

9 August 2018

Ms Kris Peach  
Chair Australian Accounting Standards Board  
via Email: [standard@asb.gov.au](mailto:standard@asb.gov.au)

Dear Kris

**ITC 39 CONSULTATION PAPER:**

**Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems**

**Phase 1: Short-term approach**

I am pleased to provide the Australian Accounting Standards Board (AASB) with my comments on the Consultation Paper (CP).

This submission reflects my position as a consultant to business including both For-Profits (FP) and Not-for-Profits (NFPs), and their own advisers including auditors. This submission has also benefited with input from discussions with key constituents.

I do not support the Proposals for the following reasons:

*1. Simpler and less costly solution for Tier 2 Entities*

IFRS for SMEs which is the default global accounting standard for non-publicly accountable entities (i.e. generally non-listed reporting entities - Tier 2) is not allowed as an option to adopt instead of International accounting standards (IFRS). IFRS for SMEs has significantly reduced recognition and measurement (R&M) requirements which are based on IFRS recognition and measurement rules. IFRS for SMEs also has significantly less disclosure requirements compared to IFRS or the AASB's Reduced Disclosure Requirements (RDR) that are an option for Tier 2 entities.

On that basis for those companies that wish to avail themselves of IFRS for SMEs, they should be able to exercise an option to reduce their costs of preparing and having audited General Purpose Financial Reports (GPFRs), like the United Kingdom (UK) which also allows as a further option a form of Reduced Disclosure Requirements (UK RDR). Many other overseas countries also allow the option of IFRS for SMEs, including most recently Papua New Guinea!

It is challenging to understand how the AASB and the Australian Financial Reporting Council (FRC) require the AASB to adopt IASB accounting standards when IFRS for SMEs is a specific accounting standard for non-publicly accountable entities (123 (b) and (c) of the CP). More particularly the AASB's view is stated on the basis that adopting IFRS for SMEs would result in additional costs. Certainly not the view of the IASB nor for those countries such as the UK that allow it for non-publicly accountable entities. As it is merely an option, there are no additional costs if not adopted.

My comments on the AASB's decision to not allow IFRS for SMEs as an option, as detailed in Appendix C of the CP, are contained in Appendix 2

## 2. *Simpler and less costly option for Entities preparing Special Purpose Financial Reports (SPFRs)*

Entities preparing SPFRs are doing so as there are no general-purpose users (SAC 1 paragraphs 6 and 12 define general purpose users). IFRS and IFRS for SMEs is designed for those entities that are preparing high quality financial reports (GPFRs), hence those standards have less relevance.

At present, it is much less costly for those entities to continue to comply with the disclosure provisions of the three basic IFRS/IAS/AASB accounting disclosure standards being AASB 101, AASB 107 and AASB 108, without having to adopt complex and costly R&M requirements that the International Accounting Standards Board (IASB) has stated are designed for publicly accountable i.e. generally listed entities. IFRS for SMEs is also less costly with simplified R&M for non-listeds that are producing GPFRs. However, for those entities that prepare SPFRs the IASB does not have any specific accounting standards, as that is not its mandate.

Interestingly the AASB acknowledges that another tier of reporting might be considered for Charities, but no such support for other SPFR entities.

I question whether the AASB's statement at paragraph 42 which states that anyone preparing AAS (Australian Accounting Standards) should be preparing GPFRs, is an appropriate reflection of the background to AASs given that AAS's do allow SPFRs of much less complexity. Before the AASB mandates GPFRs for AASs I believe it would be necessary for the AASB to consult with, which is a Phase 2 project, but in an appropriate time scale, not just 3 months, so that other regulators and entities can remove compliance with AASs that will be fundamentally different to what was originally intended by the AASB when it adopted the Reporting Entity concept in 1990.

Paragraph 66 of the CP refers to the time and effort required to make necessary legislative change, but the inability of the AASB to do just this, since it has been researching change in financial reporting requirements, might suggest that a quick fix which is not supported by those that are producing SPFRs is sufficient evidence to suggest that there may not be such a problem requiring an AASB immediate and costly solution. Complaints about SPFRs seem to basically originate from the AASB!

I would support the AASB considering basic R&M requirements that SPFR entities generally follow as other regulators have done as detailed in paragraph 8 of the CP, and simplified disclosures following further consultation with constituents, but not rushed through in less than 18 months for application a year later (hardly the medium term as referred to in paragraph 90 (b) of the CP. Further comment will follow on Phase 2 of the CP due 9 November 2018.

## 3. *Significant impact on Charities*

Paragraph 90 (b) of the CP notes the need for staggered relief in the medium term as few NFPs (Not-for-Profits, so particularly Charities) "...on the basis that few NFPs are expected to be applying full R&M."

It defies belief that any Charities would be required to adopt listed company recognition and measurement rules which simply are not fit for NFP purpose, and reduce the funds that should be spent on charitable activities. This will be a significant issue for the Australian Charities and Not-for-Profits Commission (ACNC) in meeting its objective of "...reduction of unnecessary regulatory obligations."

4. *AASB's Premise for Reform of the Reporting Entity clash misunderstands the restriction of IFRS GPRs in the IASB's Conceptual Framework for Financial Reporting (RCF)*

The RCF only applies to reporting entities that apply full IFRS. It is not applicable to non-publicly accountable entities that produce GPRs on an RDR basis, nor does it apply to entities that produce SPFRs. On that basis the AASB could simply rebadge non-reporting entities as Australian Non-reporting entities, there would be no confusion, which is acknowledged in paragraph 13 (b) of the CP.

Interestingly the IASB does not seem to have a problem for non-publicly accounting reporting entities that adopt IFRS for SMEs (paragraph 87 (c) & (d)). Clearly not an untenable problem for the IASB (paragraph 101-102 of the CP), and inconsistent with the AASB's claim of losing IFRS compliance (paragraphs 128-130 and 134 of the CP), and the costs of maintaining 2 Frameworks, which RDR requires (paragraph 148).

5. *AASB's Premise for Reform is flawed on SPFR Entities Self-Assessing*

Paragraphs 4-6 of the Executive Summary refers to the lack of comparability, trust and transparency resulting from self-assessing. However, that ignores the principle that by definition SPFR entities do not have users who are relying on their financial reports (i.e. Accounts) for making economic rational decisions. Instead, any users are able to obtain the specific information they need (i.e. owners, lenders and potential investors in particular), as otherwise the entity would not be a SPFR. In reality, the preparation of SPFRs and any audit or audit review requirements are due to the Corporations Act that requires some SPFRs, and other legislation (Charities) to prepare financial reports that require compliance with applicable accounting standards.

Paragraph 7 refers to AASB Research Report 1 which it is stated suggests a strong need to find a solution. However as previously advised to the AASB, this Report only looks at indicators of users, and not actual users of financial information. The Report is very scant on any evidence that users of financial reports exist for those entities producing SPFRs. Hence a solution looking for a non-existent problem. This issue is covered in my Technical Paper available at: [http://keithreilly.com.au/wp-content/uploads/2017/05/17\\_4-Reporting-Entities-Paper.pdf](http://keithreilly.com.au/wp-content/uploads/2017/05/17_4-Reporting-Entities-Paper.pdf)

Paragraphs 49 to 54 of the CP refer to the Incat case in 2000 and the use of financial information by data aggregators. However, ASIC has not acted against another SPFRs entity and if there is a user of more detailed GPRs, no approach has to my knowledge been made to ASIC, as that would trigger changing the entity to a reporting entity.

It is interesting to note that the ACNC allows the use of SPFRs without any R&M requirements.

The Australian Parliament has considered on several occasions the reporting entity concept but has not made any changes to the Corporations Act, which negates the argument that the Government intended the change in thresholds to lodge as being a trigger to require GPRs.

Paragraph 8 of the Executive Summary refers to a further issue with the AASB's mandate under S224 of the ASIC Act. Again a careful reading of that Section repeats the Statement of Accounting Concepts 1 Definition of the Reporting Entity (SAC 1) as to the need to allow users to make and evaluate decisions about scarce resources. For a SPFR entity, the users are able to obtain their own specific information so the S224 problem does not exist.

Therefore, I would suggest that there is no evidence of any self-assessing problem, and that is reflected by the Australian Securities and Investments Commission (ASIC) not acting on the misapplication of the reporting entity concept, apart from one instance some 20 years ago. So, no significant problems to solve.

Paragraph 63 of the CP refers to S299 of the Corporations Act in relation to enabling companies to compete effectively overseas. Not allowing IFRS for SMEs and simplified accounting for non-publicly accountable entities that are competing with overseas entities that have less compliance costs does not seem to meet the requirements of S229.

Paragraphs 88 (e) and 89-90 refer to reduced risks for directors and auditors in classification. There is no evidence that those risks exist, and no evidence has been given as to auditor report qualifications on this issue.

Paragraph 144 refers to reduced advisory costs for determining reporting requirements, but no evidence has been provided that this has been an issue to date.

#### 6. Due process issues without an Exposure Draft

It is highly unusual for the AASB to go direct from a Consultation Paper or Invitation to Comment to changing an accounting standard without giving constituents the opportunity to consider the AASB's views following submissions made and then seeking comment on a draft accounting standard (Exposure Draft). Given the significance of the issues, which have been subject to debate since 1995, the rush to amend the Reporting Entity Concept seems unwise and perhaps suggests that the AASB has already made its mind up and is not prepared to re-consider its approach.

#### 7. No Costs v Benefits Analysis

The AASB's Statement of Intent provides the response of the AASB to the Government's Statement of Expectations of 7 April 2014 and in particular to the Government's commitment to reducing red tape and compliance costs to business and the community. Not allowing entities to have the option of reducing their costs by adopting at their option IFRS for SMEs, or requiring SPFR entities to adopt listed company R&M does not appear to comply with the Government's requirements. The absence of specific costs on both IFRS for SMEs and requiring SPFRs to have more costly accounting and assurance requirements does not seem to accord with the Government's Regulatory Burden Measurement Framework.

It is disappointing that the AASB which has been researching this issue for some 20 years and at a significant but not disclosed cost to the Government Budget for the AASB, ASIC and the FRC, is still unable to provide any indication of the additional costs that SPFRs will be required to meet. There has also been no evidence of discussion with the IASB on why it believes that the costs of compliance with IFRS for SMEs compared to compliance with IFRS, nor any discussion with the UK Financial Reporting Council that allows RDR and IFRS for SMEs as an option for non-publicly accountable entities.

[http://www.aasb.gov.au/admin/file/content102/c3/AASB\\_Statement\\_of\\_Intent.pdf](http://www.aasb.gov.au/admin/file/content102/c3/AASB_Statement_of_Intent.pdf)

General statements as in paragraph 47 that the AASB wishes to understand what transitional relief may be needed to alleviate the additional reporting burden, are not consistent with reducing unnecessary red tape compliance.

Paragraph 115 notes the further empirical research being undertaken by the AASB to determine those entities including Charities that do not apply R&M. Until that research is publicly available, it seems reasonable to delay any final solutions!

It would also be useful to know the take-up of RDR as there is a view that the real cost savings in IFRS for SMEs is the simplification of R&M.

My comments on the Specific and General Matters for Comment raised by the AASB are attached as Appendix 1.

If you require any further information or comment, please contact me.

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**Specific matters for comment on Phase 1 due 9 August 2018**

Q1 – Do you agree with the short-term approach to maintain IFRS compliance by introducing the RCF in Australia? That is, do you agree that the RCF should be applicable for publicly accountable for-profit entities that are required to prepare Tier 1 GPFS and other entities that are voluntarily reporting compliance with IFRS, and the existing Framework should continue to be applicable to other entities in the short term until the medium-term solution is implemented? Please indicate reasons for your response and if you disagree, please provide suggestions for an alternative approach for the AASB to consider.

*Answer - No. Entities that are not publicly accountable should have the option, which is available in most overseas countries to adopt IFRS for SMEs. Australia has adopted the IASB's accounting standards framework that only applies to IFRS accounting standards (i.e. mandatory for publicly accountable companies). For non-publicly accountable entities, there is no need for IFRS compliance, and hence as with those countries that are allowing IFRS for SMEs as an option, or indeed a form of RDR which Australia does, there is no requirement or need to be IFRS compliant. Requiring IFRS compliance would rule out the RDR as an option, which does not seem to have been a problem for the AASB to date.*

*For entities, preparing special purpose financial report (SPFRs), there should be no requirement that they be forced to prepare costlier GPFRs that in RDR guise would be non-compliant with the IFRS framework, given that there is no demand for GPFRs.*

*Refer to the covering letter for more detail.*

Q2 – Do you agree that the short-term approach should be made applicable to both publicly accountable for-profit private sector and public-sector entities? That is, do you agree that the RCF should be applicable for publicly accountable public sector entities that are required to prepare GPFS in accordance with Tier 1 reporting requirements (who are currently claiming compliance with IFRS) as well? Please indicate reasons for your response and if you disagree please provide suggestions for an alternative approach for the AASB to consider.

*Answer - No. Entities that are not publicly accountable should have the option, which is available in most overseas countries to adopt IFRS for SMEs. Australia has adopted the IASB's accounting standards framework that only applies to IFRS accounting standards (i.e. mandatory for publicly accountable companies). For non-publicly accountable entities, there is no need for IFRS compliance, and hence as with those countries that are allowing IFRS for SMEs as an option, or indeed a form of RDR which Australia does, there is no requirement or need to be IFRS compliant. Requiring IFRS compliance would rule out the RDR as an option, which does not seem to have been a problem for the AASB to date.*

*For entities, preparing special purpose financial report (SPFRs), there should be no requirement that they be forced to prepare costlier GPFRs that in RDR guise would be non-compliant with the IFRS framework, given that there is no demand for GPFRs.*

*Refer to the covering letter for more detail.*

Q3 – Are you aware of publicly accountable for-profit entities currently self-assessing as non-reporting entities and preparing SPFS that would have implications under the AASB’s short-term approach? If so, please provide specific examples including why these entities are not currently applying AASB 1053 and preparing Tier 1 GPFS although they would otherwise meet the definition of public accountability.

*Answer – No.*

Q4 – Do you agree with the AASB’s amendments to the definition of ‘public accountability’ in AASB 1053 per IFRS for SMEs Standard (refer to Appendix A)? Please indicate reasons for your response and if you disagree, please provide suggestions for the AASB to consider.

*Answer – No. It is not clear why amendments are being proposed, and exactly what they are.*

Q5 – Do you agree with the proposed amendments to SAC 1 Definition of the Reporting Entity and the following Australian Accounting Standards, as set out in Appendix A.

*Answer – No. It is not clear why amendments are being proposed.*

Q6 – Whether The AASB’s Standard-Setting Frameworks for For-Profit and Not-for-Profit Entities has been applied appropriately in developing the proposals in Phase 1.

*Answer – No. Not allowing IFRS for SMEs, as an option for non-publicly accountable entities and foreshadowing that SPFR entities will be required to adopt IFRS R&M is contrary to the Government’s expectation of reducing un-necessary compliance costs.*

Q7 – Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

*Answer – Yes there are regulatory issues. Not allowing IFRS for SMEs, as an option for non-publicly accountable entities and foreshadowing that SPFR entities will be required to adopt IFRS R&M is contrary to the Government’s expectation of reducing un-necessary compliance costs.*

Q8 – Whether, overall, the proposals would result in financial statements that would be useful to users.

*Answer – No. Not allowing IFRS for SMEs, as an option for non-publicly accountable entities and foreshadowing that SPFR entities will be required to adopt IFRS R&M is contrary to the Government’s expectation of reducing un-necessary compliance costs.*

Q9 – Whether the proposals are in the best interests of the Australian economy.

*Answer – No. Not allowing IFRS for SMEs, as an option for non-publicly accountable entities and foreshadowing that SPFR entities will be required to adopt IFRS R&M is contrary to the Government’s expectation of reducing un-necessary compliance costs.*

Q10 – Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

## **Appendix 2**

### **Analysis of the AASB’s decision to not allow IFRS for SMEs as an option for non-publicly accountable reporting entities**

Para 21 of the CP states: Most notably, IFRS for SMEs has different recognition and measurement requirements compared with IFRS. Previous research by the AASB indicates more than 75% of non-disclosing entities that need to publicly lodge financial statements in accordance with AAS with ASIC are currently complying with recognition and measurement requirements of AAS. Therefore, moving to a framework which moves away from this seems counter-intuitive when trying to improve the consistency, comparability, usefulness and credibility of financial reporting in Australia.

*It does seem odd that the AASB is striving for a higher level of ‘consistency, comparability, usefulness and credibility of financial reporting in Australia’ than the IASB that issues IFRS for SMEs. The IASB recognises that non-publicly accountable entities do not necessarily require listed company benchmarks, hence a significant reduction in those entities costs of preparing and having audited financial statements compared to Australia. How can the AASB justify additional costs that overseas countries do not require for their entities preparing financial statements?*

*Paragraph 174 refers to the additional costs of moving from full IFRS R&M to IFRS for SMEs. Whilst no evidence is provided as to why there are additional costs when the IASB states that it is a reduced cost environment, the point missed is that IFRS for SMEs is just an option, and so if there are additional costs, then the option is not exercised. Denying entities that believe there are reduced costs, as stated by the AASB is hardly in the best economic interests of those entities.*

*Paragraphs 177-178 criticise the IFRS for SMEs standard as it has not been updated for the newer more complicated revenue, financial instruments and leases (but ignores Insurance). However, as the ASB would well know, the IASB has determined following advice from the IFRS for SMEs Implementation Committee which I (Keith Reilly) is the Australian representative, that these amended standards would complicate non-publicly accountable entities accounting and are not necessary. The simplified R&M in IFRS for SMEs follows the general principles in the amended standards.*

*Paragraph 182 refers to the AASB Staff Paper on IFRS for SMEs. It is not a AASB Paper those views do not necessarily coincide with the views of the AASB, it is stated. It is interesting that the AASB Staff disagree with the IASB which the AASB rebadges IFRS as AASBs!*

*More telling is that the AASB Staff Paper on Comparison of Standards for Smaller Entities acknowledges that in the UK there are significant differences from IFRS (and AASBs) which results from the adoption of IFRS for SMEs simplified R&M. Why does the AASB remain opposed to simplified R&M which the UK and other countries that have adopted IFRS for SMEs are able to do?*