Global financial reporting: a reality?

The AASB is obligated to implement full convergence to and harmonisation with International Accounting Standards. **KERYN CHALMERS** and **MARK SHYING** discuss the emergence of the preferred financial reporting framework and implications associated with this decision.

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The Financial Reporting Council (FRC) announced on 3 July 2002 its strategy that obligates the Australian Accounting Standards Board (AASB) to implement full convergence to and harmonisation with International Accounting Standards (IAS)[1] made by the International Accounting Standards Board (IASB) by 1 January 2005. CLERP 9 supports this position.

The AASB has considered its convergence policy in light of the FRC announcement and the CLERP 9 proposal and agreed, to the extent possible, to the verbatim adoption of IAS. In effect, reporting entities subject to the Corporations Act 2001 will be required to comply with IAS made by the IASB for periods beginning on or after 1 January 2005.

This announcement surprised the financial reporting community, given that four months earlier the Australian Accounting Standards Board (AASB) had released a revised Policy Statement PS 4, "International Convergence and Harmonisation Policy". PS 4 supported the general desirability of having a single set of accounting standards for worldwide use, but did not support verbatim adoption of IAS and certainly not in the time frame put by the FRC. The FRC's decision mirrors that of the European Union's (EU) announcement on 7 June 2002 and has international significance, given that Australia is the first Anglo-American country outside Europe with a national standard setter to replace a commitment to convergence with a commitment to verbatim adoption.[2]

Asian economies such as Singapore, Malaysia, Hong Kong and China are either adopting or are in the process of adopting IAS. If other Anglo-American countries follow Australia's lead, it appears that global financial reporting could well be a reality rather than a pipedream.

The evolution of the International Accounting Standards Board

In 1972 the Board of the International Accounting Standards Committee (IASC) was established and it commenced operations in 1973.[3] One of the IASC's objectives was to work generally for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements.

An alliance with the Technical Committee of the International Organization of Securities Commissions (IOSCO) was a catalyst for the IASC completing a core set of standards suitable for listing and cross border capital raising purposes in the global market, which was approved by the IOSCO president's committee in 2000.

Unlike the US Securities and Exchange Commission, the Australian Securities and Investments Commission (ASIC) adopted the resolution allowing non-domiciled firms to prepare accounts using IAS rather than Australian Standards,[4] without any reconciliation to national GAAP.

Recognising the need to converge national accounting standards and practices and legitimise its role, the IASC was restructured in 2000. The IASC is now an independent organisation with two main bodies—Trustees and Board (the IASB). The structural changes effectively ensure greater involvement in the IASB's deliberations by national standard setters and a more workable board.

Its revised constitution stipulates that the IASB's objectives include the development of IAS that require high quality, transparent and comparable information and the promotion of IAS by working with national standard setters to bring about convergence.[5]

Global financial reporting cannot become a reality unless these objectives are achieved. The collaboration and sharing of intellectual capital with national standard setters, including the AASB, should fuel this goal.[6]

Pacter (1998 p.21) states: "Harmonisation of diverse national standards is fraught with insurmountable obstacles. It is not the way to go into the next century. A single, global set of accounting standards will best serve investors and realistically it will take a single supreme standards board to do the job". Does the reinvention of the IASC mark the birth of a global standard setter with international supremacy?

Australia's harmonisation with International Accounting Standards

In 1996, the Australian Accounting Standards Board agreed to pursue a program of international harmonisation that would ensure that Australian Standards complied with IAS unless it was deemed inappropriate. Effectively, harmonisation means that possibilities still exist for additional national standards, elimination of choices in IAS, greater disclosure requirements and different terminology.

The Federal Government's preference for the adoption of IAS was contained in the first of the Corporate Law Economic Reform Program (CLERP) papers, "Accounting Standards—Building International Opportunities for Australian Business" (Commonwealth of Australia 1997, www.treasury.gov.au/contentitem.asp?pageId=&contentID=281).

Substantial opposition to this proposal by corporate Australia, professional bodies and accounting firms resulted in this preference not being enacted in legislation.[7] A change in the regulatory regime, most notably the formation of the FRC to oversee the AASB's activities, was another major reform proposed in CLERP 1 that was subsequently enacted in legislation. The legislative commentary notes that the FRC's key role is to "ensure that the AASB is committed to, and works towards, adoption of IASC standards" (Commonwealth of Australia 1998 p.75).

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The FRC's controversial announcement on July 3, 2002 demonstrates reversion to the Government's preferred position. It also suggests that Australia is playing a significant role in elevating the status of the IASB as the global standard setter. The unanswered questions are whether other national standard setters and jurisdictions will follow suit and whether universal agreement on 'best solutions' to accounting issues is attainable.

Implications of the adoption of International Accounting Standards by Australia

The FRC's decision has implications for: (1) shaping financial reporting in the future; (2) redefining the financial reporting regulatory environment; and (3) managing the implementation process.

Financial reporting in the future

Existing Australian Standards and IAS display considerable similarities, given the harmonisation program of the AASB in recent times.[8]

The IASB has embarked on an improvements project with the aim of raising the quality and consistency of financial reporting by drawing on best practice from around the world and removing options in IAS.

There are, however, a number of sensitive and controversial projects on the IASB's agenda, or subject to an IAS with no equivalent Australian Standard, that will have implications for Australian entities financial reporting in 2005.

Examples include the recognition and measurement of financial instruments (Kidd 2002), accounting for share-based payments (Stoddart 2001),[9] business combinations and intangible assets (Alfredson 2001). Table 1 details the current active IASB projects that are expected to result in operative standards by 2005.

The changes envisaged to IAS have significant implications for financial reporting in Australia. The responsibility to educate the financial community on these changes rests with educators, professional bodies and accounting firms.

Financial reporting regulatory regime

A number of questions arise as to the future role of various bodies currently included in the accounting standard setting process, particularly the role of the AASB. The interim role of the AASB has been articulated as actively participating in the IASB's processes, to the extent feasible (AASB 2002).

The AASB recently reconsidered its work program in light of the FRC announcement (AASB 2002). It determined that the highest priority should be to fill the significant gaps in Australian Standards, namely: Recognition and Measurement of Financial Instruments (covering IAS 39 and parts of IAS 32; Business Combinations/Intangible Assets and Impairment of Assets (covering IAS 22/IAS 38 and IAS 36); and Post-Employment Benefits (covering part of IAS 19 "Employee Benefits").

All of these are on the active project list of the IASB with expected completion dates by 2005.

The next highest priority should be to progress other current IASB projects in the same time frame as the IASB, including Share-Based Payment and Performance Reporting.

Furthermore, any IAS in the process of being 'improved' should be used as the basis for new Australian Standards.

TABLE 1 SHAPING FINANCIAL REPORTING: THE IASB'S ACTIVE PROJECT AGENDA

Active Projects	Existing IAS	Equivalent AASB	Implications for Australian entities#
Business combinations (a multi-phase project)	IAS 22 ED 3	AASB 1013 AASB 1015 AASB 1016 ED 109 (includes ED 3)	Phase 1 (the focus of ED 3) requires the 'purchase method' for all business combinations and a non-amortisation/impairment approach for goodwill. The three aspects of the Phase 2 project (currently underway) are application of the purchase method, new basis/fresh start accounting, and items excluded from Phase 1 (e.g. business combinations involving entities under common control, dual listed entities and two or more mutual entities.
Business combinations (a multi-phase project)	IAS 36 IAS 38 ED *	AASB 1010 AASB 1011 AASB 1015 AASB 1021 AASB 1041 ED 109 (includes ED *)	As part of Phase 1, IAS 36 and IAS 38 have been amended. An asset's recoverable amount is the higher of its net selling price and value in use, measured as the present value of the future cash flows associated with the asset is required. It prohibits the recognition of certain items as intangible assets (for example, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance) and requires a non-amortisation/impairment approach for recognised intangible assets with indefinite useful lives. Revaluation for intangible assets is only permitted when fair value can be determined from an active market for the intangible asset.
Consolidations (including special purpose entities)	IAS 27	AASB 1024	Entities are required to be consolidated when the parent has the 'capacity to control'. More rigorous guidance is anticipated on the concept of control.
Pension accounting (this project is part of the short-term convergence program of the IASB designed to reduce differences between IAS and US GAAP)	IAS 19	AASB 1028	Presently there is no requirement in AASB 1028 to recognise post employment benefits. The IASB is contemplating issues such as the recognition of actuarial gains and losses, the asset ceiling, the expected return on assets, the allocation of cost to accounting periods, the net presentation in the Statement of Financial Position of plan assets and liabilities, and disclosures related to plan assets.
Deposit-taking, lending and securities activities	IAS 30	AASB 1032	Scope is extended to all entities carrying out deposit taking, lending or securities activities. Required disclosures will be reviewed, with some enhanced disclosures required and redundant disclosures deleted.
Financial instruments: recognition and measurement standard	IAS 39 and parts of IAS 32 ED **	NS ITC*	Adoption of IAS 39 will require entities to recognise financial instruments (including derivatives) in their financial reports with most of these instruments to be measured at fair value each reporting date with gains/losses taken to the Statement of Financial Performance.
First-time application of IFRS	NS ED 1	NS ED 107	Australian entities will have to prepare an opening IAS Statement of Financial Position at the beginning of the earliest comparative period presented in an entity's first IFRS financial statements.
Improvements to existing IAS	VS ED ***	VS ITC**	ED contains proposals to amend 12 of the IASB's active 34 standards. The proposed changes have minimal ramifications for financial reporting in Australia as they effectively converge the IAS with existing Australian Standards.
Insurance contracts (a multi-phase project)	NS	AASB 1023 & AASB 1038	Single recognition measurement model for all insurance contracts and for all forms of insurance regardless of the type of risk undertaken.
Reporting performance	IAS 1 & IAS 8	AASB 1018	A single statement of comprehensive income in which operating and financing activities are segregated in a horizontal format with a vertical split used to highlight whether the item reported represents a change in estimate related to a future period (valuation adjustment) or another item of income and expense (income flow).
Revenue—definition and recognition—and related aspects of liabilities	IAS 18	AASB 1004	Likely to clarify the distinction between liability and equity and establish workable general principles as a basis for determining when revenue should be recognised in the financial statements. Revenue recognition approach is likely to focus on changes in assets and liabilities rather than an approach that focuses on earnings.
Share-based payments	NS ED 2	NS ED 108	The ED sets out measurement principles and specific requirements for three types of share based payment transactions. The most significant proposals deal with the recognition and measurement of share options requiring: (a) fair value of options is taken at grant date and adjusted for vesting conditions; (b) using this deemed fair value per unit of services expected to be received is calculated; (c) expense is recognised for the number of units of service received each year in the vesting period; and (d) amounts recognised are not reversed subsequently if options are forfeited or lapse unexercised.

Source: Adapted from http://www.iasb.org.uk/cmt/0001.asp Search on website for 'active project agenda'.
Key: # For exposed EDs, outcomes are those proposed in the ED. Otherwise, the likely outcome is that tentatively suggested by the IASB and/or anticipated by the authors
ED = exposure draft; ED* = exposure draft of proposed Amendments to IAS 36 Impairment of Assets and IAS 38 Intangible Assets; ED** = exposure draft of proposed Amendments to IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement; ED*** = exposure draft of proposed Improvements to International Accounting Standards; ITC* = invitation to comment Proposed Improvements to IAS 32 and IAS 39; ITC** = invitation to comment Proposed Improvements to International Accounting Standards and their Impacts on Australian Standards; NS = no standard; VS = various standards.

Implementing the adoption of International Accounting Standards

The FRC's commitment to adoption for reporting periods beginning on or after 1 January 2005 means that Australian entities will have to prepare an opening IAS Statement of Financial Position (which would include, for example, all financial instruments including derivatives and exclude, for example, internally generated intangibles) at the beginning of the earliest comparative period presented in an entity's first IAS financial statements.

Australian accounting standards for which there is no IAS counterpart will be retained to the extent that the addition is agreed by the AASB. Further, the AASB decided that it should retain or develop additional Australian Standards when this is required to cater for domestic issues (e.g. concise reports).

CLERP 9 suggests that the body of IAS would be adopted. The AASB has decided that except for Australian accounting standards peculiar to the not-for-profit or public sectors or those that are purely of a domestic nature, IAS should be used as the "foundation" Standards to which material detailing the scope and applicability of the standard in the Australian environment and any other statements dealing with local requirements will be added.

Additions to IAS 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 IAS. The basic IAS wording should not be edited, unless absolutely necessary (AASB 2002). It is envisaged that an example of this necessity will be the AASB's replacement of the terms 'shall' and 'should' in IAS with the term 'must'.

Abernathy (2002 p.23) in his interview with Sir David Tweedie, the IASB chair, reports, "The non-aligned status of the IASB is important to Tweedie. It means the ability to work with speed and professional excellence rather than having to battle the mitigating effects of politics".

We contend that Tweedie would also be pleased that the IASB does not have to battle the peculiarities of a sovereign state, such as legal and tax challenges. Koster (2002) warns the principle-based IAS have not yet benefited from being challenged in court or by regulators, and it will be the real-life experiences and challenges in court or by regulators that will start the refinement process of IAS, perhaps requiring more rules to explain them.

Bernhardt (2002 p. 9) comments that "automatic adoption in Australia [of IASB decisions to date on developing a standard on accounting for share-based payments], without consequential income tax changes, would have the adverse result of preventing Australian companies from franking their dividends without paying an effective double tax liability". Discussions with the Government over such issues will be necessary.

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CONCLUSION

The emergence of the IASB as the potential global standard setter has been fuelled by acceptance of IAS by IOSCO, the restructure of the IASC, and the effective adoption by Australia and the European Union of IAS. The apparent commitment by national standard setters and the IASB to converge accounting standards also suggests the pivotal role of the IASB in shaping future financial reporting.

However, it is too early to assess the success of such partnerships, both in terms of working relationships and the quest for convergence. If mutually acceptable agreements can be found then global financial reporting seems a realistic possibility. Currently, the IASB is immune from legislative and judicial interference. However it is reasonable to assume that its constituents will not allow it to be free of legislative, judicial and political interference in its future decision-making.

Adoption of IAS will have substantial ramifications for Australian firms' reporting practices. The transition will not be smooth as impediments have been identified that will impede the ability for verbatim adoption and a number of issues on the IASB's agenda are sensitive and complex. Given the international reputation of the AASB, the success of our transition will be eagerly monitored and observed by the global accounting standard setting community.

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NOTES

1 The short form IAS is used throughout to mean International Accounting Standards and the successor standards, International Financial Reporting Standards (IFRS).

2 The New Zealand Accounting Standards Review Board has recommended to the New Zealand Government the compulsory adoption of IAS by listed issuers by 1 January 2007 and has extended the recommendation to both the public and private sectors with entities having the option to adopt IAS from 1 January 2005. (Available:http//www.asrb.co.nz/press.htm#19/12/02, [Accessed: December 19 2002]).

3 Initially the IASC was a collaborator group comprising accountancy bodies representing 10 countries. Subsequently, the IASC joined forces with the International Federation of Accountants (IFAC). This effectively expanded the membership base of the IASC to include all members of the IFAC (professional accounting bodies from around the world), and other organisations with an interest in financial reporting, in addition to the professional bodies that were parties to the original agreement.

4 'Australian Standards' is used to mean the AASB series of accounting standards. The expression 'Australian Accounting Standards' is used to mean the AAS series of accounting standards. 'Australian accounting standards' is used to mean both series of accounting standards.

5 In subtle contrast to harmonisation, convergence of accounting standards refers to working with other standard-setting bodies to develop new or revised standards that will contribute to the development of a single set of accounting standards for worldwide use.

6 The other national standard setting partners are from Canada, France, Germany, Japan, New Zealand, the UK and the USA.

7 The Australian Stock Exchange's (ASX) submission was one of only two received in favour of immediate adoption. Given that the harmonisation program was funded by the ASX imposing a levy on listed companies, they appear to have been influential in driving the accounting standards-setting reform agenda (Collett et al. 1998).

8 Major areas of divergence are noted in the back of Australian Standards. For a more comprehensive examination of divergence see "The Australian Convergence Handbook", AASB, Melbourne 2002. http://www.aasb.com.au/international/other_index.htm

9 Proposal 15 in CLERP 9 refers to adoption by the AASB of the IASB standard requiring share options to be expensed. The AASB has expressed concerns with the IASB's position and the impracticality of applying it.

Note: This article contains the authors' views and does not necessarily represent the views of the AASB.