A Review of the Costs and Benefits of Australian Adoption of IFRS

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Abstract

Since the announcement in July 2002 that Australia would adopt International Financial Reporting Standards (IFRS) much has been written on the issue by commentators in academic and professional journals, as well as in the financial press. This paper reviews this commentary by focusing on the cited costs and benefits of the decision in the lead up to and immediately following the adoption date of 1 January 2005. Based on this review it is possible to consider, albeit in a fairly subjective manner, whether in fact the benefits of adoption to both business and the profession are likely to outweigh what appear to be not insignificant costs.
Introduction

The Financial Reporting Council (FRC) announced on 3 July 2002 that Australia would adopt International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), previously referred to as International Accounting Standards (IAS), for reporting periods beginning on or after 1 January 2005.\(^1\) Since the announcement much has been written about the expected benefits and costs likely to flow from the decision. Indeed, the merits of such a policy were discussed to some extent before the FRC’s announcement, largely in the context of the Australian Accounting Standards Board’s (AASB) previous policy, adopted in 1996 (AARF & AASB 1996), of harmonisation with IAS, and also arising from earlier proposals, contained in the Federal Government’s 1997 Corporate Law Economic Reform Program (CLERP) Paper No. 1 (Commonwealth of Australia 1997), to adopt international standards in Australia from 1 January 1999 (see Collett et al. (1998) for a fuller discussion of these earlier proposals).

Discussion of the relative merits of the adoption of IFRS in Australia has appeared in both the academic and professional literature. As the date of adoption approached the issue also received increasing coverage in the financial press. The academic papers on the issue provide comprehensive analysis of specific aspects of the decision. For instance, Howieson and Langfield-Smith (2003) deal with the appropriateness of the FRC edict and issues associated with the timing of the proposal, including the short interval between announcement and adoption dates. Haswell and McKinnon (2003) comprehensively discuss, amongst other things, issues related to the impact of the decision on the quality of accounting standards, and therefore financial reports, in Australia, and the influence of corporate lobbying of the IASB on the outcomes included in IFRS.

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\(^1\) Given the requirements of AASB 1, *First-time Adoption of Australian Equivalents of International Financial Reporting Standard*, the first annual reports based on Australian equivalents of IFRS for companies with 30 June balance dates will be for the year 1 July 2005 to 30 June 2006. However, as comparatives also need to be based on the new standards, their statements for the year 1 July 2004 to 30 June 2005 need to be recast, giving a transition date of 1 July 2004. Companies with 31 December balance dates have a transition date of 1 January 2004. These dates are likely to pose challenges for at least some companies when it is considered that the Australian equivalents of IFRS weren’t made by the AASB until mid-July 2004, with amendments to some of these appearing as late as December 2004.
Since the FRC announcement articles on the adoption of IFRS have regularly appeared in the professional literature, in particular the monthly magazines *Charter* (previously *CA Charter*) and *Australian CPA* (now titled *IN THE BLACK*), respectively published by the Institute of Chartered Accountants in Australia (ICAA) and CPA Australia. These tend to take one of three forms: succinct discussions of specific issues related to adoption in general, commentary upon specific proposals contained in one or more IFRS to be adopted in Australia, or general updates on progress by the AASB of the period leading to adoption. Carroll (2004a), in one of a series of articles she wrote for *Australian CPA*, provides an example of the first class of paper, a short discussion of the issue of whether Australia should adopt IFRS verbatim, or allow additions or deletions in the Australian versions. In their discussion of the likely impact of the new rules on intangible assets upon the quality of corporate reports in Australia, Picker and Hicks (2003) provide an example of the second class of article that has appeared in the professional literature. Alfredson (2003a) is an example of the last, where the then chair of the AASB provides a status report on progress to implementation as at April 2003. Many more examples of each class have appeared in the professional journals over the past three or so year, some of which are referred to later in the paper.

With the approach of the adoption date newspapers such as *The Australian Financial Review (The AFR)* have published with increasing frequency articles highlighting the approach of the deadline and the impacts of adoption, generally or of specific standards, upon corporate Australia, often citing financial impacts on particular companies. For instance, *The AFR* on 13 September 2004 published an article suggesting changes to accounting rules for defined benefit superannuation plans would lead to a negative impact on corporate retained earnings of up to $4 billion, with 90 per cent of this being accounted for by five companies specifically named in the article (Buffini 2004a).
Recognising the significant contribution and importance of all avenues of information and debate on the question of the appropriateness of Australia’s decision to adopt IFRS, this paper provides a wide-ranging review of the cited benefits and costs of the decision. While the adoption decision has been made, and the critical date of 1 January 2005 is now past, it is informative to reflect on what Australian business and the Australian accounting profession have been told about these costs and benefits. Based on this it is possible to consider, albeit in a fairly subjective manner, whether in fact the benefits of adoption to both business and the profession are likely to outweigh what appear to be not insignificant costs. Possible reasons for an apparent imbalance observed in the commentary are discussed. The review proceeds by considering first the benefits of adoption and then the costs. In both cases, as far as is possible, each are considered as they relate to first the business community in general, and then to the accounting profession, broadly defined. Those that extend to parties beyond these two groups are also considered.

**Benefits of Adoption of IFRS**

Carroll (2003a, p. 76) states that ‘The benefits of adopting IFRS are obvious’, citing more effective communication and engagement between business, investors and other stakeholders. On this basis one might expect a significant amount about these benefits to have been written. Interestingly, as will become clear as the reader progresses through this paper, this does not seem to be the case. An alternative hypothesis which might explain this apparent imbalance in the debate, and which is explored further later in the paper, is that the benefits of adoption are so clear and well understood as not to warrant extended explanation or discussion.

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2 Interestingly the then president of CPA Australia, David Baulch, used these exact words in a paper presented to the ASEAN Federation of Accountants conference in Bangkok, Thailand, on 10 October 2003 (Baulch 2003).
**Benefits to Australian Business**

*Quality and Comparability of Financial Statements and More Efficient Capital Markets*

A frequently cited benefit of adoption of IFRS is ‘improvement in the efficiency of the capital markets that will arise from the existence of a set of globally acceptable accounting standards that result in high-quality, comparable and transparent financial reporting’ (Alfredson 2003a, p. 50; Alfredson 2003b, p. 66). While Alfredson (2003a) refers to the European Union’s (EU) desire to create a single capital market, it can be asked whether this is relevant to Australia’s adoption decision. Australia is not part of a formal multinational economic grouping such as the EU. Further, the EU is requiring adoption of IFRS only for consolidated financial statements, not for primary single company reports, and ‘There is little indication that EU countries are likely to switch to IFRSs for primary reporting’ (Haswell & McKinnon 2003, p. 10). Indeed, Collett *et al.* (2001, p. 177) indicate that ‘The Commission of the European Communities … acknowledges that IASs could be inappropriate and possibly invalid for the preparation of individual accounts, given various national regulatory and taxation requirements’.

In a somewhat similar vein Knapp (2003, p. 54) lists the benefits of adoption of IFRS as ‘facilitation of cross-border listings, financial statement comparability for investors, reducing the cost of capital in Australia and improving access to foreign capital for Australian entities’. Similarly Haswell and McKinnon (2003, p. 8) refer to reduction in ‘the information costs of transporting capital around the world’, and benefits to Australia in particular due to its ‘isolation, small size and need for competitive advantage in attracting foreign investment’. Collett *et al.* (2001, p. 176) elaborate on the source of these benefits, explaining that increased comparability encourages the flow of international investment, while a lower cost of capital results from ‘removal or reductions in premiums associated with the risk of not fully understanding the financial report’. Warren McGregor, an Australian member of the IASB, strongly supports this view, stating
'Australian corporations are certainly the winners: they’ll be able to produce accounts that are instantly comparable with a significant number of international players’ (Abernethy 2002a, p. 38).

It is important to note that the benefits suggested by these commentators to flow from adoption of IFRS, such as more efficient capital markets, improved access to foreign capital and a lower cost of capital, are all contingent upon the greater comparability of Australian financial reports with those produced by overseas companies. Investors, both domestic and foreign, will be better able to comprehend the information contained in Australian financial reports and make valid comparisons with alternative investment opportunities. It is argued that this increased comparability, together with increased confidence in the quality of the financial reports produced using IFRS, will lead to better investment decisions. Warren McGregor contends that ‘accepted standards that are supported internationally … [will] create confidence among investors that what they are reading is high-quality financial reporting’ (Abernethy 2002a, p. 38), a view supported by Greg Pound, the Chief Accountant of the Australian Securities and Investments Commission (ASIC), who argues that ‘Consistent and comparable reporting in accordance with the standards is important to the confident and informed participation of investors and others in our markets’ (Pound 2004, p. 65). Whether the improvement in the quality of Australian financial reports is likely to eventuate given the AASB’s particular approach to adoption of IFRS is discussed further later in the paper.

Lower Reporting Costs

Attraction of foreign capital by Australian companies may require them to list in a foreign jurisdiction. On this point Warren McGregor identifies the second oft cited major benefit to flow to such companies from adoption of IFRS: ‘Australian companies won’t have to have two sets of books any more in respect of the fact that [other foreign] jurisdiction supports international accounting standards’ (Abernethy 2002a, p. 38). Collett et al. (2001, p. 176) similarly cite the
benefit of lower reporting costs by removing the need for production of more than one set of financial reports to satisfy the requirements of differing sets of regulations. Haswell and McKinnon (2003, p. 9) agree that ‘Savings in accounting costs, particularly for transnational companies, could be enormous’.

It is important to note that these benefits will flow mostly to large listed companies (Howieson & Langfield-Smith 2003), a relatively small percentage of the total number of companies in Australia. Haswell and McKinnon (2003, p. 9) are clear that ‘For smaller companies … the move to IFRS will have no obvious immediate benefit. They will, however, be faced with massive changeover costs’. These limitations on the benefit to smaller Australian entities exclusively raising capital domestically were recognised some years earlier by the then head of the AASB, Ken Spencer (1998).

Carroll (2004a, p. 76) further questions whether the approach to ‘adoption’ in Australia will allow full realisation of these cost savings, given that the AASB is not adopting IFRS verbatim. She argues professional accountants employed by or servicing multinational companies such as BHP Billiton, ‘which will continue to prepare accounts using multiple sets of standards’ will not benefit to the extent they could if verbatim adoption occurred, and that these decisions ‘exacerbate the ability for these entities to reduce financial reporting costs and allow comparison of their financial reports across multiple jurisdictions’. The costs associated with non-verbatim adoption of IFRS in Australia are further explored later in the paper.

3 It is be recognised that while small in number, these large companies account for the vast majority of the invested capital and wealth creation in Australia.
Benefit to the Australian Stock Exchange

The Australian Stock Exchange (ASX) is likely to be a winner in the adoption process. Adoption of IFRS may dissuade Australian companies from listing on other exchanges that allow IFRS as the basis for financial report preparation (Collett et al., 2001, p. 180). Further, allowing IFRS as the basis for listing in Australia might attract more overseas companies to list on the ASX (Haswell & McKinnon 2003), increasing the Exchange’s revenue. Collett et al. (2001, p. 180) go as far as suggesting that strong ASX support for adoption of IFRS in Australia might be related to the floating of the ASX, and the consequential positive effect of increased listings and access to overseas capital upon the value of the Exchange.

Benefits to the Accounting Profession

Simplification of Accounting for Multinationals

Simplification of the accounting function for multinational companies is an oft touted benefit of harmonisation of accounting standards, and as such would be expected to be realised by Australia’s adoption of IFRS. Forms such simplification might take would include: more straight-forward consolidation of the financial statements of multinational groups, easier preparation of comparable internal reports for management of subsidiaries in different countries, and making appraisals of international business combinations/takeovers simpler (Nobes & Parker 2004). Interestingly these benefits were given little prominence in the Australian debate leading up to adoption of IFRS. To some extent these benefits are perhaps captured under the general heading of ‘more efficient capital markets’, and their lack of specific mention in the debate may be related to the relatively small number of parent entities of major consolidated groups which are headquartered in Australia. It is far more likely for Australian companies to be subsidiaries of parents domiciled overseas in countries with major capital markets, such as the US. In the case of those with US parents the benefits of accounting simplification disappear, since, as discussed further below, currently the US
is not explicitly considering adoption of IFRS, nor even does the SEC allow foreign companies to
list unless a reconciliation to US GAAP is provided. The situation is further complicated for dual-
listed companies. On 14 January 2005 Lee (2005a, p. 4) reported in The AFR that ‘AASB chairman
David Boymal said Australian companies would have to issue two sets of accounts … if they were
dual-listed, or restate their accounts if they had an overseas parent’ and provided BHP Billiton and
Brambles as examples of dual-listed companies in Australia; both are listed on the ASX and the
London Stock Exchange. Only where an Australian parent’s subsidiaries, or the parent of an
Australian subsidiary, are domiciled in a country which has also adopted IFRS will these benefits to
Australian companies be realised. While the number of such countries is growing, with
approximately 90 countries claiming to be following IFRS from 2005, until they include the major
capital markets such as the US, Japan and Canada these benefits are not likely to be fully realised
(IASB 2004).

International Accounting Firms

An obvious advantage to international accounting firms such as the Big-4, as well as smaller firms
with international affiliations, is the improved transferability of their staff. This transferability will
extend to individual accountants with IFRS expertise, for whom it is expected to work in both
directions. Gavin Ord, the Technical Policy Manager of the National Institute of Accountants
(NIA), indicates that ‘there will be a continuing shortage of accountants involved in financial
reporting and particularly IFRS … [which] means firms are going to have to look outside Australia
to find more staff’ (Heathcote 2005, p. 68). This need is likely to be exacerbated by the fact that
Australian accountants experienced in IFRS are likely to be in high demand overseas. Ord suggests
that since ‘Australia is one of the first countries to move to international accounting standards …

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4 The adoption from 2005 of IFRS for preparation of consolidated financial statements by the UK, one of the world’s
largest capital markets, as part of the EU’s adoption policy, while a significant step toward realisation of such benefits,
is limited by the decision not to adopt IFRS for preparation of domestic single entity financial reports; the reports of
dual-listed companies fall into the latter group.
Australians will often have a few years more experience than other accountants’ (Heathcote 2005, p. 68). This offshore demand, together with often higher salaries on offer overseas is likely to put further pressure on Australia’s already stretched IFRS expertise.

It has also been suggested that large international accounting firms will benefit from the homogenisation of business transactions that will result from adoption of a single set of internationally accepted accounting standards (Perera et al. 2003, p. 29). In particular, such firms can benefit from development of products or services which can be sold in multiple markets, a practice referred to by Perera et al. (2003, p. 29) as ‘product globalisation’, with specific examples of such products being audit software and e-business systems. However, Perera et al. (2003, p. 32) suggest that the benefit of decreasing costs to large firms from the move to global standards needs to be balanced against a likely decrease in revenues. ‘Homogenous standards will reduce the cost of doing an audit because audit systems and procedures can be standardised. At the same time, uniformity in accounting standards will accelerate the commoditisation of audits…. removing differences in expertise with regard to local accounting standards will make audits within the [then] Big 5 even more alike. Unable to differentiate their products, the Big 5 will be forced to cut prices, which will reduce revenues’ (Perera et al., 2003, p. 32).

**Benefits to the Australian Government**

Given that much of the push for adoption of IFRS in Australia has come from the Federal Government, particularly under the auspices of its CLERP reforms, it is not surprising that it has been suggested that it will be one of the beneficiaries of the process. Haswell and McKinnon (2003) indicate that prior to adoption of IFRS the AASB incurred expenses of around $3 million per annum in the process of formulation of domestic accounting standards. Thus, cost savings to the Australian government are likely to result from being able to wind down the Board’s operations.
Balancing this is the potential impact on the status of Australia as a national standard setter, addressed below.

Haswell and McKinnon (2003) also suggest adoption may benefit the government by providing the ability to distance itself from any future corporate collapses, which tend to raise questions about the role of accounting and the quality of accounting standards in such incidents. Leaving aside the substantial collapses in the US involving companies such as Enron and Worldcom, the recent Australian corporate collapses involving Harris Scarfe, One.Tel and HIH alone suggest that such a benefit is likely to be non-trivial.

**Costs of Adoption**

The July 2002 decision by the FRC was not expected to be a simple and costless one to implement. Having only recently bedded down the introduction of the goods and services tax, a major challenge for Australian business and the accounting profession, both were asked to face an even greater challenge. According to Ham (2002, p. 40) ‘The demands on time and brain power required to adopt IASs before 2005 would dwarf the goods & services tax (GST) introduction’. Similarly, Haswell and McKinnon (2003, p. 9) proclaimed ‘The forthcoming upheaval will be the biggest accounting disruption ever, eclipsing by far the introduction of the goods and services tax in 2000’.

**Costs to Australian Business**

*Education of Users/Stakeholders*

A major cost of the introduction of a new set of financial reporting requirements is the need for external users to educate themselves regarding the changes in the financial statements, and companies need to ensure these stakeholders understand the changes (Knapp 2003; Ravlic 2003). For instance, banks need to be informed if loan covenants rely on accounting numbers, and analysts
need to understand why numbers may change (Ravlic 2003). Williamson (2003, p. 74) suggests other stakeholders affected by the change to IFRS include ‘company analysts, auditors, … debt holders, IT suppliers and shareholders’. Pound (2004, p. 64) regards this responsibility as falling upon the companies themselves, rather than the users, and states: ‘Companies should start to inform and educate members and other users of their financial reports on the impact of the new standards now. Users need to understand the extent to which changes in financial position and performance are attributable to the new standards as opposed to changes in the underlying business’.

**Staff Training and System Changes**

The direct costs to business of ensuring readiness for the transition to IFRS are not inconsiderable, and include staff needing to be dedicated to ensuring changed requirements are understood (Ravlic 2003), and making any system changes required (Pound 2004). Williamson (2003, p. 76) suggests that these changes require ‘A lot of time and effort’, while Dodd and Sheehan (2004, p. 67) indicate the need for ‘new and greater volumes of data to be collected’, with changes not only required to external financial reporting systems but also to ‘systems for budgeting and internal management reporting’ (see also Williamson 2003). Further, controls need to be extended to cover the new data (Dodd & Sheehan 2004). Alfredson (2003a; 2003c) suggests system changes are necessitated by complex accounting changes, such as in accounting for derivatives. As a further example, Williamson (2003, p. 76) identifies the additional information requirements relating to ED 2 (now IFRS 2), *Share Based Payments*, which ‘include number of staff, option conditions and detailed history of staff turnover’. Pound (2004, p. 64), ASIC’s Chief Accountant, emphasises the need for ‘company boards and management to take an active interest now [May 2004] and develop and implement a strategy to effectively manage a timely transition to the new standards’, arguing that ‘Failure to plan adequately to meet the 2005 deadline may result in your company being at risk of breaching the financial reporting requirements of the [Corporations] Act’ (Pound 2004, p. 65).
Interestingly, the approach of the implementation date has seen a surge in interest in the financial press regarding these costs to businesses. For instance, an article in The AFR on 15 September 2004 outlines the likely costs of implementation of IFRS for the Big 4 banks – CBA estimates the likely cost to be $10 million, mostly related to staff and consultants; Westpac has budgeted $46 million; for the ANZ the cost is estimated to be around $10 to $20 million; and for the NAB it is expected to be around $120 million (Moullakis 2004a, p. 56). On 2 September Foley and Buffini (2004, p. 5) reported in the same newspaper that Peter Day, CFO of Amcor Ltd, indicated the change to IFRS would cost more than $3 million.

The importance of adequate training and planning is emphasised by recent changes to the Corporations Act, requiring CEOs and CFOs to sign an annual declaration on the company’s financial statements and records. A survey of ASX listed companies by RSM Bird Cameron, reported in The AFR on 18 January 2005, established that 41% of CEOs lack sufficient knowledge to sign the declaration, with 45% saying ‘they might be overly reliant on their chief financial officer to sign the declaration’ (Lee 2005b, p. 6).

For many companies implementation of system changes needed to adopt IFRS is an extended process. Williamson (2003, p. 74), based on experience with a conversion for a large European company, suggests ‘an IFRS conversion could take anywhere from a few months to longer than a year’. Carroll (2003b, p. 79) suggests that ‘Members [of CPA Australia] are … aware of the importance of creating a business strategy to support a smooth transition to IFRS’. However, a survey of 800 members reported in June 2003 (Carroll 2003c, p. 80) reveals that only 11 per cent ‘indicated their business has a strategy in place to manage the transition’. While Carroll (2003c, 80) reports that the same survey indicates over 75 percent of respondents believed ‘their company has
adequate resources to meet the challenge of IFRS implementation’, for many businesses acquiring the necessary resources to perform the transition may be problematic ‘as demand will be high for suitable trained staff’ (Dodd & Sheehan 2004, p. 67). Subsequently, on 5 October 2004 PricewaterhouseCoopers reported the results of a national survey of primarily Australian listed companies, indicating that many anticipated having difficulty meeting the 1 January 2005 implementation deadline. In fact, the survey revealed that ‘while 90 per cent understand the importance of IFRS implementation, 85 per cent are not confident they have the right skills and resources in place to help them complete the change in time’ (PricewaterhouseCoopers 2004, p. 1). Further, it ‘showed that 75 per cent of companies surveyed feel they have significant work ahead of them to correctly identify missing information that will be needed to complete their first 2005 IFRS report’. Somewhat disturbing is that ‘only 61 per cent of companies that responded have some full-time resource working on their IFRS transition project’, and ‘Just 24 per cent of companies surveyed have sourced their IFRS data and completed the assessment of their IT systems to ensure they are IFRS ready’ (PricewaterhouseCoopers 2004, p. 1). This apparent lack of readiness for adoption may be of particular concern in light of ASIC’s indications that it will not provide relief from compliance with IFRS requirements, and nor will it grant an extension of time to comply with those requirements (ASIC 2004).

Reporting on 12 January 2005 in The AFR, Lee (2005c, p. 3) indicates that a survey by Hays Accountancy & Finance ‘of more than 400 finance directors found that half of all Australian employers felt there was a more severe shortage of accountants with IFRS skills than any other finance discipline’. With Fenton-Jones (2005, p. 6) reporting that a survey by the Finance and Treasury Association found ‘that one in three Australian and New Zealand organisations with a December 31 financial year-end had not yet begun the transition to the new standards as of August
[2004], the demand for staff with IFRS experience is likely to become more acute. Williamson’s (2003, p. 75) suggestion that to ensure implementation proceeds effectively ‘Companies that have limited resources or lack significant, and available, project management experience should consider bringing in external support’ may not prove to be practical in the face of a such a skills shortage. Of course, the companies needing such external support are likely to be the smaller ones, least able to afford to pay for these services. Indeed, and perhaps not surprisingly, the impact on the small business sector received growing attention with the arrival of the adoption deadline. Lynch (2005, p. 47) reports on 1 February 2005 in The AFR of the chiefs of both CPA Australia and the NIA urging small businesses to advance their preparations for adoption of IFRS, with the head of the former body suggesting they ‘need to get on with it’. Reporting a week later on the Senate inquiry into IFRS adoption, Fabro (2005) indicates a push by some groups for assistance for small and medium enterprises. A further week later Lynch and Fabro (2005) report on the inquiry’s recommendation of a one month extension to the first reporting deadline faced by such businesses under the new standards regime. Whether such an extension proves to be adequate for these businesses remains to be seen.

*External Experts and Support*

Greater input from external experts will be needed as part of the transition, including actuaries and valuation experts (Dodd & Sheehan 2004). Williamson (2003, p. 75) identifies areas that may require external experts as including ‘pension valuation, testing impairment of goodwill, deferred taxation, and the classification of financial instruments’, with IT vendors’ support also needed to implement ‘changes to reporting and budgeting systems’. She also raises the interesting issue of whether the fees paid to these external experts during the implementation process are in fact effectively subsidising the training of these experts, to whom reporting under IFRS is also new

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5 New Zealand companies are required to adopt IFRS from 1 January 2007, but may early adopt from 1 January 2005.
(Williamson 2003). Notably, the need for the services of these external experts is likely to extend beyond the initial implementation process, and may be ongoing.

**Business Impacts of Amended Standards**

While it is not the purpose of this paper to discuss in detail changes to the requirements of specific accounting standards, it is important to note that some of the new requirements will have broad impacts upon Australian businesses. Pound (2004, p. 64) identifies possible impacts on companies as ‘changes to profit that affect the ability to pay dividends; a need to revise profit incentive schemes; impact on loan covenants; and tax implications such as thin capitalisation issues’. Picker and Hicks (2003, p. 78) confirm significant impacts in these areas simply from the new requirements relating to intangible assets. In a similar vein, Ravlic (2003) warns that the consequences for business in relation to classification of financial instruments as debt rather than equity, and the effect on profits of the change to an impairment test for goodwill are significant and need to be taken into account. Cunico (2004) provides an illustration of the impact of the latter change, as well as other areas of operations that are likely to be affected by the move to IFRS. Williamson (2003, p. 75) suggests the effects of the changes on debt covenants ‘may require complex renegotiations with debt holders that can take a significant amount of time and management resources’. Dodd and Sheehan (2004, p. 66) indicate that ‘a greater focus on fair value will increase volatility of results’, which will affect aspects of company strategy and policy, including remuneration, acquisitions and divestments, and dividend policy. They argue this necessitates good management of analyst and investor relationships, ensuring ‘proper communication and explanation of IFRS impacts’ (Dodd & Sheehan 2004, p. 67). As far as impact on remuneration agreements is concerned, Dodd and Sheehan (2004) suggest good communication with unions and employees will be vital, while information reported to regulatory authorities, such as the Australian Prudential Regulation Authority (APRA), will also need to be assessed. Boyd
(2005, p. 55) reports that ‘Banks are concerned about APRA’s interpretation of the IFRS because of the potential impact on their capital’, particularly the potential reclassification of hybrid equity instruments out of Tier 1 capital acting to disadvantage local banks relative to their international counterparts.

While many of the new standards’ impacts will change the way a business reports its assets, liabilities, income and expenses, they will not change the underlying fundamentals of the business itself as they have no effect on the cash flow of the entity. An exception to this is the case of the thin capitalisation tax rules, which affect companies with foreign parents (Fenton-Jones 2004a). According to Fabro and Buffini (2005, p. 3) ‘The rules require companies to maintain a certain level of equity relative to their debts if their debt repayments are to be tax deductible’. Write downs of assets and reclassifications of financial instruments caused by the adoption of IFRS in this case have the potential to affect companies’ cash flows via deductibility of interest. To meet the concerns of multinational companies in relation to this matter the Federal government announced on 24 January 2005 that it would provide a three year transitional period, during which time calculations can be undertaken using the accounting principles in place prior to adoption of IFRS (Treasurer of the Commonwealth of Australia 2005). Whether this will require preparation of two sets of accounts is not clear, but even if it does not, any ‘concession’ requiring that companies simultaneously operate two systems of accounting standards for a three year period will impose significant additional costs on these companies. The fact that this comes so late in the process of adoption suggests that the rush to adoption may, as Howieson and Langfield-Smith (2003, p. 24) suggest, not have allowed sufficient time to ‘deal with the practical difficulties involved in implementing IFRSs in two-and-a-half years (effectively 18 months)’.
While Pound (2004, p. 64) recognises that ‘Concern has been expressed that the new standards will increase the volatility in reported profit because it will reflect the results of operational resource flows as well as the economic impact of movements in the market value of assets and liabilities’ he refutes this by stating that ‘Accounting standards don’t create volatility. This is in the underlying transactions and events and the standards merely ensure that the impact on a company’s economic resources and wealth is well reported and explained. An “economic substance over legal form” approach should be reflected in applying the standards’ (p. 64).

Not surprisingly these business impacts have been the subject of considerable coverage in the financial press during the lead up to the implementation date. The lead article in The AFR on 13 September 2004 refers to fear of the new standards causing a ‘dramatic increase in the volatility of profits [which] might affect their [companies’] ability to borrow, confuse investors and hurt their international competitiveness’ (Buffini 2004b, p. 1). It also indicates that Woolworths CEO ‘Roger Corbett described accounting changes as, “complex and ... quite time consuming”. “At the end of the day, I don’t know [if they will be] significantly for the better. There’s nothing that’s going to change the impact or import of accounts or the transparency of accounts,”’ (Buffini 2004b, p. 1). Interestingly, Wood (2004, B1) reports in the The Age a month later on a plan by Woolworths to restructure its executive payment schemes ‘in a bid to circumvent new accounting standards that force them to charge share options against profits’.

As early as 10 April 2003 The AFR suggested adoption of IFRS requirements on intangible assets was ‘likely to wipe billions of dollars from the balance sheets of Corporate Australia’ (Buffini 2003, p. 4). With the approach of the adoption date these impacts are more explicitly quantified. Foley and Buffini (2004, p. 5) indicate in the same daily on 2 September 2004 that ‘The switch to the international rules will … wipe some $40 billion of intangible assets from corporate balance sheets,
require recognition of $4 billion in superannuation shortfalls and reclassify $12 billion of hybrid securities. These financial impacts are again referred to by Buffini (2004b) in the lead article in The AFR less than a fortnight later, on 13 September, in which she highlights an initial impact on Coca Cola Amatil’s retained earnings of $1.9 billion from the need to write off previously recognised intangibles. Two days later Durie (2004) mentions the same impact in his article covering the broad impacts on business of the adoption of international standards. In the same issue Burbury (2004) provides a feature article dealing solely with the impact of the changes in accounting for intangibles, particularly brands. Only two days later Buffini (2004d) highlights the uncertainty surrounding the impact of the need to value stock options under the new accounting rules. This flurry of commentary in the financial press in the latter part of 2004 is likely reflective of the growing activity, and possibly concern, within corporate Australia regarding their readiness for the impending adoption deadline. On 19 November Moullakis (2004b, p. 69) reports the results of the August survey commissioned by the Finance and Treasury Association of Australia which found ‘only 12 per cent of respondents had completed or almost completed the transition to IFRS’.

Finally, adding to the burden on Australian companies at this time is the requirement under AASB 1047, Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards, to disclose in financial reports for periods ending on or after 30 June 2004 (up to the first set of IRFS reports) details of how the transition to IFRS is being managed and explaining any key differences in accounting policies likely to arise from adoption (AASB 2004, para. 4.1). Such disclosures may also be required in any prospectuses issued (Pound 2004). Buffini (2004e) reports on a review by ASIC of the disclosures made under AASB 1047 by over 1,100 listed companies with 30 June 2004 balance dates which indicates 99 per cent reporting the effect of

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6 Subsequently, in December 2004, AASB 119, Employee Benefits was amended to allow alternative accounting treatments to immediate recognition of actuarial gains and losses on defined benefit superannuation plans.

7 In the same issue Buffini (2004c) produces an article solely on the impact of the changes to the requirements on accounting for superannuation, subsequently amended, specifically identifying those companies to be most impacted by the new standard.
the change to IFRS, but only 10 per cent providing expected quantitative details of the impacts. While such quantified disclosures were not required in 30 June 2004 accounts, they will have to be made in those for periods ending on or after 30 June 2005 (para. 4.2). It appears significant preparation and consideration of the impact of adoption of IFRS remains to be undertaken by Australian businesses.

Adding to the total cost of adoption of IFRS to Australian businesses is the fact that the standards are to apply to all reporting entities in Australia, not just listed corporations (as in the EU) (Howieson & Langfield-Smith 2003). Picker and Blumberg (2003, p. 65) elaborate, explicitly pointing out that since the AASB produces only one set of standards for all reporting entities, the requirements ‘will effectively apply also to reporting entities that are not Corporation Act entities’. The relative costs of implementation are likely to fall more heavily upon the smaller unlisted entities, which are less able to bear those costs. As stated by Miller (2003,p. 2) ‘With the uneven distribution of pain and benefit, some reporting entities will eagerly anticipate the changeover dreaded by others’. Carroll (2003b, p. 79) suggests that while ‘The big end of town will bear the greatest impact of the transition to IFRS … smaller entities are not exempt’. While this may be true of the impact in terms of the absolute number of dollars, it is unlikely to be the case in a relative sense.

Costs to the Accounting Profession

Re-education

There is no doubt that the need to re-educate in light of the change to IFRS extends beyond users to members of the accounting profession itself. Bill Edge, chair of the Audit and Assurance Standards Board, identifies the ‘need for auditors to understand the changing reporting landscape against which they will need to benchmark the reporting done by external audit clients’ (Ravlic 2002a, p.
60). Professional bodies and educational institutions must amend their programs in light of the changes (Alfredson 2003a; 2003b; 2003c; Knapp 2003). This is considered by Howieson and Langfield-Smith (2003, p. 19) to be ‘one of the most critical aspects of effective implementation’. Late in 2004 CPA Australia announced the revision of those segments of its program which cover reporting and disclosure requirements of accounting standards, for implementation from 2005 (Carroll 2004b). It is difficult to dispute Howieson and Langfield-Smith’s (2003, p. 22) belief that ‘Re-educating preparers, users, auditors, accounting students and academics for the contents of IFRSs in time is critical’. Whether the resources necessary for this to occur are, or will be made available remains to be seen.

_Dilution of Existing Standards_

The possibly has been raised that the adoption of IFRS in Australia dilutes the requirements contained in the pre-existing, highly regarded, local standards (Abernethy 2002a). Prior to the Australian decision to adopt IFRS from 2005, and the consequential program of improvement embarked upon by the IASB, there was much criticism of IFRS for their lack of rigour, a result of having ‘emerged from a process of much greater compromise than that required for national standard setting (Collett et al. 2001, p. 177). International standards were described as resulting in minimum standards, ‘more permissive and less comprehensive than domestic standards in Australia’ (Spencer 1998, p. 21). While the improvements and convergence programs implemented by the IASB since this view was expressed may have met these criticisms to some extent, it is still the case that some IFRS contain more than one allowable accounting treatment. In some cases the Australian versions of the international standard outlaw alternatives, resulting in a more stringent set of requirements. This approach, which requires non-verbatim adoption of IFRS, is by no means without its problems. Foley and Buffini (2004, p. 5) report in _The AFR_ on 2 September 2004 the severe criticism by Peter Day, the CFO of Amcor, of the AASB’s decision to alter the standard on
superannuation by choosing a particular option out of those available in the equivalent IFRS. His view, and that of many others, is that ‘Australia should follow the international accounting standards “to the letter, unless it’s clearly adverse to Australia’s national interest”’. A further point he makes, which is also made by others, is that some companies will have to prepare two sets of accounts, negating some of the significant benefits of adoption discussed above (Foley and Buffini 2004). Carroll (2004a, p. 76) says it ‘create[s] apathy and confusion among our [CPA Australia] members and the general public’. Haswell and McKinnon (2003, p. 15) speculate that a possible outcome of this policy of the AASB could be ‘Uniformity-Minus, or Rule by Exception’, such that ‘interests with special needs would be allowed to use an Australian modification. The allowed modifications could be few, or many. If the latter, then we are no better off than if we did not have uniformity (and the IFRSs still have too many exceptions). But even a few exceptions will present problems’.

Collett et al. (2001, p. 179) note that the adoption of international standards was actively opposed by a number of parties prior to the July 2002 announcement by the FRC, including the G100, who felt heavier reporting burdens would result from adopting some international standards, as well as by ‘the [then] Big 5 accounting firms, the professional accounting bodies, and the major banks’. Even ASIC ‘highlighted in its submission [on CLERP Reform Paper No. 1 proposing adoption of IASC standards from 1 January 1999] the potential loss of quality in accounting standards flowing from a hasty adoption of IASs. Taking the same view was the Accounting Association of Australia and New Zealand’ (Collett et al. 2001, p. 179). Even the national standard setters in the US and UK, the Financial Accounting Standards Board (FASB) and Accounting Standards Board (ASB), ‘cautioned against early adoption’ of international standards (Collett et al. 2001, p. 179).
Similarly, Ravlic (2002a, p. 59) indicates ‘that there is more detailed guidance in some Australian accounting pronouncements than exists in IASB counterparts’, and quotes Colin Parker’s view that in at least some Australian standards there ‘is arguably superior and clearer guidance’, with two examples being ‘the easily understandable income tax standard and the robustness of our consolidations standard. Any quest for verbatim adoption of international accounting standards will result in several instances of poorer quality financial reporting’. Haswell and McKinnon (2003, p. 9) suggest that ‘closing some holes (providing standards where no Australian ones exist) will not necessarily make up for any damage done by losing our presently “tight” standards’. Warren McGregor disputes the view that in moving to IFRS much is being lost (Abernethy 2002a, p. 38), stating that ‘we have no future in clinging to our home-grown standards’. Haswell and McKinnon (2003, p. 9) point out that in defending the decision of the FRC to adopt IFRS, ‘Problems with the quality of IFRSs are played down’. After analysing a number of examples where pre-adoption Australian requirements are at odds with the requirements of IFRSs, they conclude (Haswell & McKinnon 2003, p. 15) that ‘Claims that IFRS are “tighter”, “stricter” or more valid and so on do not seem to be based on evidence. We see, instead, evidence of innovative and competent Australian standards being threatened with reduction to conceptual mediocrity’.

Adding further to the argument against adoption of IFRS in place of locally formulated standards, Collett et al. (2001, p. 176) refer to the extensive research suggesting that environmental differences between jurisdictions in relation to cultural, political, legal and economic factors suggest that some differences in accounting standards are necessary and desirable, ‘and any country that adopts nondomestic standards carte blanche must worry about whether the users of reports will be serviced less well than at present [i.e. prior to adoption]’.
Lower Status of the AASB

Adoption of IFRS in place of locally developed standards may lead to a reduction in the status of the AASB as a national standard setter. Haswell and McKinnon (2003, p. 10) describe Australia as ‘one of the world’s leading authorities on accounting’. It would arguably be a significant loss if the AASB were relegated to the role of ‘rubber stamping’ of IFRS. Warren McGregor has stated that ‘It is terribly important that national jurisdictions continue to maintain a capacity to be involved in international accounting standard setting’ (Abernethy 2002a, p. 38). The extent of their expected role is not made clear. Harrison (2002, p. 7), CEO of the ICAA, suggests that ‘the local standard-setters’ role may diminish over the long term’. Further, it may be more difficult to influence the outcome of the standard setting process of the IASB than it has been under the AASB (Harrison 2002). Similarly, Howieson and Langfield-Smith (2003) suggest that national standard setters, such as the AASB, will have reduced influence over the outcomes of the standard setting process under the IASB. Haswell and McKinnon (2003, p. 12) suggest that ‘When complicated and voluminous, but not necessarily good, accounting disclosure spreads outwards from influential countries, we will be less able to resist if we are not our own boss’. Also, it appears that small Australian businesses will be relatively worse off in terms of their influence over the decisions of the IASB, since ‘Only the largest Australian businesses will have the resources to influence the IASB significantly’ and ‘Even they will need to compete for attention with the world’s giant corporations’ (Haswell & McKinnon 2003, p. 15). Carroll (2003d, p. 75) suggests that if Australia is to ensure that future standards developed by the IASB are relevant to the Australian environment it is necessary that Australia is positioned ‘as an influential leader in the international business environment’. She does not indicate how this might be achieved, and it is difficult to see how adoption of IFRS contributes to this aim given the likely effect on the status of the AASB as a standard setting body, as outlined by the other commentators. Indeed, Collett et al. (2001, p. 181) suggest that for any country

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8 The AASB has a role in relation to ‘standards peculiar to the not-for-profit or public sectors or that are purely of a domestic nature’, which are not within the ambit of IASB standards (Alfredson, 2003c, p. 5).
‘mechanically adopting international accounting standards [there] is the risk of diminishing its reputation and effectiveness in the international arena’.

The question of the continued role of the Urgent Issued Group (UIG) is also raised. The International Financial Reporting Interpretations Committee (IFRIC) of the IASB is likely to be the only body interpreting IFRS, suggesting little or no role for the UIG in the future. Indeed, Carroll (2003e, p. 78) indicates that the chair of the IASB, Sir David Tweedie, has signalled that it is the IASB’s intention to ‘amend standards rather than issue interpretations, thus minimising the number of national-based interpretive committees’. Confusion over the role of the AASB in the interpretation of international standards was reported on the front page of The AFR on 11 January 2005, with the Board’s chairman indicating the AASB, presumably through the UIG, would issue interpretations on issues where the IASB was reluctant or slow to do so (Lee & Buffini 2005). This raises the possibility that issuing local interpretations would diminish the previously discussed benefits of international comparability purported to be associated with adoption of IFRS. Further confusing this issue is the suggestion by the Chief Accountant of ASIC, Greg Pound, that this body would provide advice to companies and auditors on accounting issues where there was uncertainty of interpretation (Lee & Buffini 2005). Add to this the views of Greg Ward, the CFO of Macquarie Bank, that ‘the job of interpretation would fall to accounting firms. “The reality is that the AASB now just rubber stamps [international] standards”’ (Lee & Buffini 2005, p. 6).

While there is significant speculation about the future role of the AASB, whether in interpretation, as a testing ground for implementation, undertaking projects jointly with the IASB, or tackling issues not yet covered by the international standards, there does seem to be agreement that the Board’s role will need to change if it wishes to maintain its relevance (Lee 2005d).
**Loss of Accounting Innovation in Australia**

The future of Australian accounting research and development, and the attendant innovation and progress it fosters, is likely to diminish as control of the standard setting process is transferred to the IASB. Despite the hope expressed by the then chair of the AASB, Keith Alfredson, that “‘thought leadership’ will remain an enduring characteristic of the AASB’ and that ‘the AASB should be a participating partner with the IASB and not just a printing press for IASB exposure drafts and approved IASB standards’ (Alfredson, 2003c, p. 4), it has been suggested that the supply of ‘experienced (and influential) standard setters’ currently in Australia is likely to decline in a short period of time as Australia becomes removed from direct involvement in national standard setting (Howieson & Langfield-Smith 2003, p. 22). Collett *et al.* (2001, p. 181) suggest adoption of IFRS is ‘likely to be associated with an erosion of technical support for, and expertise in, the standard setting process, which must further diminish innovation and effectiveness’. Haswell and McKinnon (2003, p. 9) suggest that the chair of the FRC himself has implied ‘that local requirements and innovations are now less important than the need for uniformity’.

**US GAAP Rather Than IFRS?**

A niggling possibility in the minds of some commentators is that Australia may have erred by choosing to adopt IFRS rather than US GAAP, which are regarded by some as of higher quality. In particular, in the long term Australia’s decision will be costly if convergence of IFRS and US GAAP does not occur. As suggested by Jan McCahey, a partner with PricewaterhouseCoopers, ‘if America has got it so wrong, why has it got the biggest and most successful capital market and the most resilient economy?’ (Ham, 2002, p. 40). Howieson and Langfield-Smith (2003, p. 22) suggest there will be ‘little benefit for Australian companies that must comply with SEC requirements’ if the US does not adopt IFRS. On the other hand, as the chair of the IASB, Sir David Tweedie, points out (Abernethy, 2002b, p. 23), the IASB is less subject to political interference: ‘we’re not
political – no-one can fire us because no-one elected us’. Carroll (2003e, p. 78) cites the IASB’s strong stance on the EU’s reluctance to endorse IAS 32 and IAS 39 on financial instruments as evidence that it ‘is not being swayed by political causes’. Interestingly, as pointed out by Fenton-Jones (2004b p. 60) in The AFR, in October 2004 the EU adopted IFRS ‘with a watered-down version of IAS 39’, Financial Instruments: Recognition and Measurement. The IASB is undertaking consultation on proposed amendments to IAS 39, including two which address the issues ‘carved out’ by the EU, namely provisions relating to the fair value option for financial assets and liabilities, and certain provisions relating to hedge accounting. While these amendments may have been considered as part of the IASB’s planned review of IAS 39, it is possible to interpret this as signifying that the IASB may not be as immune to political considerations as may first have been suggested. According to Allen Blewitt, the head of the UK Association of Chartered Certified Accountants (ACCA), ‘the debate around IAS 39 … opened up the scope for lobbying by interest groups and for political interference in the standard-setting process’ (Fenton-Jones 2004b p. 60). Certainly the IASB’s strong preference for full adoption of IFRS has not dissuaded the EU from its decision in relation to IAS 39.

Howieson and Langfield-Smith (2003, p. 18) point out that ‘the recent spate of high-profile corporate collapses in the US … has seriously damaged the alleged superiority of US GAAP’, with Haswell and McKinnon (2003, p. 8) suggesting the extent of the damage is probably fatal. Haswell and McKinnon (2003, p. 8) also point out that US GAAP are regarded by many countries ‘as too different from their own’ and that ‘US regulators … are viewed as uncontrollable from outside the country’. The Norwalk Agreement may be seen as evidence of US preparedness to consider IFRSs, but this may result in ‘IFRSs that are dominated by the FASB’s influence’ (Howieson & Langfield-Smith, 2003, p. 22). According to Haswell and McKinnon (2003, p. 8) ‘The IASB offers a more
neutral and participatory vehicle’. Once again it seems that only time will tell if Australia has made the most appropriate decision in choosing to adopt IFRS.

Conclusion

The above discussion indicates that in the commentary on the merits of Australia’s adoption of IFRS there is a relative imbalance in emphasis upon the costs as opposed to the benefits of the decision. A simple interpretation of this might be that the decision was made in error and Australia would have been wise not to move so swiftly to adopt IFRS. Such a conclusion does not however take into account a number factors which make drawing strong conclusions from such an analysis extremely difficult. As suggested above, the relative paucity of discussion of the benefits of adoption in the literature may be reflective of their being presumed to be self evident, or at least well understood, and therefore not being regarded as requiring or worthy of extensive discussion. Further, the benefits, flowing largely from improved comparability of financial statements, are by their nature difficult to quantify in dollar terms. This is certainly reflected in the commentary reviewed above, where no attempt is observed to quantify in any way the benefits expected to flow to corporate Australia or the accounting profession from the adoption decision. On the other hand, as the review indicates, the costs of the decision have at least to some extent had dollar values placed upon them. Numerous examples of the estimated direct costs to Australian companies and of the estimated negative financial statement impacts can be found. This ability to quantify the costs may make them inherently more ‘newsworthy’, to some extent accounting for their greater coverage in the commentary reviewed.

A more pragmatic, and some might argue more cynical, explanation for the imbalance in the commentary might be that costs make for better news than benefits. In the discussion of benefits commentary is sourced exclusively from the academic and professional literature. There is no
evidence of the financial press discussing the good news regarding the benefits to be derived from adoption of IFRS. In contrast, there has been significant commentary, especially in *The AFR*, on the negative side of the decision. It is inherently easier to grab and hold peoples’ interest with negative rather than positive spin on an event. There is research dating back 40 years, with its origins in the international relations, social psychology and communications literature, which supports the often flippantly put view that ‘bad news is good news’. For instance, Galtung and Ruge (1965) and Östgaard (1965) respectively identify negativity and ‘sensationalism’ as factors influencing the flow of news in the media. In a review of a major West German study by Schulz (1976), Kepplinger (1978) indicates negativity was found to be one of a number of significant predictors of news coverage.\(^9\) Nadkarni (2003, p. 14) supports the view that bad news, as opposed to good news, ‘tends to get magnified, discussed, argued about’, and suggests that the answer to why this is the case lies in the realms of human psychology. The ground breaking work of Fiske (1980) in the area of social psychology provides some insight into the impact of negativity upon perception, which has given rise to a view that negative information is regarded as more salient and useful, and as being more informative than positive information. The conclusion from this may be that in a review such as the one presented in this paper, it is almost inevitable that the negative side of the issue is likely to provoke the most commentary. In this sense, the costs will always ‘come out on top’.

Despite their greater newsworthiness being a possible reason for the prominence of costs in the debate on adoption of IFRS in Australia, it does not, in the view of this author, provide sufficient excuse for the lack of depth in the coverage of the benefits of the decision. The review demonstrates that the costs of Australia’s decision to adopt IFRS are numerous and considerable. While not forgetting long term impacts on Australia’s reputation as a standard setter and on the

\(^9\) The original study by Schulz was written in German. Details are provided in the list of references.
future of accounting innovation in Australia, to a large extent the costs are short term. The benefits on the other hand are likely to be of an enduring nature, albeit contingent upon the less than certain prospect of success in future efforts to converge IFRS and US GAAP. Given this, it would not seem unreasonable to suggest that a much clearer explication of the benefits of the decision ought to have been made. It is not sufficient to dismiss the benefits as ‘self evident’. Consideration needs to be given to how the benefits might be better explained to those parties who are to bear the costs of adoption. Also, it seems little effort has been expended to clarify the extent of the benefits. While quantification of the likely positive impacts would necessarily involve estimation, at least some attempt to undertake this form of assessment would seem appropriate. For affected parties to be persuaded that the very clear and tangible costs are worth bearing they must be persuaded that the purported benefits are real and even more substantial. The review of the commentary presented here suggests that this case has not been sufficiently made.

There is no doubting Australia is a leader in the quest for internationally harmonised accounting standards and practices. Whether we were fully prepared for this role, and the attendant requirements for successful execution that it involves, will only be accurately determined with hindsight, once the new regime has been in place and operating for some time. Accounting researchers might usefully begin to consider how best this analysis ought to be conducted, in the hope that it provides some guidance to others in their decision on whether to follow the path to adoption of IFRS.
REFERENCES


Carroll, N., 2004a, ‘2005 Not a Start Date’, *Australian CPA*, April, p. 76.


