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A Discussion on Australia's adoption of International Accounting Standards.

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Abstract:

In July 2002 the Financial Reporting Council (FRC) announced that it fully supported the adoption by Australia of the International Accounting Standards (IAS). The main, predicted, benefits of adopting the IAS were improved access to international capital flows and reduced financial reporting costs for Australian multinational companies. This announcement was in line with section 227 of the *Australian Securities and Investments Act 2001* where the Australian Accounting Standards Board (AASB) was required to participate in the development of accounting standards for worldwide use. Australian reporting entities are now required to prepare their financial statements based on the Australian Equivalents of the International Accounting Standards.

The following is a fictitious transcript of an interview, in June 2003, by Mr Kerry O'Brien from the ABC with Mr Peter Costello the Federal Treasurer of the Commonwealth of Australia.

This paper is based on an assignment designed by Ms Sandra Chapple of the University of Wollongong.

Key Words: International Accounting Standards; International Financial Reporting Standards; Financial Reporting Council; AASB; and Harmonisation

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O'Brien: Good evening Mr Costello

Costello: Good evening Kerry

O'Brien: Mr Costello tonight I would like to explore the reasons behind the move by the Liberal Government to, some may say, hijack the accounting standard setting process in the Australia. In particular I would like to discuss the relatively recent decision, July 2002, by the government controlled Financial Reporting Council (FRC) to prescribe that Australian organisations, both public and private sector organisations, adopt wholesale the International Accounting Standards (IAS) which are still being developed.

Costello: It would be a pleasure Kerry however the term 'hijack' I would suggest is quite inappropriate in today's environment.

It is true the Howard government has made significant progress in improving the financial reporting framework for Australian reporting entities including private and public sector organisations.

One of the Howard government's first crucial tasks to undertake back in 1996 was to improve the public's and the national and international markets' faith in the government's financial management processes which had been destroyed by the previous Labor governments.

When we first came in to power I initiated the Corporate Law Economic Reform Program (CLERP) with the intention of meeting three key objectives. The first objective was to develop a clear and relevant policy framework in which sound accounting standards could be developed. The second was to improve the institutional arrangements for the standard setting process so that the process operates in a responsive, efficient and effective manner and the third objective was to implement a more equitable method of funding the standard setting process.

O'Brien: Wait a minute. Your counterpart in the Opposition, Mr Crean, only last night on this program outlined that CLERP was actually a Labor government

initiative which “the Liberals have borrowed due to a lack of imagination”. Mr Crean advised that the 1999 Report on the Corporate Law Economic Reform Program Bill 1998, by the Parliamentary Joint Commission on Corporations and Securities, stated;

The Labor Government began this process with the Corporations Law Simplification Program in 1993, and the Howard Government, to its credit, has continued it under the rebadged CLERP.

Costello: Well Mr Crean would say that but let us stick to the facts. The Labor Government attempted to introduce a relatively insignificant program to simplify corporate law. This program had no substance and was really just a piece of window dressing in the vain attempt to be re-elected in 1996.

The Howard government, on the other hand, introduced in March 1997 the very significant program [CLERP] with the purpose of reducing the cost of business regulation as well as making it easier for new businesses to be established. These objectives were to be the result of reforming four key areas of the Corporations Law: Director’s Duties and Corporate Governance; Fundraising; Takeovers; and Accounting Standards.

O’Brien: Mr Costello the key reform I would like to focus on this evening is the wholesale adoption of the International Accounting Standards. Could you briefly discuss this key reform?

Costello: Thank you Kerry. There is, currently, considerable divergence between the Australian Accounting Standards and the International Accounting Standards (IAS). Given increased globalisation and the increasing role Australian companies play in the global community it was considered the best way to support the Australian economy and improve the international competitiveness of Australian businesses we align our accounting standards with the international accounting standards.

Australian businesses will benefit from the adoption of the international standards due to reduced financial reporting costs [multinational businesses] and by removing barriers to international capital flows.

Australians in general will benefit due to increased comparability of financial reports prepared in different countries, and therefore lower analyst costs, and the improved quality of financial reporting in Australia which of course would assist through providing more useful information for decision makers.

O'Brien: But aren't the current Australian accounting standards similar if not better, more comprehensive, than the proposed international accounting standards?

Costello: Kerry, the current Australian standards and standard setting process are recognised around the world of being of the highest quality, however they are different and it is imperative that we adopt the international standards. It is probably also worth noting that Australia has a representative on the International Accounting Standards Board so it is not as though Australia doesn't have some influence in creating the international accounting standards.

O'Brien: So what are the differences? Are they really that significant we need to adopt the international standards?

Costello: There are two areas of significant differences. The first relates to where Australia does not have a current accounting standard. The second area of difference is where there are no equivalents to current Australian accounting standards.

The first area of difference, where there are no current Australian accounting standards, will have the most significant impact on Australian reporting entities, especially in the areas of intangibles and recognition and measurement of financial instruments. For example the proposed international standard for intangibles IAS 38 only allows for the valuation of intangibles in an active and liquid market, therefore intangibles such as internally developed software currently measured at cost or deemed cost can no longer be shown on an organisation's financial statements. In relation to the proposed international standard for recognition and measurement of financial instruments IAS39 will require all financial assets and liabilities to be recognised.

The second difference is where there are current Australian standards which will have no international equivalent such as AAS 27, 29 and 31 which are specifically for the public sector and AASB 1022 Accounting for Extractive Industries, AASB 1023 Financial Reporting for General Insurance Activities. To address the issue of no equivalent international standards the Australian Standards will remain in force until an appropriate international equivalent is developed.

O'Brien: Mr Costello while the benefits could be debated on a number of fronts and the differences more significant than you have outlined it appears the greatest concern in relation to the adoption of the international accounting standards is about the level of influence the government has in the setting of accounting standards. This concern stems from the fact you, Mr Costello, as Treasurer appoint the members of the primary over-site board, the Financial Reporting Council (FRC), of the Australian Accounting Standards Board (AASB) as well as appointing the Chair of the AASB. There seems to be a significant lack of independence. This concern is supported, among others, by Senator Andrew Murray, from the Australian Democrats, who commented during a Parliamentary Joint Committee on Corporations and Securities in 1999 that

The process by which these appointments are made is, and is seen to be, must be transparent, accountable, open and honest.

Costello: Kerry, you are referring the role of the Treasurer having responsibility to appoint the members of the Financial Reporting Council (FRC) as well as the responsibility to appoint the Chair of the AASB. This is entirely appropriate. As the Treasurer I am accountable not only to the government but also to Parliament and the public. As reiterated numerous times by various authorities on corporate governance, including the current Commonwealth Auditor-General, the only way accountability can be properly exercised is if the person to be held accountable has control over what he or she is accountable for.

O'Brien: But surely you see there is a perception that the government has undue influence in the setting of accounting standards and that the level of openness and transparency is compromised.

Costello: Such a perception is quite unfounded. If you were to refer to the *ASIC Act 1989*, under which the FRC was established, and the *ASIC Act 2001* where it continues its operations, you will find the role of the FRC could be summarised as providing broad oversight for setting accounting standards in Australia. Indeed section 225 of the *ASIC Act 2001* outlines that the FRC does not have the ability to become involved in the technical deliberations of the AASB, nor does it have power to direct the AASB in the development of a particular standard and nor does the FRC have the power to veto a standard made or recommended by the AASB. These limitations placed on the FRC are to ensure the independence of the standard setter.

O'Brien: That appears to be a bit of a furphy. You, as Treasurer, appoint the members of the FRC and they in turn appoint the members of the AASB – except for the Chair of the AASB whom you appoint. Obviously if the members of the FRC wish to remain in their positions they would not appoint AASB members who would entertain ideas contrary to the government. The notion of independence of the AASB is eroded by the fact you directly control the appointment of the members.

The notion of independence is even further eroded because the FRC sets the AASB's priorities, its business plans, budgeting and even its staffing arrangements. The government through your department, Treasury, has financial and operational control of the FRC and in turn the AASB.

Costello: I don't agree, the AASB is significantly independent of the FRC. Firstly, as mentioned earlier, the *ASIC Act 2001* explicitly states that the FRC does not have the ability to become involved in the technical deliberations of the AASB, it can not direct the AASB to develop particular standards and even if the FRC disagrees with a particular standard it can not veto the adoption of the standard.

Also, as you know, the budgets of all government organisations go through a significantly in-depth evaluation process through the Senate Estimates. So even though the FRC sets the AASB's budget, before any money is provided the budget estimates need to go through the senate for approval.

O'Brien: So how is it possible for the AASB to be independent? The fact that current and potential government (opposition) members have the power to decide for what and how much to fund the board certainly supports the argument about the lack of independence. There doesn't appear to be any independence on the contrary the AASB seems to be highly dependent on both FRC and the Parliament.

Costello: Well we need to agree we disagree. There is specific legislation this government has enacted to ensure there is independence in the accounting standard setting process.

O'Brien: Anyway, I can see we won't be able to clarify this issue tonight.

Mr Costello, it has been suggested that the FRC is stacked mainly to suit and serve the government and the members of the FRC are basically government stooges. How do respond to this sort of suggestion?

Costello: Well Kerry it couldn't be any further from the truth. The initial membership of the FRC was a broad range of people from different backgrounds representing different stakeholders.

O'Brien: But isn't true that as Treasurer you appoint the Chairman as well as all the other members?

Costello: Well yes Kerry that is true however if you consider the mix of the FRC it is clear that the members have been selected based on ability and not on political alignment. This government is adamant that the right people are selected for specific roles rather than providing 'jobs for the boys' as the opposition has previously done.

O'Brien: What about other key stakeholders such as the accounting professions who seem to be loosing more and more control over their profession. Are the main accounting professions, ICAA, CPA Australian and NIA appropriately represented?

Costello: They certainly are, for example the Chairman is not only a director of significant corporate players such as Telstra and Westfarmers, he is also a fellow of

CPA Australia, as well as a number of other professional associations. There are also another seven members of the current FRC who are also fellows of either CPA Australia or ICAA.

O'Brien: But aren't some of these people also senior members of the public service? For example one of the members is a senior manager, a First Assistant Secretary, in the Department of Finance and Administration (DOFA). Wouldn't he be expected to support the government's policy in this regard?

Costello: No, not at all. While this member is indeed an officer working for DOFA it is important to realise that all members of the FRC act foremost based on their integrity and professionalism. That is why these people have been appointed to the FRC.

O'Brien: Another concern mentioned by various key stakeholders, such as some of the largest public listed companies, is the timing of the required adoption of the International Accounting Standards. It is been suggested there has been insufficient time for organisations to properly prepare themselves for the new requirements.

Costello: I don't agree and I think if you went to the boards and senior management of these organisations and discussed this issue in private you find almost unanimous support for the adoption of the international accounting standards by January 2005.

Kerry, we found this out through high level of consultations with key stakeholders. The Chairman of the FRC had numerous formal meetings with the senior management of the ten top publicly listed companies; the national presidents of the three professional accounting bodies; and the CEO of the AXS (Australian Stock Exchange). I have also been involved in various formal meetings as has the Shadow Minister for Finance.

O'Brien: What about other stakeholders such as the community in general, surely they are as important, if not more important than public organisations and the accounting profession. Have you or the FRC consulted with them?

Costello: Not only have I and the Chairman consulted widely within the community the Chairman has also appeared before the Senate Economics Legislation Committee. As you well know these senate committees offer the Senators, both government and non-government, who represent the community to explore as deeply as they like into any issues the committee believes is necessary.

Indeed all members of the FRC have actively consulted with huge numbers of people and groups to find out exactly what organisations and the community really need.

O'Brien: That is all well and good but why has the government endorsed the recommendation of the FRC to adopt wholesale the International Accounting Standards from the 1st January 2005? Is there any logical reason why this date has been selected or has this date just been plucked out of the air?

Costello: Kerry as you would be aware this government does not make such important decisions without giving considerable thought to the possible implications.

The FRC, which was established under CLERP, has the responsibility to oversee, but not develop, the setting of accounting standards as well as appoint the members of the new accounting standard setting board (AASB). It is the new independent board (AASB) which will prepare, approve and issue accounting standards for both private and public sectors.

Based on consultations with various national groups such as the ASX, ASIC, CPA Australia, ICAA and international groups such as the International Federation of Accountants and the International Accounting Standards Committee the FRC has recommended that Australia adopt the accounting standards issued by the International Accounting Standards Board (IASB) from 1st January 2005.

This adoption will require reporting entities under the *Corporations Act 2001* to prepare their financial statements in accordance with IASB standards for accounting periods beginning on or after 1st January 2005.

This wholesale adoption will be a real bonus for Australian corporations and indeed the Australian public. It means that our corporations will be able to overcome some of the economic barriers that currently inhibit them from operating effectively in foreign countries such as the UK and France.

O'Brien: But you haven't answered my question. Why the 1st of January 2005?

Costello: The 1st of January 2005 was chosen for two specific reasons.

Firstly, the IASB has a timeframe to complete and amend all necessary standards so that they are appropriate and applicable without causing unnecessary hardship or difficulties. This work is scheduled to conclude by early to mid 2004. By Australia adopting these standards in early January it will ensure that Australian companies are on the front foot when the economic barriers to foreign competition are decreased.

Secondly, it has been noted that there are currently a number of gaps in Australia's set of accounting standards which the IAS will address. By adopting the IAS as soon as is reasonably possible will help not only accountants but also the financial community (including mum and dad investors) at large.

Kerry, it should be noted the government actually wanted the adoption to be earlier than the 1st January 2005, however after consultation with the FRC, International Accounting Standards Board and the AASB it was determined earlier adoption would not be appropriate.

O'Brien: It has been put forward that the main reason we are adopting these standards is because the European Union will be adopting the same standards on the 1st January 2005. What is the relevance of the European adoption of the IAS in relation to Australia adopting the standards completely?

Costello: That is a very good question. Firstly, the decision to adopt the IAS was not based on the decision of the European Union. They, the EU, are in a different position to Australia and the implementation of the IAS in Europe will be slightly different to Australia. For example in Australia all reporting entities will be required

to follow the new IAS whereas only certain groups in Europe must follow the standards initially.

Going back to your question on the timing of the adoption of the IAS, by adopting them at the same time as Europe Australian organisations will be able operate more effectively and efficiently in the European market. I suppose it is much like having a camera phone, it is only truly useful when others also have a camera phone.

Kerry, it is important to note that reporting entities aren't going into the adoption on 1st January blind. For example AASB 1 First-Time Adoption of Australian Equivalents to International Financial Reporting Standards, which explicitly outlines the requirements of reporting entities under the international accounting standards, is currently being developed. This standard is due for release around July 2004.

Obviously with such an important change it necessary for there to be a specific transition process. To assist in the transition the AASB has released the standard AASB 1047, which requires reporting entities in 2003-04 to disclose in their financial reports how the transition is being managed and the key differences in their accounting policies arising from the adoption of the IAS. The AASB 1047 also requires, in 2004-05, reporting entities to disclose any known or to reliably estimate information about the impacts on the financial report, had it been prepared using the IAS.

During this transition period reporting entities have the opportunity to identify areas of concern and address them fully before 1st January 2005.

O'Brien: Mr Costello, you mentioned that all reporting entities will need to adopt the IAS. How about the public sector? How are they progressing?

Costello: The Howard government believes there is a high degree of commonality between the private and public sectors and as such the IAS's accounting framework and standards would apply to both sectors. There are of course some minor differences and where there are differences or a particular IAS is not relevant the AASB will examine the situations individually.

The public sector has been fully prepared and briefed on this transition due in no small part to the Australian National Audit Office (ANAO). However while the current Auditor-General believes the degree of the changes will differ from entity to entity depending on their business and financial statements each entity will need to individually review the changes that will arise from harmonisation with the IAS and assess how they will impact upon them. AASB 1 and 1047 will be of particular value.

O'Brien: What about the US? The Howard government has just signed a Free Trade Agreement (FTA) with the US yet they, the US, aren't going to adopt these standards. Doesn't that seem a little counter productive when you consider the much talked about importance of the relationship between ourselves and America.

Costello: You are quite right Kerry. The new FTA is a wonderful opportunity for Australia and Australian businesses. However, it is wrong to consider that even though the US is not directly adopting the standards at this point in time, they are and have been for quite some time preparing to move along the lines of IASB.

For example the Chairman of the International Accounting Standards Board (IASB) Sir David Tweedie recently advised that the IASB and the US Financial Accounting Standards Board (FASB) are undertaking a convergence program to more closely align US GAAP with the IAS.

It is important to note that in September 2002 there was a Memorandum of Understanding agreed between the IASB and US's FASB, The Norwalk Agreement, where the IASB and FASB are working towards eliminating the differences between the US's generally accepted accounting principles (GAAP) and the IASB's International Accounting Standards.

One of the new key IAS has actually been developed based on the existing US 'Financial Instruments' accounting standard. And I might add this has been a 12 year process. So obviously Australia adopting the IAS is actually a move closer to the current US GAAP.

O'Brien: I suppose time will tell whether the objectives identified for the adoption of the international accounting standards will be achieved. I look forward to discussing this issue with you again once the standards have been adopted. Mr Costello, thank you for your time.

Costello: As always Kerry it has been a pleasure.

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Biographical Information:

I am currently a PhD Candidate from the University of Wollongong in the School of Accounting and Finance. This article is a revision of an assignment I completed during the course work component of the Masters of Research from which I transferred to a PhD in late 2005. I have presented a number of conference papers during my candidature, primarily on public sector accountability.