Standards Board, based in London, began operations in 2001 taking over from the former part-time IASC founded in 1973. It is funded by contributions from the major accounting firms, private financial institutions and industrial companies throughout the world, central and development banks and other international and professional organizations. The 14 Board members (12 of whom are full-time) reside in nine countries and have a variety of functional backgrounds. The IASB is committed to developing, in the public interest, a single set of high-quality, global accounting standards that require transparent and comparable information in general purpose financial statements. In pursuit of this objective, the IASB cooperates with national accounting standard setters to achieve convergence in accounting standards around the world. For more information about the IASB, visit its website at www.iasb.org.

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