

ITC - Interpretations sub 12

18 January 2006

Professor David Boymal FPNA
Chairman
Australian Accounting Standards Board
Level 4
530 Collins Street
Melbourne VIC 3000

Dear David

Re: Exposure drafts on changes to the interpretative process

The National Institute of Accountants (NIA) is pleased the Australian Accounting Standards Board (AASB) has begun to consider the implications of the changes to the global standard setting environment on the processes and procedures it has adopted in the past. While the NIA has serious reservations about various aspects of the proposed changes to the interpretation regime, the initiative to place a set of ideas proposing fundamental changes to the way interpretation of accounting standards is conducted within our jurisdictional boards is commendable.

We are a supporter of the adoption of a single set of accounting standards and acknowledge the need to have consistent interpretation and application of the accounting standards in our jurisdiction. Fundamental to this entire objective, however, is an acknowledgement by the process and people at the most senior levels of the accounting profession and the standard setting process that the standard setter is a body that is accountable to all members of the community other stakeholders. There is a danger that the proposals will be perceived by practitioners outside the major firms and large corporations as not factoring in their role in the implementation and application of standards. There is no acknowledgement of the role of the broader constituency in ensuring consistency of application of the standards in the proposals as the currently stand. This limitation threatens to create an even greater gap between those with a sophisticated knowledge of how the new requirements operate and other practitioners.

The knowledge gap to which we refer comes about as a result of the nature of the work some accountants do and the areas in which they predominantly practice. Smaller practitioners and even second tier firms do not have the same access to global resources for interpretation or guidance as larger firms. They also have limited opportunities to participate in the standard setting and interpretations process so their views are often not aired. The abolition of the Urgent Issues Group (UIG), which is the result of the proposed model, removes from the landscape an opportunity for practitioners and even those from the professional bodies that serve them to provide a different insight into the implementation and interpretation issues.

While the AASB has moved to reject a representation model such as the present UIG it must acknowledge in some manner the need to maintain regular contact with and encourage the involvement of practitioners in other segments of the financial reporting community. The current proposals are drafted in a manner that excludes a large body of practitioners and corporate accountants that have a legitimate claim to participating in a process that results in accounting law that they must follow.

We submit that the AASB must take great care in reviewing its proposals because there are significant weaknesses within the structure as exposed for comment. We submit that these weaknesses will contribute to the estrangement of large parts of the financial reporting community that have an equal right to participate in a process that results in the development of law. The NIA cannot support the package of proposals in their present form despite the fact we see some merit in contemplating changes in processes. They require significant changes to ensure that any altered process is accountable to the financial reporting community as a whole in various ways.

AASB is yet to articulate a comprehensive vision for its role

Proposing change to the interpretation process is a de facto way of telling the community that the AASB as an organisation believes its role must be expanded in a changing global regulatory environment. The AASB must articulate a vision for the standard setting process in a comprehensive sense. Piecemeal amendments to the processes of standard setting simply send a confused message to the marketplace about the role the standard setter seeks to assume for itself in a world where it is largely a taker or purchaser of a finished product except in circumstances where it is asked to assist in developing material for the international body. This is an issue that must be urgently addressed by the AASB and it is the intention of the NIA to further contemplate the role of the standard setter and send a subsequent submission addressing the future of standard setting in this country.

A comprehensive plan must be in place to ensure the AASB's stakeholders have a full appreciation of the direction the Board is heading. Fixing up one part of the system independently of articulating a holistic vision for the future of standard setting in this country comes with a danger the AASB will be seen as dealing with one issue in isolation.

Due process concerns

The AASB's present proposals contain no acknowledgement of the requirement for a proper due process when deliberating on interpretation matters. It is inconsistent with the AASB's general approach to the development of accounting standards, which are subject to an extensive due process that includes a period of exposure. A comprehensive review of the AASB's proposals should entertain the establishment of a series of measures that assure the community being served by the AASB that its interests are being pursued by the standard setter.

Any change to the interpretation process within this jurisdiction requires a replication of the kinds of processes operating at the international level regarding interpretation. The AASB must facilitate the publication of

exposure drafts of interpretations like those published by the International Financial Reporting Interpretations Committee (IFRIC) so that there is an opportunity for public participation in the process.

The IFRIC processes are also a useful example where the publication of rejection statements is concerned. If the new accounting standards clearly cater for a set of circumstances that have been put to the board for discussion then a reason for the rejection of the issue should be set down in a publication put out by the AASB. The existing *Action Alert* could be used for this purpose although there is merit in the AASB entertaining the establishment of a more regular and more comprehensive publication incorporating a more general analysis of accounting regulation rather than limiting the communications from the AASB to those issues dealt with by the standard setter at meetings of the Board.

It would be inappropriate for the standard setter to limit the access to any deliberations related to interpreting the new standards. Each standard is a part of law in Australia and must be complied with. The NIA believes that the AASB must ensure all parties can have access to the deliberations and final decisions of the board where they relate to matters regarding interpretation. The above principle in our view requires the AASB to ensure all agenda committee meetings, advisory panel meetings and other meetings related to interpretative matters be open to a public gallery.

Selection of the panels

It is unclear from the proposals how the panels would be selected and this creates the potential for structuring panels that are composed of individuals in the midst of transactions giving rise to complex accounting problems that give rise to the need for an interpretation. The appointment process must be transparent and there needs to be a commitment to ensuring the composition of those panels deliberating on technical matters is not subject to the influence of individuals that have active conflicts of interest.

Our concern in this area relates to a possible scenario where a company, a non-audit service provider of technical advice, an external auditor and other parties involved in the same transaction, which could include an underwriter to an initial public offering such as an investment bank, may end up composing a majority of individuals chosen for a panel. Individuals from these organisations will be members of various bodies such as professional accounting bodies, the Australian Institute of Company Directors or any of the various bodies dealing with the financial services sector. They could be appointed on the basis of representing a certain constituency whilst having expertise in an area, but they would also have a conflict because of their intimate knowledge of an existing transaction. The process needs to be safeguarded from that and the AASB must have an appropriate code of conduct in place when considering the appointment of the various advisory panels.

It would also be unfortunate if the AASB was perceived by the community to be allowing conflicts of interest to permeate the panels following the intense focus on issues of audit independence and the independence of directors over the past few years. Four suggestions for how the AASB may avoid the perceptions of conflicts are set out below.

'Two thirds' rule

There are several ways in which the Board may limit the possibility of 'stacking' the panels with people with a conflict in a particular area. The first is to have a policy that not more than two thirds of a panel should be constituted of experts on an issue. Other interested parties capable of understanding and, more importantly, asking relevant questions of fellow panelists on a panel. Such a mechanism would offer the flexibility of appointing select committees while maintaining some control over the extent to which conflicts of interest occur on panels convened to help solve a problem.

Pool of 50

Another mechanism the board may wish to consider is for there to be a pool of no more than 50 individuals with various levels of expertise and interest in financial reporting matters that can be identified as being a pool from which a panel can be drawn to resolve accounting issues. These individuals would be identified in public as being a part of the pool of 50 individuals and the AASB would be able to select from the 50 individuals that have indicated an interest in participating. While 50 is an arbitrary number it would appear to us to permit the Board to have on the list for the pool of experts a range of expertise and level of skills that can be drawn on for the interpretations process. Such an appointment process for panels would be transparent and it would be clear to people that the individuals are drawn from a pool of talent that was assembled on the basis of competence, independence and interest in the area of accounting rather than for the fact they have a pressing accounting issue arising from a transaction. A panel of eight, for example, may contain all the experts on a specific area of accounting available for selection as well as a generalist that could bring an alternate perspective to the accounting problem under examination.

Those individuals named as members of the pool should be brought together at least once a year for a meeting with the Board so that they have some contact with the system even if they have not been called upon to participate on a panel. Such a meeting would ensure the maintenance of goodwill between those named as part of the pool of 50 and the AASB so the Board is able to draw on their support when required.

Retain UIG as a basis for selecting panels

A further option but one that holds less appeal for the NIA is for the UIG membership to be retained but a panel drawn from those UIG members with specific experience in the types of issues being considered. About a third or even half the UIG could be used to consider for-profit sector matters while the remaining members may be called on to deal with public sector specific issues. While it maintains the UIG representational model it does not allow for the additions to a panel of expertise.

Maintenance of the UIG as a 15-member body

Some commentators do advocate the maintenance of the UIG as a body because they believe it still serves a legitimate purpose. The only way in which the UIG as presently constituted could operate under the proposed

model is for it to be convened only when the AASB decides the services of the group are required in resolving an issue. While this is possible it does not permit the same degree of flexibility as the first two options outlined above.

The AASB has assumed responsibility for the endorsement of interpretations in the same way that the international body endorses the pronouncements prepared by its interpretations subcommittee. This assumption of responsibility means that even if the present composition of the UIG was retained there would be no certainty that it would even meet on a regular basis as it does now.

The NIA prefers the first two options as they provide a level of flexibility for the AASB while also providing other stakeholders an opportunity to participate in the processes of the panels.

Dominance of major practices

Firms other than the major practices and the three professional bodies deserve to play a role within the proposed panel structure. These organisations bring to any table at which they sit a perspective that needs to be borne in mind when setting accounting standards and interpreting those same standards. The AASB must ensure that any changes made to an interpretations structure allows for a balanced set of views. While the major firms have a key role to play they are not the only organisations with a right to be heard in the development of laws that impact on their work.

It would be easy for the AASB to limit involvement in panels to the major practices on the basis of access to international resources and implementation experience, but it is arguable whether such an approach is fair in an environment where it makes more sense to allow the practitioners in firms other than the major practices to have ownership of at least part of the process.

The accounting standards apply to a broader range of entities in Australia and these entities are serviced by firms outside the Big Four. It is a part of the responsibility of the AASB to encourage participation from other parts of its constituency so that all bound by the standards can take some ownership of the outcomes.

Corporate regulator should have observer status

A regulator has an important role in a capital market. There is no real substitute for strong regulation in the form of surveillance and, where necessary, enforcement action to ensure the behaviour of individuals occurs within a set of norms deemed appropriate. The corporate regulator should have observer status at the public meetings of the advisory panel dealing with a specific issue if these proposals proceed.

A regulator is involved in the task of interpreting the standards in the enforcement role and as such should be encouraged to be at the table during discussions on interpretative issues. Placing the regulator in a position where a policy officer is present at discussions held by an advisory panel allows for both feedback from the regulator and enables the regulator to understand developing practice within the country. Over the past 12

months there have been few avenues other than the UIG for a regulator to track developing thought on accounting for complex transactions under the new body of accounting standards. All parties within the Australian financial market have a moral obligation to assist each other to better understand the development of thinking where implementation of new accounting requirements is concerned. The exclusion of corporate regulators from such discussions makes it inevitable that tensions between practitioners and a regulator will emerge when interpretations of international standards are debated in the context of both general application of principles and specific fact patterns.

The regulator should also be given the opportunity to attend meetings of the subcommittee of the AASB in order to raise issues that the AASB should consider. This committee should meet in public so that the structure is fully accountable to those that are subject to the interpretations that may arise from these processes.

Please contact me should you have any queries or comments in relation to our submission on the proposed changes to the interpretation structure. I am available at my usual contact points.

Kindest Regards

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