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FORUM : INTERNATIONAL STANDARDS

THE FRC AND ACCOUNTING STANDARD-SETTING: SHOULD I STILL CALL AUSTRALIA HOME?

This paper analyses the decision of the Financial Reporting Council (FRC) to replace Australian accounting standards with international accounting standards on 1 January, 2005. Two main topics are considered: the appropriateness of the FRC's directive, and the case against the proposed adoption date. We argue that the FRC has not conducted sufficient consultation with affected parties and that the hasty implementation will impose costs that could have been avoided with the exercise of more caution.

In recent years, Australian accounting standards have been developed by the Australian Accounting Standards Board (AASB) under the oversight of the Financial Reporting Council (FRC). At its 28 June 2002 meeting, the FRC decreed that "from 1 January 2005, the accounting standards applicable to reporting entities under the [Corporations] Act will be the standards issued by the International Accounting Standards Board (IASB). After that date, audit reports will refer to companies' compliance with IASB standards" (FRC 2002a). Although this is not the first time that wholesale adoption of International Financial Reporting Standards (IFRSs) has been proposed for Australia (Treasury 1997), the FRC's status makes it likely that Australian accounting standards (AASBs) will be replaced by IFRSs. Indeed, the FRC's chairman, Jeff Lucy, has been reported as saying: "This is the biggest change to accounting standards ever" (Buffini 2002b).

We review this decision and urge caution on the part of accounting regulators. It is argued, *inter alia*, that the FRC's edict has not been subject to adequate due process and that the 1 January 2005 deadline fails to allow adequate time to resolve myriad institutional and implementation problems associated with the adoption of IFRSs. There is a strong demand for a global set of accounting standards but the FRC does not appear to have considered adequately the implications of allowing Australian financial reporting practices to be determined by a foreign private-sector body. The decision process was better handled by the European Union, which undertook an extensive and public consultation process (European Commission 2000, European Parliament 2002a).

BACKGROUND TO THE FRC'S EDICT

In 1997 the treasurer issued CLERP 1 (Treasury 1997), which proposed the reorganisation of accounting standard-setting in Australia. The outcome was the reconstitution of the AASB and the establishment

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of its oversight body, the FRC. At that time, CLERP 1 proposed: "From 1 January 1999, the AASC[1] should issue identical exposure drafts of standards for public comment to those issued by the IASC[2] with the objective that final standards issued by the AASC would be consistent with Australian law and be the same as those issued by the IASC, unless the Government, upon advice from the FRC, determines that to do so would not be in Australia's best interests" (Treasury 1997). This proposal generated a lively debate[3] but was eventually modified (Stoddart 2000)[4] to one in which the FRC and AASB would work to ensure that AASBs were consistent with IFRSs, although an AASB might have additional disclosures or a reduced set of acceptable alternative accounting policies (Howieson 1997).

The AASB's harmonisation policy was revised with the reissue in April 2002 of PS 4 *International Convergence and Harmonisation Policy* (AASB 2002b). The AASB indicates in PS 4 that it intended to pursue both "international convergence" and "international harmonisation". The former refers to cooperation with other standard-setters towards the eventual development of a single set of accounting standards for worldwide use, and the latter refers to the aim of making AASBs "compatible" with IFRSs. Paragraphs 5 and 6 of PS 4 describe the AASB's objectives and include the aim of working towards a single set of international accounting standards. However, consistent with prior AASB policy, PS 4 states:

"A single set of internationally accepted accounting standards is not likely to be achievable in the short term. Accordingly, the AASB's international harmonisation objective is to work towards the development of accounting standards in Australia that harmonise with IFRS and International Public Sector Accounting Standards (IPSAS) issued by the PSC,[5] where the AASB concludes that such standards are likely to be in the best interests of both the private and public sectors in the Australian economy. Where IFRS and/or IPSAS are considered by the AASB to not represent best international practice, the interim objective is to work towards adopting standards that are considered by the AASB to be best international practice and to endeavour to influence the deliberations of the IASB and the PSC to adopt what the AASB considers to be best international practice" (para. 6).

The FRC endorsed this policy at its 22 March meeting, but the policy was unilaterally changed at its 28 June meeting to the wholesale adoption of IFRSs.[6] Why might the FRC have changed its position on harmonisation?

SOME COMMENTATORS HAVE ARGUED THAT US ACCOUNTING STANDARDS ARE DRIVEN TOO MUCH BY "RULES" RATHER THAN BROAD "PRINCIPLES" AND THIS ALLOWS UNSCRUPULOUS MANAGEMENT TO COMMIT LARGE-SCALE FRAUD.

We offer some possible explanations. First, in its *Bulletin* 2002/4 the FRC said the choice of 1 January 2005 was driven by the European Union's (EU) decision that IFRSs be used by EU-listed companies from that date. In early June 2002 the Council of Ministers of the EU approved a draft regulation requiring listed companies "to prepare their consolidated accounts in accordance with International Accounting Standards (IAS) from 2005 onwards" (European Commission 2002). The EU Commission can, on advice of the Accounting Regulatory Committee (ARC), adopt IFRSs. The ARC is advised by a private-sector body, the European Financial Reporting Advisory Group (EFRAG). On 19 June 2002, EFRAG recommended the "endorsement of the current standards[7] 'en bloc'" (EFRAG 2002).

A second reason for the FRC's about-face may be a response to the recent spate of high-profile corporate collapses in the US which, as noted by Haswell and McKinnon (2003), has seriously damaged the alleged superiority of US GAAP.[8] Some commentators have argued that US accounting standards are driven too much by "rules" rather than broad "principles" and this allows unscrupulous management to commit large-scale fraud such as that in the WorldCom and Enron cases (Daniel and Parker 2002, Garcia 2002). IFRS, it is argued, are "principle-based" and so can help reduce fraud. The Australian financial reporting framework also relies on general principles rather than a rulebook approach. Accordingly, the desirability of a principle-based rather than rule-based financial reporting framework is, of itself, no reason for Australia to adopt IFRSs.

A third factor likely to have influenced the FRC was the announcement on 12 June 2002 by Senator Ian Campbell that $2 million would be made available over two years to the IASB to assist it in developing a set of global accounting standards. The FRC has reportedly embarked on a further drive to raise $1

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million a year for three years for the IASB from large listed companies (Walters 2002, Fenton-Jones 2002), as the IASB's efforts were "without much success". At the same time, additional funding of $100,000 a year for the AASB was being sought from companies (Ravlic 2002b). Minutes of the FRC's 5 September 2002 meeting indicate that there had been an "encouraging" response. However, the FRC chairman's letter of December 2002 to the ASX states: 'While we have received significant contributions and commitments to date, the rate of response has been slow and indications are that we will fall short of our target of $750,000 annually for three years" (Ravlic 2003b). The parties involved in these fundraising activities more broadly reflect underlying political agendas associated with the harmonisation objective. For instance, Senator Campbell's involvement is consistent with the objectives of the federal government, as noted by Haswell and McKinnon (2003), to promote the adoption of IASB standards in Australia (see Treasury 1997, 2002). They also illustrate the close working relationship described by Stoddard (2000) between the Australian Stock Exchange (ASX) and the government to achieve harmonisation.[9]

The FRC also repeated some earlier arguments for the adoption of IFRSs, namely that they "will greatly facilitate cross-border comparisons by investors, reduce the cost of capital, and assist Australian companies wishing to raise capital or list overseas" (FRC 2002a). Interestingly, many of these advantages appear to be primarily directed to the large corporations rather than to other types of entities or the users of financial reports, an argument which was previously made when the wholesale adoption of IFRSs was first proposed in 1997 (Collett *et al* 1998).

CLERP 9: *Da capo* – the same story from the same people?

In September 2002, CLERP 9 *Corporate Disclosure: Strengthening the Financial Reporting Framework* was published by the Treasury (2002) under the auspice of Senator Campbell. Part 6 of CLERP 9 deals with accounting standards, in particular the adopting of IFRSs by 2005:

"Proposal 14 – Adoption by Australia of IASB accounting standards by 2005

"Australia will adopt accounting standards issued by the International Accounting Standards Board (IASB) for reporting entities under the law for accounting periods beginning on or after 1 January 2005, in line with the European timetable . . . The FRC and the AASB will consult stakeholders on the measures that they regard as necessary between now and 2005 to ensure a smooth transition to IASB standards."

This proposal is most peculiar, since the decision had already been made by the FRC. On page 104 of CLERP 9 it is stated that the FRC's decision is consistent with the government's long-standing policy under CLERP 1 and that the government "fully supports" the timetable. This is hardly surprising, given the overlap between the FRC secretariat and those involved in drafting CLERP 9.[10]

Concerns about the FRC's edict

Our concerns about the FRC's action fall into three broad categories. The first category questions the timing of Australia's adoption of IFRSs (coordination with EU adoption) while the second identifies questions about the propriety of the FRC's decree. The third category relates to a multitude of questions about whether the wholesale adoption of IFRSs is in Australia's best interests and about the implementation issues to be addressed. This latter set of questions has been well reviewed and we do not intend to repeat them here. However, there have been significant developments in the general acceptability of IFRSs since the 1997 debate and so some matters need to be revisited.

Whatever the relative merits of AASBs and IFRSs, the decision has been poorly handled by the FRC. The failure to articulate the role, if any, of the AASBs in the lead-up to 2005 and beyond, and the process by which IFRSs will become mandatory, suggests that the FRC made an in-principle decision without a full consideration of its implications. CLERP 9, Proposal 14, "requires" the AASB and FRC to consult stakeholders in determining the measures necessary to ensure a smooth transition: "The FRC and AASB have particular responsibilities for ensuring that a strategy for adoption is developed and communicated to stakeholders at an early stage, and that stakeholders are kept fully informed of progress. The accounting bodies also have a key contribution to make through their programs of professional development and their influence on accounting education" (Treasury 2002, p. 105). This is one of the most critical aspects for effective implementation.

Doing "the Continental"

A false analogy – Australia is not the EU

The FRC and other supporters of *en bloc* adoption of IFRSs place much reliance on the decision of the EU to adopt IFRSs. There is one critical difference: the EU decision extends only to listed entities, whereas the FRC's decision will apply to all reporting entities.[11] Many supporters of *en bloc* adoption do not understand the significance of the distinction between (a) the adoption of individual IFRSs by the EU Commission (which creates the obligation to comply) and (b) their full implementation (including the enforcement mechanism) under the domestic law of the EU member states. Thus while the EU Commission is not constrained by considerations of interpretation and enforcement, member states must deal with these complex issues. Also, it is assumed that a decision by the EU, which currently has no mandatory accounting standards, should be equated to the decision made by Australia which has a relatively comprehensive set of mandatory accounting standards. One major reason for the EU decision is to harmonise financial reporting practices within the EU. While the 4th and 7th EU Directives, through their

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adoption by legislation in each of the member states, put in place a general framework for financial reporting, it does not represent a uniform set of accounting standards such as those in found in Australia and many other countries. Most member states have no legislatively binding GAAP.[12] Indeed, for listed entities, there can be a choice of GAAP – for example, domestic GAAP, IASB GAAP or US GAAP. Thus, while international harmonisation is one of the objectives underlying the EU's move, "internal" harmonisation seems to be equally important, if not more important.

Is the EU ready for IFRSs?

In the EU the 2005 implementation date has been in the public arena for some time, but concerns have been widely expressed about whether all listed EU companies will be prepared in time. In a recent survey of 650 EU chief financial officers "more than 60 per cent of companies have yet to start transition planning from national to international standards, although 93% of the CFOs thought that they would be ready on time" (Bingham 2002). However, only 15% of the companies had implemented IFRSs at the time of the survey.[13] The state of preparedness also varies across countries. For instance, just under half of major Portuguese companies are not expected to be fully compliant with IFRSs by 2005 (Dow Jones Newswires 2002).

A number of implementation issues have been identified, not the least being issues of translating the IFRSs (and their interpretations) into the relevant language of each member country (Fearnley and Loft 2002). As the EU discovered when it translated the term "a true and fair view" for use in its 4th Directive, the meaning of the expression was not easily transferable to other countries within the EU (Chastney 1975). Dealing with the intricacies of ensuring a common understanding across languages may take time and opens up the opportunity for an accounting rule to be interpreted and implemented in different ways across countries. Further, most EU members still need to change their own laws to facilitate the implementation of the EU regulation, but concern has been expressed whether this will be done in time (Stewart 2002). Consequently, the 1 January 2005 start date is ambitious for the EU, let alone Australia. Although synchronising Australian adoption of IFRSs with the EU may be a major factor behind the FRC's edict, these implementation issues suggest that Australia probably does not need to rush the change to IFRSs. The rules need to be finalised at least a year before the implementation date, so that comparative amounts can be determined (Abernethy 2002, Treasury 2002).

The process adopted by the EU is different from that proposed by the FRC. The EU Commission, on advice of the ARC, will determine the acceptability and applicability of each IFRS (European Parliament 2002a). In doing so, due regard must be given to meeting the qualitative standard for financial reporting – the true and fair view – and the "understandability, relevance, reliability and comparability" of the resulting financial information. Under the regulations, IFRSs include both standards and interpretations (European Parliament 2002b). Although Article 4 requires companies in member states to "prepare their consolidated accounts in conformity with international accounting standards adopted [by the EU Commission]", the regulations do not deal with compliance. Paragraph (16) of the preamble to the draft regulations states, in part, that "Member States, by virtue of Article 10 of the Treaty [of Rome], are required to take appropriate measures to ensure compliance with international accounting standards". Since enforcement depends on the interpretation of the standards, presumably these provisions will include interpretation rules applying to IFRSs. Thus, although adopted IFRSs are to be published by the EU Commission (European Parliament 2002a), the direct obligation to comply with them, and the sanction for non-compliance, will arise under laws made by the various member states. Such laws will be quite complex; hence the desirability of a cooperative development of a common enforcement approach (European Parliament 2002b).

Has the FRC acted appropriately?

Lack of due process?

Significant concerns must be raised about the manner in which the FRC developed and issued its edict. Although CPA Australia has claimed that the FRC has taken "a responsible approach to the ongoing need to achieve international convergence of standards" (CPA Australia 2002), other commentators have condemned the lack of due process and consultation by the FRC. In a letter to *The Australian Financial Review,* Parker (2002) states:

"The Financial Reporting Council's 2005 position lacks substantiation. There was no due process, there was not a regulatory impact statement identifying costs, benefits and options.

"The AASB makes its deliberations in public; the council does not, as is evident with its 2005 decision.

"Intriguingly, in May, the FRC endorsed the AASB revised Policy Statement 4 *International Convergence and Harmonisation Policy* that was developed through due process. That policy did not canvass the adoption of international accounting standards by January 1, 2005. The FRC "decree" trumps that policy statement. It appears that the AASB was not even consulted on the fundamental change in direction of standard-setting.

"In an environment where the Federal Government trumpets transparency, accountability and consultation under CLERP 9, such lofty ideals are not pursued by its own creature, the Financial Reporting Council."

Other critics (Bernhardt 2002, Ravlic 2002a) have made similar strong comments.

The FRC claims that its decision "was taken following extensive consultation with stakeholders regarding the European union decision to embrace IASB standards by the same date" (Financial Reporting Council 2002b). These stakeholders are not identified.[14] The process is shrouded in a level of secrecy

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that calls its integrity into doubt. The failure to engage in generally acceptable due process in making this decision is extremely unfortunate.

Has the FRC acted ultra vires?

Another key issue is whether the FRC has exceeded its powers by directing the AASB to replace all AASBs with IFRSs. The FRC's 2000/01 annual report summarises its powers under section 225 of the Australian Securities and Investments Commission Acts 1989 and 2001 (FRC 2001) as including:

- overseeing the operations of the AASB, including:
  - approving and monitoring its priorities, business plan, budget . . . ;
  - determining its broad strategic direction;
  - giving it directions, advice or feedback on matters of general policy and its procedures; and
  - monitoring the effectiveness of its consultative arrangements.
- monitoring the development of international accounting standards and accounting standards that apply in major international financial centres;
- promoting the adoption of international best practice accounting standards in the Australian accounting standard setting process if doing so would be in the best interests of the Australian economy;
- monitoring the operation of Australian accounting standards to assess their continued relevance and effectiveness in achieving their objectives . . .

The legislation expressly limits the FRC's ability to become involved in the technical deliberations of the AASB. It provides that the FRC does not have power to direct the AASB in relation to the development, or making, of a particular standard, or to veto a standard formulated or recommended by the AASB. This provision is designed to ensure the independence of the standard-setter on technical matters. Lucy has been reported as saying (Fenton-Jones 2001):

"We are prohibited through the legislation from trying to interfere, or to be seen as interfering, in the workings of the AASB as it relates to the preparation of standards . . .

"In some areas of the community, there is an understanding that we have the right of veto of accounting standards. That is simply not the case.

"Similarly there is, out there in some areas, an attitude that we do have a level of influence over the AASB. Again, it is not factually the case."

Despite this rhetoric, it is difficult to see how the FRC's decree has done anything but veto the technical content of existing (and future) Australian accounting standards. It is possible to argue that the FRC has exceeded its statutory power. If so, what are the consequences? Under section 225(2)(f) of the ASIC Act the relevant function of the FRC is "to monitor the development of international accounting standards and the accounting standards that apply in major international financial centres, and (i) to further the development of a single set of accounting standards for world wide use with appropriate regard to international developments; and (ii) to promote the adoption of international best practice accounting standards in the Australian accounting standard setting process if doing so would be in the best interests of both the private and public sectors in the Australian economy".

One could dispute that the FRC's determination is concerned with the "development a single set of accounting standards for world wide use" or promotes the adopting of international best practice. Of course, a contrary argument can also be sustained. We conclude that these provisions cannot be relied on to support the FRC's action. Also, under section 225(2)(l), the functions include "other functions that the Minister confers on the FRC by written notice". Presumably, they must not nullify the prohibitions in sections 225(5) and (6). Further, under section 225(3) the FRC has "power to do all things necessary or convenient to be done for or in connection with the performance of its functions". Can this be used to justify an effective emasculation of the AASB? We do not think so, since it was originally intended that the FRC would have a power of direction but this did not find its way into the legislation. To the contrary, it is clear from section 233 that the FRC does not have the power to do so. Under section 233 the minister can make a direction about "the role of international accounting standards in the Australian accounting standard setting system". The role of the FRC is merely to provide a report to the minister on the desirability of doing so. If such a report has been made, its content has not been published and there is no reference to it in the FRC minutes. It seems even the minister could not make a direction that IFRS must be adopted, since arguably it does not relate to the role of such standards *in the context of an Australian accounting standard-setting system.* To the extent that any direction made by the FRC is *ultra vires*, the AASB is not bound to comply. However, it may be that the FRC did not envisage that the AASB will have a role in the adoption of IFRSs, but that would be inconsistent with the comments made in the FRC's minutes and in its annual report.

These legal niceties are largely irrelevant if it is intended that the Corporations Act will be amended to require compliance, rather than compliance being achieved by a ministerial direction.

One potent influence in this situation is that the minister has long supported the adoption of international accounting standards in Australia and this preference is likely to be well known to members of the FRC. Accordingly, the FRC's decision is explicable, albeit *ultra vires*.

IMPLEMENTATION ISSUES

Is there enough time to align IFRSs with Australian regulations?

The 1 January 2005 deadline for the verbatim adoption of IFRSs imposes a tight timeline that will be dif-

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ficult for many Australian companies to meet. Partners of Big-4 accounting firms and legal practitioners believe there is insufficient time to overcome many implementation problems (Bernhardt 2002, Buffini 2002a, Buffini 2002b). Bernhardt notes some undesirable tax implications that might flow from the adoption of IFRSs. While a nexus between taxation and financial reporting treatments may be questionable, the fact that such uncertainties have been allowed to arise is cause for concern. Of course, this and similar problems with Australian taxation legislation can be avoided by the appropriate authorities. The key points are that the full implications of adopting IFRSs must first be identified and time will be needed to make any necessary changes.

Perhaps a more telling, if inadvertent, endorsement of our concerns is the fact that the chairman of the AASB, Keith Alfredson, had warned the FRC members before the June 28 meeting of his "reservations about the short time horizon for the adoption of the international standards" (Ravlic 2003a). He noted that the ability to meet the deadline depended partly "on AASB resources (both board and staff), but significantly also on the ability of corporates (including boards of directors and audit committees), accounting firms and others to cope with the change". He went on to suggest that the resources for re-education "may well be strained" (Ravlic 2003a). That Australia's top standard-setter should have made such warnings suggests that more caution and information-gathering could have been undertaken by the FRC in making its decision.

What role for the AASB?

The verbatim adoption of IFRSs begs the questions of what role is left for the AASB and what is the future place of Australia in accounting standard-setting? The IASB outsources much of its work in cooperative arrangements with national standard-setters, including the AASB. The final decisions are still made by the IASB. The IASB is able to shift costs through such cooperation, but the national standard-setters have reduced influence over the outcomes, domestically and in IFRSs. Several Australians are currently active in international standard-setting (FRC 2002a).[15] Despite their excellent contribution, there is no guarantee that this level of influence will be maintained. Others might argue that Australia's influence is disproportionate and that its role should be adjusted accordingly. Should a major world player such as the US seriously seek to adopt IFRSs, Australian influence could rapidly diminish.

We must question the future of Australian accounting research and development. Innovation and progress are sometimes easier when a small player such as Australia is able to control its own destiny. We have acted as a laboratory for innovation. Our adoption of the entity concept in consolidation accounting is an example. These experimental opportunities will be lost when *de facto* control is transferred to the IASB. Even if our own standard-setters come to have a larger influence in IASB deliberations, the neatly contained laboratory environment of Australia will no longer exist. At present Australia is well supplied with experienced standard-setters who are in demand at the IASB, but if Australia adopts IFRS from 2005, this may change within a few years. Who will supply the experienced (and influential) standard-setters to the IASB and its committees in the future? Presumably it will be those countries that maintain active and vibrant standard-setting bodies. The US and UK are likely to continue to have a ready supply of such people, but what about Australia? What will be the future of the AASB? How in future will the government address the formulation of accounting policy for the specific needs of the Australian environment?[16]

Will everyone sing the same tune?

One objection to adopting IFRSs is that financial reports prepared under them may not be acceptable in the US. If the FASB does not adopt IFRSs, then there will be little benefit for Australian companies that must comply with SEC requirements. The Sarbanes-Oxley Act may limit the ability to adopt IFRSs in the US despite the optimism of McGregor that the FASB and SEC are "very supportive of the development" of IFRSs (Abernethy 2002). There is a big difference between being "very supportive" and effectively ceding standard-setting authority to the IASB. US acceptance of IFRSs remains the key issue and it has been argued that US companies and accountants continue to resist non-US accounting principles (Ham 2002).

On the other hand, in October 2002, the FASB and the IASB signed a memorandum of understanding (the Norwalk Agreement) "marking a significant step toward formalizing their commitment to the convergence of U.S. and international accounting standards" (Financial Accounting Standards Board 2002). This signals the FASB's willingness to explore IFRSs as a response to Enron and other corporate collapses. Whether this spirit of cooperation ultimately results in IFRSs that are dominated by the FASB's influence is problematic.

Re-education costs

Re-educating preparers, users, auditors, accounting students and academics for the contents of IFRSs in time is critical. Despite the present harmonisation policy, differences remain between AASBs and IFRSs and significant resources will be needed for re-education. As Bernhardt (2002) put it: "The 'de-skilling' of every auditor and accountant involved in financial reporting is not adequately addressed [by the FRC], let alone the huge effort to get up to speed by 1 January 2005". In the long term, the benefits of harmonisation may outweigh the short-term costs of the re-education and retooling necessary to ensure compliance, although this depends in part on the extent to which IFRSs are adapted for "local" conditions.

In short, there remain significant practical issues to the wholesale adoption of IFRSs. The implementation date fails to recognise that these matters will take

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time to resolve. In the interests of minimising the transitional costs to Australian preparers and users of financial reports (as well as legislators, regulators, auditors, and accounting educators), the FRC should seriously reconsider the time-line and seek informed input from the relevant stakeholders.

Do costs exceed the benefits?

In the EU substantial cost reductions are possible, since there is no uniform reporting framework, but is this likely in Australia? In the EU, the mandating of IFRSs is limited to listed entities (European Parliament 2002a), whereas in Australia all reporting entities are affected. While some entities may experience a cost reduction – those that raise finance outside Australia or are listed on a foreign stockmarket – most will not. In the short term, changeover costs and borrowing costs are likely to increase. Of the estimated 25,000 companies affected, only 1,349 entities (of which 67 were foreign) are listed on the ASX in November 2002. Thus there is a considerable asymmetry between those bearing the costs and those receiving the benefits.

The costs of the transition to IFRSs will depend on how it is implemented. The consultation envisaged in recommendation 14 of CLERP 9 is still to be undertaken. These significant changes require transitional provisions, particularly for financial reports in which IFRSs are first applied. Whether the transition will be governed by IFRSs, rather than under domestic requirements imposed by the AASB or through the Corporations Act or Regulations, has been a matter of speculation. IFRSs can be adopted other than as required by the IASB; CLERP 9 envisages that individual IFRSs may be modified in their application to Australia (Treasury 2002, p. 104). Under IASB ED 1 *First-Time Application of International Financial Reporting Standards* (IASB 2002b),[17] the comparative prior-period statement of financial position is restated using IFRSs (IASB 2002b, para. 6). The reconciliation between the amounts presented under IFRSs and the prior-reporting basis is apparently done in the notes rather than by an explicit adjustment to the corresponding comparative reporting period's opening retained profits (IASB 2002b, para. 30).

The AASB is required to include a "regulation impact statement" for its standards. The FRC should have conducted such an analysis before mandating IFRS. If amending legislation is necessary, it must be supported by a regulatory impact statement identifying both the costs and benefits using the guidelines of the Office of Regulation Review.

The question of who wins and who loses remains an enigma. In her analysis of the 1997 proposal to adopt IFRS, Stoddart (2000) noted that the ASX and corporations were keen advocates of the adoption of IFRSs but she indicates that, after some reflection, these parties lost their enthusiasm: "The initial proposal to adopt IASC standards was presented as beneficial to business and in line with the emphasis in other economic policies on 'globalisation'. It could also be described as a 'reward' to the Australian Stock Exchange. The interim diminution represented a response to the strength of the opposition among respondents to the initial proposals and may be attributable in part to the realisation that, as noted in several submissions, verbatim adoption of IASC standards would render rather empty the newly established control over the domain, diminish the power of patronage in relation to appointments, and make it more difficult to elicit contributions from the other stakeholders. The ultimate turnaround reflects the changed position of many of the original protagonists. During 1998, many large companies began to realise that adoption of IASC standards did not offer them an increase in permitted accounting methods but would decrease their discretion, particularly in two significant areas: identifiable intangible assets and the revaluation of non-current assets" (p. 724).

Why the FRC believes that these concerns of Australian companies have now lessened is unclear. The Group of 100 believes that "harmonisation and convergence with IFRSs should, by 2006, supplant the need for national standards" but adds the caveat "except where national, legal and cultural differences require otherwise" (Group of 100 2002). Whether the clouds of secrecy surrounding the FRC's decision will be removed is problematic.

Operationalising and enforcing IFRS in Australia

Merely adopting IFRSs does not mean that we can enforce their requirements. The EU recognised that appropriate enforcement mechanisms must be put in place to support the decision to adopt IFRSs. The FRC *Bulletin* includes this statement: "Mr Lucy noted that implementation issues would also need to be considered by the FRC (to the extent they did not involve the content of particular standards) and the AASB between now and 2005. These could relate, for example, to the timing of introduction of particular IASB standards in Australia before 1 January 2005 (which would be AASB standards until that date), as well as to issues of interpretation" (FRC 2002a). Since enforcement depends on interpretation, one would have thought far greater emphasis may have been placed on overcoming formidable issues of interpretation.

The interpretation of IFRSs is complicated by two drafting styles, one for the IAS series and another for the IFRS series of standards. The IASB has decided neither to redraft nor to redesignate the old IAS series. While the style to be adopted for IFRSs appears consistent with the rules applied to subordinate legislation in Australia, the drafting of IAS is not. For example, the preamble to each IAS includes the statement: "The standards which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard ..."[18]

This is inconsistent with interpretation rules under the Corporations Act 2001 and the Acts Interpretation Act 1901. Ultimately, enforcement depends on the

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willingness and ability of the courts to punish digression and direct compliance with particular provisions. Confusion as to what is required will make this task much more difficult. Inadvertent non-compliance due to misdirection inherent in the IAS drafting style is a concern. UIG Abstracts cannot overcome these problems as, unlike in the EU, they are not recognised under the Corporations Act. Accordingly, there is a major obstacle to adopting IFRSs in Australia.

Implementation mechanism

The mechanism by which IFRSs will become mandatory under the Corporations Act was not explained by the FRC. Nor was the AASB's role, if any, in that process. Apparently, the AASB decided to proceed on the basis that adopting IFRSs would be through the existing standard-setting framework, although this is by no means clear (Anonymous 2002, Buffini 2002b). In CLERP 9 it is stated that matters of detail will be for the AASB as "independent standard setter" (Treasury 2002, p. 105), suggesting implantation through standards made by the AASB. In August 2002, the AASB decided that:

- IASB standards should be used as the "foundation" standards to which it should add material detailing the scope and applicability of the standard in the Australian environment and any other statements dealing with local requirements. Additions, where necessary, should be made to broaden the content to cover the not-for-profit sector and domestic regulatory or other issues.
- Additions to IASB standards and their application should be clearly identified and, to the extent feasible, should be made in a manner that preserves the format and structure of the IASB standards.
- The basic IASB wording should not be edited, unless absolutely necessary Alfredson 2003).[19]

While many implementation problems have been addressed, many have not. It is of concern that the AASB developed this policy without its usual due process but the need for the AASB to make a quick response to the FRC is understandable.[20]

Domesticated IFRSs, like existing AASBs, will not be able to override the provisions of the Corporations Act or Regulations. Standards, to the extent of any inconsistency, would be both invalid and ineffective, but this will not greatly assist those subject to them. The AASB is obliged to consider whether a proposed standard is *ultra vires*. However, the IASB does not, and cannot be reasonably expected to do so. Thus, another level of potential confusion is added to the unquestioning adoption of IFRSs.

CONCLUSIONS

The world is moving towards the adoption of a single set of global accounting standards. However, our review suggests that the FRC's edict to impose the verbatim adoption of IFRSs in Australia is premature and does not deal with the practical difficulties involved in implementing IFRSs in two-and-a-half years (effectively 18 months). The FRC seems to have failed in its duty of due process and may have exceeded its powers by effectively determining the technical content of accounting standards. It has also failed to address the ongoing need of ensuring that the objectives of mandatory standard-setting will continue to be satisfied if we are obliged to adopt all IFRSs even if they imperil the quality of the financial reports prepared by Australian companies. Accordingly, the current interest in the role of the general qualitative requirement of a true and fair view is timely (Ravlic 2002c).

Many concerns raised in 1997 about the wholesale adoption of IFRSs have not yet been resolved, despite the progress in gaining wider acceptance of IFRSs. Regulators must carefully consider a variety of issues, including changes to the Australian tax regime, before IFRSs are uncritically embraced. The FRC should at least amend the implementation date so that interested parties can comment on the proposal, the implementation issues can be identified and addressed, and the full implications of the verbatim adoption of IFRSs can be assessed. The difficulties already identified by EU companies in meeting the 1 January 2005 deadline suggest that a more measured approach by the FRC should have little negative effect on the competitive position Australian companies and may avoid unnecessary costs and confusion.

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NOTES

1 The CLERP 1 proposal to rename the AASB as the Australian Accounting Standards Committee (AASC) was not implemented.

2 Since the time of CLERP 1 the International Accounting Standards Committee (IASC) has undergone its own reorganisation and has had its name changed to the present IASB.

3 See, for example, Collett *et al* 1998, Howieson 1998, Zeff 1998.

4 Corporate Law Economic Reform Program Act 1999, Schedule 2, Item 1, amending the Australian Securities and Investments Commission Act 1989, replacement Part 12.

5 The Public Sector Committee of the International Federation of Accountants.

6 FRC minutes prior to the June 2002 FRC meeting do not suggest that such a direction was imminent.

7 This included IAS 1 to 41 and Standing Interpretations Committee's interpretations 1 to 33 in force at 1 March 2002.

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8 The importance of IASB standards relative to US GAAP has also increased substantially through EU and IOSCO support.

9 Mandating of IASB's standards by a major standard-setting country like Australia was an important political coup for the IASB, evidenced by the readiness of the IASB's chairman to visit Australia to endorse the FRC's decision.

10 Mike Kooymans, one of the two contacts for CLERP 9, is also the secretary of the FRC.

11 EU member states can extend the application; this is being considered in the UK (Department of Trade and Industry (UK) 2002). Also, domestic standard-setters may decide to so, as in the UK (Accounting Standards Board (UK) 2002). In New Zealand, it is proposed that only listed entities will be caught (Accounting Standards Review Board (NZ) 2002).

12 The code requirements in France and Germany impose a form of legislative GAAP, although it is very different from the standards-based approach in Australia and the US.

13 This low rate reflects the fact that IFRSs are not yet allowed, or only recently allowed, in countries such as the UK, Ireland and Italy.

14 The FRC minutes do not disclose their identity or the nature of the consultation process. However, they include "representatives of corporations, business organisations" but apparently exclude accounting organisations (Financial Reporting Council 2002b).

15 These include Ken Spencer, Warren McGregor, Kevin Stevenson, Peter Day, Ian Mackintosh and Wayne Lonergan. Each had a direct role in the Australian standard-setting framework before their involvement with the IASB.

16 We are indebted to Stephen Haswell and Jill McKinnon for these latter thoughts.

17 Currently SIC 8 *First-Time Application of IASs as the Primary Basis of Accounting* deals with this issue.

18 The "Preface to International Financial Reporting Standards", para. 14, states (IASB 2002a): "Standards approved by the IASB include paragraphs in bold type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. An individual standard should be read in the context of the objective stated in that standard and this Preface." This is a significantly different approach to that in IAS standards. Since the implementation guidelines are not part of the accounting standard, they are outside the scope of paragraph 14. Nothing else in the preface suggests that implementation guidelines can vary the meaning of the standard.

19 Although the agenda included an item "Discuss Process for Implementing FRC's Decision", no supporting documents were placed on the AASB's website. The AASB did not publicise its decision by issuing a media release, but it was detailed in an *Action Alert*, which is only available by subscription (AASB 2002a).

20 This decision was made before the publication of CLERP 9. It is unclear if the AASB was given advance notice of the content of Recommendation 14.

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