



Financial Reporting Specialists

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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
P O Box 204
Collins Street West
Victoria 8007

By post and email to k.stevenson@asb.gov.au

Dear Mr Stevenson

**Differential Financial Reporting - AASB Consultation Paper, Exposure Draft
192 (ED 192) and AASB roundtables**

We refer to the recent roundtable discussions held in Sydney on 5 May 2010 in connection with the AASB Consultation Paper *Differential Financial Reporting - Reducing Disclosure* and the accompanying ED 192 *Revised Differential Reporting*.

As preparers of financial statements, Financial Reporting Specialists (FRS) is in support of the proposal to introduce a differential reporting framework that provides a two tier disclosure regime.

However, we are not in favour of using *IFRS for SMEs* as a basis of preparation for non-publicly accountable entities due to the following reasons:

- Having more than one recognition and measurement basis for all Australian entities would remove the fundamental purpose of adopting IFRS in the first place, being comparability between entities
- Maintaining two sets of standards would involve ongoing costs
- Training and education costs of accounting professionals would increase
- Mobility of accounting professionals would decrease

We believe that IFRS in general should be simplified for all preparers and would encourage the AASB to work with the IASB to achieve this.

In particular, we draw your attention to two areas that were discussed between Vik Bhandari and yourself at the conclusion of the roundtable in Sydney, being:

- 1) Issue with the transitional provisions for entities applying Tier 1 and Tier 2 for the first time and moving between Tiers; and

2) An alternative principle for the proposed reduced disclosure regime for entities within the second tier.

1) Issue with the transitional provisions for entities applying Tier 1 and Tier 2 for the first time and moving between Tiers

During the roundtable you mentioned that AASB 1 *First-time Adoption of Australian Accounting Standards* and its international equivalent IFRS 1 could be used more than once.

The requirement to prepare an opening IFRS balance sheet when an entity applies Tier 1 and Tier 2 for the first time and each time it is required to apply AASB 1 when moving between tiers proposes a number of challenges.

Many entities in Australia have already applied the recognition and measurement requirements of the Australian Accounting Standards. However, they may not have been able to make the explicit and unreserved statement of compliance with IFRS due to not complying with the disclosure requirements of the standards (having prepared 'special purpose financial statements'). These entities would therefore be required to apply AASB 1 on transition.

AASB 1 requires such a first-time adopter to use the same accounting policies in its opening IFRS balance sheet and for all periods presented in its first IFRS financial statements (AASB 1.7). To achieve this, the entity should comply with each IFRSs (or Australian equivalent) effective at the end of its first IFRS reporting period (AASB 1.7). This means that the current IFRSs must be applied retrospectively at least to the date of transition (the start of the earliest period presented in its first IFRS financial statements). Retrospective application prior to the transition date is, of course, subject to the allowed exemptions and mandatory exceptions within AASB 1. The effect is that the current IFRSs must be applied retrospectively to the comparative period (as illustrated in the example after AASB 1.8) even if a new current standard would otherwise be applied prospectively under its transition rules. AASB 1.9 is explicit that the transitional rules in other (non-AASB 1) standards do not apply to a first time adopter. Furthermore, the requirements prohibit a first-time adopter from applying previous versions of standards that were effective at earlier dates (AASB 1.8). Therefore first time adoption in this situation would not be as simple as first thought.

For example, Entity A has a 30 June year end and has been preparing financial statements in accordance with the recognition and measurement but not disclosure requirements of Australian Accounting Standards. For the year ended 30 June 2009 Entity A has applied the 2007 version of AASB 3 *Business Combinations*. For the year ended 30 June 2010 Entity A has applied revised AASB 3 *Business Combinations (March 2008)* for all business combinations from 1 July 2009, using the transitional provisions available within revised AASB 3.

If during the year ended 30 June 2010 Entity A meets the definition as a Tier 1 entity, it would have to apply AASB 1 and therefore apply revised AASB 3 for all business combinations since 1 July 2008, as AASB 1 prohibits applying AASB 3 (2007). Therefore, any business combinations occurring during the year ended 30 June 2009 would have to be

restated to comply with revised AASB 3. This retrospective application of revised AASB 3 could add significant burden to the preparer.

Furthermore, Entity A may have reset its Foreign Currency Translation Reserve (FCTR) in 2005 on transition to Australian equivalents to IFRS. Many companies adopted this option because of practical difficulties in applying the foreign currency standard fully retrospectively. Applying AASB 1 again on transition to Tier 1 would allow Entity A the opportunity to reset the FCTR again. Indeed, since full retrospective restatement is still likely to be impracticable the entity would have no choice but to use the option again.

Notwithstanding the fact that entities transitioning to Tier 1 have to apply AASB 1 to be IFRS compliant, the transitional rules for Tier 2 should not be as onerous. For example, an entity that previously prepared a special purpose financial report that may not have complied with all recognition and measurement, should only fix up the non-compliances when moving to Tier 2 rather than applying AASB 1 in total.

2) An alternative principle for the proposed reduced disclosure regime for entities within the second tier.

During the roundtable you mentioned that the principles used in reduced disclosure regime (RDR) were based on the disclosures in IFRS for SMEs. This principle would require entities to disclose additional information that is not currently disclosed in practice in special purpose financial statements, such as:

- Related party transactions
- Risk management policies
- Capital management policies

and to a lesser extent:

- tax reconciliations
- property, plant and equipment reconciliations

We suggest that the AASB should not limit RDR to the above principle but look at other alternatives. If the purpose of RDR is to reduce the burden placed on non-publicly accountable entities one such alternative is to start with information that would normally be derived from an entity's reporting system, with disclosures based principally on notes supporting the numbers within the primary financial statements. This approach may be similar to the principles in AASB 8 *Operating Segments*, such that if the entity's systems and what management reviews are basic then the information being disclosed in the financial statements should be basic.

That said, such disclosures may be open to abuse and the AASB may stipulate what would normally be expected if such an approach is adopted.



We would like to thank you for the opportunity for allowing us to address our specific concerns based on the roundtable discussions.

Should you wish to discuss the contents of this letter with us, please contact Vik Bhandari on 02 9943 0201 or by email on vik.bhandari@frsgroup.com.au.

Yours faithfully

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