

## TIME FOR A RETHINK ON IFRS?

**Chris Biermann** and **Frank Betkowski\*** make a considered assessment of where Australia's convergence with International Financial Reporting Standards leaves Australian business



**T**he global convergence of accounting standards is a laudable goal. The process, started in earnest only a few years ago, has gained an international momentum that currently appears unstoppable bar a few minor hiccups in some areas.

Who would have thought a few years ago that the SEC in the US would provide exemptions for companies reporting under IFRS, or even entertain the

idea of removing a US GAAP reconciliation? These are strange times indeed.

Australian companies are left to fight with one arm behind tied their back in some cases, as their international competitors have more options in reporting performance than they do

The global push for convergence, if implemented properly and transparently, offers enormous benefits for global companies, streamlining capital raising and levelling the playing field, so economic decisions are not clouded by the nuances of differences in accounting standards between countries. The flow on benefits in the mobility of resources in the accounting and finance arenas offers benefits to both business and individuals alike – a truly global market for capital and human resources awaits us if we get this right.

Australia's move to full adoption of IFRS took some by surprise; some might even say that this included the Australian Accounting Standards Board (AASB) which is responsible for standard setting in Australia. Originating from proposals by the Federal Government and Financial Reporting Council in 2002 to adopt IFRS outright from 2005 as the reporting framework in Australia, the beast that is "Australian equivalents to IFRS" (A-IFRS) is what we have been left with.

The AASB has adopted nearly word-for-word versions of IFRS in creating A-IFRS, but in doing so

has deleted some treatments permitted under IFRS, provided additional guidance and made the standards "sector neutral" by adding specific not-for-profit requirements. This is what we like to call "one way convergence", i.e. entities complying with A-IFRS will automatically comply with IFRS, but the converse is not true.

Therein lies the rub. Australian companies are left to fight with one arm behind tied their back in some cases, as their international competitors have more options in reporting performance than they do. Foreign investors may be suspicious of the "Australianised" version of IFRS even though they purport to comply with IFRS.

Local subsidiaries of global companies are prohibited for accounting for transactions in the same way as their parent even though both use "IFRS". Real costs are increased as the transitional costs of convergence exceed those of other countries due to additional requirements and a scramble for local resources with knowledge of the local flavour of IFRS.

All companies with the exception of the very small ones are subject to the same rules – a "one size fits all approach" that has been rarely adopted in other countries.



So what are some of the problem areas? The AASB has already backed down on one major area: pension accounting.

The AASB disagreed with the IASB's original standards, and deleted the option of using the "corridor approach" in Australia, even though it is widely used internationally to effectively

"smooth" some of the effects of volatile changes in the underlying values in defined benefits funds.

The prevalence of defined benefit funds in Australia is waning, but those entities affected were not amused at having to have increased volatility in their reported

profits and being blocked from using the globally accepted approach.

In the end, the AASB reissued the standard and allowed three options to align the standard with the additional option recently inserted by the IASB.

'This divergence in standards has the potential to undermine the benefits to organisations such as ours from global convergence, creating unnecessary and unproductive reconciliations and costs'

Business combinations is another area of difference between A-IFRS and IFRS. Due to a number of reasons, including past Australian practice and Senate disallowance of equivalent exemptions under existing standards, common control business combinations have been "scoped into" the Australian standard, but "scoped out" of the equivalent international standard.

While easily applied under the "rules" based and legalistic view of "acquisitions" under existing standards, the application of the IFRS "principles based" approach has quickly been identified as a

hotbed of uncertainty and debate.

The AASB is now proposing to align the A-IFRS and IFRS standards.

There is another area where there has yet to be an outcry for "full" convergence: joint venture accounting. IFRS permits two treatments for some types of joint ventures – proportional consolidation and equity accounting – whereas A-IFRS only permits the latter approach.

Arguments for the superiority of one view over the other aside, the elimination of the option under A-IFRS has direct consequences for the extractive industries sector where these types of arrangements are common – a sector where global players dominate and differences should be minimised.

The extractive industries are also affected by the extensive prescriptive amendments made in the Australian equivalent to the IFRS standard on exploration and evaluation.

An example in point. BHP Billiton, as a dual-listed company based in Australia and the United Kingdom, is able to use either treatment for joint ventures under "pure" IFRS applicable in the UK, but is limited to one choice under A-IFRS.

The problem is that BHP Billiton globally may want to use the option that is not available in Australia.

Nigel Chadwick, vice president, group accounting and controller with BHP Billiton, notes the perhaps inadvertent consequences of the Australian approach: "This divergence in standards has the potential to

undermine the benefits to organisations such as ours from global convergence, creating unnecessary and unproductive reconciliations and costs. However, this outcome is exactly what global convergence of accounting standards seeks to avoid."

What is the lesson from all of this? It appears that in many cases, the IASB has had good reason to adopt the view that it has on many of these issues and others. The AASB has acted in good faith perhaps causing a few unintended consequences, but in the process has undermined the benefits that major corporates like BHP Billiton might realise – and these are the very entities that the global IFRS convergence project seeks to benefit.

The current situation is an "almost there" outcome for Australia. We strive for the holy grail of "IFRS convergence", but have done so in a way that causes difficulties for truly global organisations and forces standards applicable to the top end of town across the board.

Paul Pacter, a director with the IASB and also a Deloitte IFRS director, notes that Australia is at risk of suffering from the "all the pain without the full gain". In other words, Australian entities will go through a great amount of effort to transition to A-IFRS, only to potentially face an uncertain response from global capital markets – putting Australian entities at a disadvantage, resulting in lost opportunities and increased costs.

The challenge for Australia is to take stock of how far we've come and to not lose our eagerness for reform. We need to reconsider the basis for amendments to IFRS when creating A-IFRS, with a goal of creating "two way" convergence.

We need to be careful about how the A-IFRS framework is presented in global capital markets. We need to realise the "full gain".



Longer term, when IFRS is truly a high-quality accounting framework, the original proposal of adopting "pure" IFRS as Australia's reporting framework might then be considered appropriate and more easily implemented.

*\* Chris Biermann is a senior audit partner and IFRS specialist with Deloitte Touche Tohmatsu in Australia. Frank Betkowski is a client director in Deloitte's National Technical group. The views expressed are their own*