IAS: Headlong into trouble?

Recent Professional Development seminars focused on the implications of Australia's proposed adoption of international accounting standards and the attractions of offshore property markets.

The proposed adoption in Australia of international accounting standards could result in many companies being "knocked around badly", a Securities Institute professional development seminar was warned.

Wayne Lonergan, managing director of Lonergan Edwards and Associates and a member of a number of accounting regulatory bodies, said there was considerable doubt about whether adoption, scheduled for 2005, would be a good thing. It had been "heavily sold" by proponents, including the federal government, on the basis of criteria such as uniformity, quality, universal compliance, assurance of market survival and stimulus of investment capital inflow.

"The reality is that the United States, the world's biggest capital market, was never going to adopt IAS," Lonergan said. "Europe is a long way from being on board. The so-called 'stable platform' on which the standards are supposed to be based hasn't been quite built and it's definitely not stable, and some of the standards are poor." Adoption of IAS was of no benefit to Australia "until the mess is sorted out".

Lonergan was addressing a seminar focusing on IAS 38 Accounting for Intangibles and its effect on Australian accounting practice. His co-presenter, Steve McClintock, chief financial officer of Southcorp, explained the new rules that would apply under IAS 38 for recognising research and development expenditure and internally generated assets such as mastheads, customer lists, etc. In most cases, revaluation of these assets would be prohibited.

The adoption of the standard would require a change in Australia's traditional approach to intangible asset valuation, McClintock said. It was important for companies to consider the implications now, because current transactions could be in breach of the standard following its adoption.

There would be further problems with the implementation of IAS 36, which dealt with asset impairment, McClintock said. IAS 36 would constitute a major change in accounting in Australia, requiring new definitions of recoverable amount, cash-generating units and value-in-use. "There are some logic flaws in IAS 36 when considering future cashflows," he said. The standard was being amended to resolve this, he said, but "what other errors are to be found that would give us nonsense outcomes?"

Lonergan agreed that under the international standards most identifiable intangibles — brands, mastheads, licences, patents etc. — could not be recognised or revalued. He noted that some 60% of market capitalisation was represented by intangibles of one sort or another.

"The process has gone a bit off the rails," Lonergan said. "The IAS conceptual framework is much less developed than Australia's in terms of its detail. It is precedent-driven rather than principle-driven, and is bound by rigid rules. European regulators are locked into a historic cost approach and don't properly understand revaluations."

Writing down intangibles under the new standards could wipe so much off balance sheets that some companies may be unable to pay or maintain dividends. Others could find themselves in breach of loan covenants or left with negative shareholders' funds. "A lot of companies, including private companies, will be knocked around badly," he said.

The adoption of IAS would see Australia's standards board handing over responsibility to an international body in which Australia has only a small voice, Lonergan said. A result would be interpretations that could disadvantage Australia.

"A lot of idiosyncratic Australian issues will get scant attention in the interpretation process," he said. "This will be very sad for our mining industry, our agriculture, our financial institutions. European rule-makers are simply not interested in Australia."

Grass may be greener

International property markets hold good prospects for Australian investors, although institutions are slow to diversify globally. Andrew Parson, head of real estate securities, Lend Lease, said reasons for this reluctance included the taxation of unrealised property gains and losses, the limited availability of securitised markets and poor-quality global benchmarks.

There was also a perception that there was no need to invest offshore — the domestic property market was sufficiently vigorous.

New markets emerging in the United States and the United Kingdom were broadening the opportunities with vehicles such as listed property trusts, he said. Further, global markets were diverse, embracing residential property, hotels, etc., compared with Australia's, which was dominated by office and retail real estate.

As these attractions become better known, we are likely to see a rebalancing of offshore investments into proportionally more property, Parson predicted.

Geoff Lovell, general manager of Macquarie ProLogis Trust, emphasised that the US represented a "massive market" for Australian property investors. Direct investment, particularly in such a distant market, was risky, but the existence of real estate investment trusts (REITs) and access to a large capital market add appeal to the US. J

Audio tapes of Professional Development seminars are available by emailing: audiotapes@securities.edu.au