

Dear Secretary,

## **BRIEF REMARKS ON THE STANDARD SETTING REGIME CHANGES**

I apologise for my lateness in providing remarks to the committee as news of the referral of the legislation to the Economics Committee of the Senate came to me somewhat late.

I have spent most of the past 30 years of my career being involved in aspects of accounting and auditing with periods as a lecturer at two universities, 12 years within the accounting profession working within associations, and also with an involvement in working groups of standard setters.

The following remarks are made with my experiences in mind, and I sincerely hope their brevity does not impair their usefulness to the committee.

### **STRUCTURAL CHANGES**

No sound case has been made for a change in the structure of the standard setting process. The only argument that individuals have raised with me is that the revised structure is more flexible and allows an easier method to establish specialist committees or boards to deal with new or emerging areas of technical literature.

Nothing has come to my attention that would suggest the current structure is unable to cope with the accounting, auditing or sustainability standards workload.

An option to set up a separate standard setter for sustainability standards in the manner that the AASB and AUASB have been set up in legislation in the past was clearly rejected by the government. Parliament has done this in the case of two standard setters. It could have done so in this instance without the need for this exercise in 'renovation rescue'.

The government is clearly of the mind to change the standard setting structure, but it seems more like a renovation fetish than an undertaking that has sound organisational or technical merit. That said: the following should be borne in mind to preserve the best elements of the standard setting traditions in Australia.

### **WORK OF THE ERA**

The body known as the ERA should not do anything other than set standards. It should only craft specialist legislation dealing with accounting, audit, sustainability and similar guidance. Surveillance and enforcement should be done by others. Ensuring that the rule maker is not the investigator nor the judge or jury on any matter is critical. Consider the separation of powers as a key principle when contemplating the nature of this new structure that has your attention.

Standard setting is about getting the technical literature correct, and not about policing conduct. Other authorities should investigate and police conduct.

### **SCOPE OF TECHNICAL WORK**

Standard setting is a specific discipline, and the setting of accounting and auditing standards has a long, rich history in Australia the committee should understand better before opining on a piece of legislation that is the most significant change in

the structure since the Howard government introduced the Financial Reporting Council through CLERP 1 in a 1997 discussion paper.

It is sufficient to point out to the committee for the purposes of this proposal that accounting and auditing standard setting processes were funded for several decades by the accounting profession as a public interest activity and the profession's sole stewardship ended with the creation of the FRC.

There were weaknesses in the structure – funding arrangements created a clear impression the structure could be corrupted in the early days – and there was also problematic behaviour when public sector accounting standard setting issues were being considered. AASB members, for example, were directly lobbied by a member of the Financial Reporting Council to agree with a specific technical agenda on public sector standards. This was interference in technical matters considered by the board that should never have occurred.

Committee members should reflect on how the new structure will impact independence of technical thought, and whether there are ways in which the standard setting process can be corrupted by technical or policy preferences expressed by individuals that consider an opinion on technical matters – as ill-founded but as well-intentioned as it may be – to be an adequate substitute for subject matter expertise. A previous inquiry on audit regulation undertaken by the Corporations and Financial Service committee heard from witnesses that brought up the concept of 'independent idiots'. Any standard setting structure that emerges from this legislative process will be healthier if the balance is struck in favour of knowledgeable individuals rather than 'independent idiots'. The latter function as lead in the saddle bags for any process that deals with technical matters.

I have attached an academic paper co-authored with Brad Potter and Sue Wright that will assist members of the committee to understand some aspects of the existing structure. I would be happy to speak with members of the committee individually if they want to understand more about the current process before they finalise an opinion of the legislation before them.

## **APPOINTMENTS TO COMMITTEES**

The standard setting committees set rules. They do not have a quasi-judicial function such as the Tax Practitioners Board. Amendments such as those made to legislation governing the TPB are unnecessary, and ought to be rejected by the Senate if they are proposed as amendments. Appointments to the boards should continue to be done as they have been in the past, but ministers and their advisers need to bear the following in mind.

A rule of thumb in appointing members to boards from the major accounting firms should be considered, and that is no partner that is client facing as an audit partner or a sustainability consultant or similar should be appointed to the boards. The accounting firms of reasonable size have technical partners that do not have client facing responsibilities. These are the individuals with technical expertise that should be appointed to the boards.

Board members of the AASB and AUASB are appointed not as representatives of their firms but as individuals. I have been present during board meetings held over my 30-year career during which members of a board have disagreed with the

position of their firm as submitted to the standard setter as a part of the due process. I am not as concerned as some members of the Senate about conflicts of interest given my first-hand knowledge of how the process has worked since the mid-1990s.

## **FURTHER TO APPOINTMENTS**

A further matter that must be considered by the committee is that the predominant sources of guidance considered by the boards are committees or boards of organisations based overseas. The International Accounting Standards Board, the International Auditing and Assurance Standards Board, the International Sustainability Standards Board, and the International Ethical Standards Board for Accountants are all organisations that are based in either London or New York. There is little original work that Australian standard setters can do where international guidance is slated for adoption here. Areas where original work can be done may be for not-for-profits or other entities that might have previously been known as non-reporting entities. Most of the work the boards end up doing centres around getting consistent reporting standards across the globe.

The expertise required on domestic boards – that is, boards that are appointed under the new structure should it pass in its present form – must be from organisations that are at the cutting edge of financial reporting and auditing. You cannot simply rely on retired partners or academics to sit on standards boards as they will not be across contemporary practice. They just won't and it is simply nonsensical to argue otherwise. Accounting standards dealing with complex financial arrangements – typically known as financial instruments – are changing as you contemplate this legislation. These standards are not easy to understand nor are they easy to apply and they require those working with that guidance every day to give their understanding of how the standards will impact on reporting and compliance for entities in Australia. This is the kind of literature that will have some experts' eyes glaze over – it is not a subject matter that will ever attract the attention of the average punter. The best that can be managed for the average punter is some form of disclosure that explains what the numbers mean.

The committee may find it useful to ask the major accounting firms how they structure their technical divisions globally, and how technical positions on the application of accounting rules are agreed within a global network. The practice since the adoption of IFRS has typically been that international desks handed down the interpretation as it should apply across the firm. I mention this so that there is at least an illustration before the committee of how the adoption of international standards impacts what our standard setters can do here.

I apologise for not being able to write a more substantive submission on financial reporting and audit regulation given time constraints. I hope the material above assists the committee's reflections on the legislation. I am happy to assist further if the committee wants further background.

Kind Regards

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