

9 November 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 2: Medium-term approach**

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

I have considered the ED, as well as the accompanying draft Basis for Conclusions. I have also reviewed the submissions made on Phase 1, and the AASB's staff analysis of those submissions. It is disappointing that these submissions have only been recently made available (late October 2018) with the 13 November 2018 Board Papers which appears to be a change from previous AASB policy that submission are available once the deadline for submissions has past (9 August 2018).

Also of concern given the need for transparent and timely due process, is the AASB's determination to proceed with amendments based on the Phase 1 proposals, without giving those who made submissions, the time to consider the reasoning in the 40-page 13 November 2018 Board Paper which supports these amendments. Statements such as 'Noted, however the AASB etc) suggest that the AASB is not prepared to have its reasons subject to public scrutiny for any considered length of time. I would appreciate having some time to respond on what are fundamental changes that the AASB intends to make, and with the benefit of considering views expressed in other submissions.

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

I do not support the proposals for Phase 2 for the following reasons:

#### CP 14 (a) Applying the International Accounting Standards Board's (IASB) Conceptual Framework for Financial Reporting (RCF) to Publicly Accountable Entities

The RCF is not an accounting standard and therefore should not be elevated beyond what the IASB requires which is set out in IAS 8/AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors, as guidance only. AASB 108 makes it clear that the RCF is not mandatory. Instead management judgement is required (paragraph 10), and as part of that judgement, management shall refer to and consider the RCF (paragraph 11).

## CF 14 (b) Revision of the AASB 1053 Tier 2 Framework

### *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, were included in my 9 August 2018 submission to the AASB on the Phase 1 proposals in the CP.

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

Entities preparing SPFRs ie non-reporting entities 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 4 basic IFRS/IAS/AASB accounting disclosure standards being AASB 101, AASB 107, AASB 108 and AASB 1054, 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 in an appropriate time scale, not just 6 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).

### *3. Significant impact on Charities*

Paragraph 90 (b) of the CP notes the need for staggered relief in the medium term "...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."

I note that the AASB has announced that it will not be proceeding with NFPs for now with Phase 2, however I believe that the AASB should also exclude NFPs from Phase 1.

### *4. AASB's Premise for Reform of the Reporting Entity clash misunderstands the restriction of IFRS GPRFs 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 GPRFs 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 refers 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 GFRs, 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 GFRs.

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 an Appendix.

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

A handwritten signature in black ink, appearing to read 'Keith Reilly', with a stylized flourish at the end.

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**Specific matters for comment on Phase 2:**

Q11 – Do you agree with the AASB’s Phase 2 approach (described in paragraph 166) Why or why not?

(a) the RCF will be made applicable to all entities required by legislation or otherwise to comply with AAS;

*No. As detailed in my earlier comments, the International Accounting Standards Board’s (IASB) Conceptual Framework for Financial Reporting (RCP) is not intended to be mandatory for entities to follow, so there is no reason for the AASB to mandate it. The RCP provides guidance, but it is not an accounting standard. Additionally, as I stated in my Phase 1 submission the RCF only has relevance to reporting entities that follow full IFRS which includes full IFRS disclosures i.e. not entities following RDR.*

*AASB 108 Paragraph 10 In the absence of an Australian Accounting Standard that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:*

*(a) relevant to the economic decision-making needs of users; and*

*(b) reliable, in that the financial statements:*

*(i) represent faithfully the financial position, financial performance and cash flows of the entity;*

*(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;*

*(iii) are neutral, i.e. free from bias;*

*(iv) are prudent; and*

*(v) are complete in all material respects.*

*AASB paragraph 11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:*

*(a) the requirements in Australian Accounting Standards dealing with similar and related issues; and*

*(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.*

(b) the Tier 2 framework in AASB 1053 will be revised to include one of the following alternatives (these alternatives are described in more detail in paragraphs 167-170):

(i) Alternative 1: GPFS – Reduced Disclosure Requirements (RDR) – Existing Tier 2 (full recognition and measurement with reduced disclosures from each Accounting Standard, includes consolidation and equity accounting where applicable); or

(ii) Alternative 2: GPFS – Specified Disclosure Requirements (SDR) – New Tier 2 (full recognition and measurement with specified disclosures from some Accounting Standards, includes consolidation and equity accounting where applicable)

*No. I do not support listed company accounting for non-publicly accountable entities (i.e. non-listeds) as the IASB has stated quite clearly that non-publicly accountable entities should have the option of adopting more simplified IFRS i.e. IFRS for SMEs that has simplified disclosure and measurement, as well as simplified disclosures. This view was stated in my submission on Phase 1 of the CP.*

(c) Consequential amendments to AASB 1048 Interpretation of Standards and other Standards will be required as a result of changes in paragraph 166(a)-(b) (these will be detailed in the next phase of the consultation

process, once the alternative for revising Tier 2 has been determined); and transitional relief would be provided for entities moving from SPFS to GPFS and from one tier to another. Refer to Appendix B for illustrative amendments to pronouncements resulting from the AASB's medium-term approach.

*No. As I do not support the proposals in Q11 (b) above, I also do not support the consequential changes whatever they are.*

Q12 – Which of the AASB's two GPFS Tier 2 alternatives (described in paragraphs 167-170) do you prefer? Please provide reasons for your preference.

*I do not support either of the alternatives as detailed in my comments in Q11 (c). My reasons are that the IASB has a cheaper alternative as an option being IFRS for SMEs, and it is not in the interests of the Government, the AASB or the accounting profession to ban a cheaper alternative that some believe is in the interests of clients rather than in the interests of accountants and auditors who have and will charge additional fees for listed company accounting rules. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has demonstrated that apart from being illegal in not acting in the best interests of your client, it is also unacceptable to society.*

Q13 – Do you agree that we only need one Tier 2 GPFS alternative in Australia (either Alternative 1 GPFS – RDR or the new Alternative 2 GPFS – SDR described in paragraphs 167- 170)? Why or why not?

*No. As detailed in my submission on Phase 1, I believe that for the AASB to be in compliance with its own mandate from the Government, it needs to both allow IFRS for SMEs as an option for non-publicly accountable entities, and I see no reason why non-reporting entities (e.g. family owned large pity companies) need to adopt full IFRS listed company recognition and measurement rules. The AASB has already acknowledged that it will consider simpler rules for charities in the not-for-profit sector, so why not for the for-profit sector?*

*The AASB should also be mindful of significant entities such as the major professional accounting firms that have revenues in excess of \$1 billion who do not have to comply with IFRS. It does seem unfair to hit smaller businesses with increased compliance costs in comparison, does it not?*

Q14 – Do you agree with the AASB's decision that GPFS – IFRS for SMEs (outlined in Appendix C paragraphs 18 to 36) should not be made available in Australia as a Tier 2 alternative for entities to apply? Please give reasons to support your response, including applicability for the for-profit and not for-profit sectors.

*No. As detailed in my 9 August 2018 submission on Phase 1, I believe that IFRS for SMEs is a less costly solution for non-publicly accountable entities, it is designed by the IASB for that purpose, and it is widely adopted globally. On that basis it should be available as an option and let the market decide.*

Q15 – If the AASB implements one of the two proposed alternatives (described in paragraphs 167- 170) as a GPFS Tier 2, what transitional relief do you think the AASB should apply (in addition to what is available in AASB 1)? Please provide specific examples and information.

*No. I do not agree with either of the 2 proposed alternatives, however if they are mandated, a period of at least 5 years would seem reasonable given the changes in accounting systems that will be required.*

Q16 – What concerns do you have on consolidating subsidiaries and equity accounting associates and joint ventures as proposed in the AASB's medium-term approach? What transitional relief do you think the AASB should apply? Please provide specific examples and information.

*As detailed earlier I do not agree that non-publicly accountable entities should be required to comply with IFRS recognition & measurement rules. Instead they should have the option to adopt IFRS for SMEs recognition and measurement, or if a non-reporting entity, there should be no specific requirements. As detailed in Q15, a transitional period of at least 5 years should be allowed if the AASB does not change its mind on IFRS for SMEs or non-reporting entities.*

Q17 – If the new Alternative 2 GPFS – SDR described in paragraphs 167-170) is applied, do you agree that the specified disclosures would best meet users’ needs? If not, please explain why and provide examples of other disclosures that you consider useful.

*No. I do not agree as the disclosures appear to be significantly in excess of IFRS for SMEs and the existing AASB disclosure standards (AASBs 101, 107, 110, and 1054).*

Q18 – Do you have any other suggested alternative for the AASB to consider as a GPFS Tier 2 and whether this would be applicable for for-profit and not-for-profit sectors? Please explain rationale (including advantages and disadvantages and the costs and benefits expected).

*As detailed earlier, allow IFRS for SMEs as an option, allow non-reporting entities to maintain compliance only with the disclosure AASBs, and consider more simplified reporting requirements to those non-reporting entities after further research and consultation with constituents, which is what the AASB has announced it will do for NFPs.*

Q19 – Do you think service performance reporting, fundraising and administration cost disclosures for NFP private sector entities should be included as part of the chosen GPFS Tier 2 alternative? Please explain rationale (including advantages and disadvantages).

*No. This should be an option given that it is not clear what the costs of collecting this information would be, and the concern that any increase in administration costs results in a reduced spend on charitable activities which is what the NFP has been established for.*

Q20 – Are you aware of any legislation that refers to SPFS that might be impacted by these proposals? If yes, please provide specific information.

*No but I am surprised that the AASB has not researched this.*

## **General matters for comment on Phase 2**

Q21 – Whether the AASB’s Standard-Setting Frameworks for For-Profit and Not-for-Profit Entities have been applied appropriately in developing the proposals in Phase 2 regarding the reporting entity problem (note the AASB will consult further on other NFP amendments required for the RCF).

*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.*

Q22 – 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 non-reporting entities will be required to adopt IFRS recognition and measurement rules is contrary to the Government’s expectation of reducing un-necessary compliance costs.*

Q23 – 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 non-reporting entities will be required to adopt IFRS recognition & measurement is contrary to the Government’s expectation of reducing un-necessary compliance costs. On that basis:*

*(a) I believe that the AASB should allow IFRS for SMEs as an option to full IFRS/AASBs, or RDR for non- publicly accountable reporting entities as is allowed by most overseas countries; and*

*(b) Non-Reporting Entities should be allowed to adopt the simplified disclosures in AASB 101, 107, 108 and 1054.*

Q24 – Whether the proposals are in the best interests of the Australian economy.

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

Q25 – 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 nonfinancial) 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.

*In 2013 Moore Stephens were quoting a cost of around \$10,000 for Charities to convert from simplified non-reporting accounting to full IFRS which included additional audit costs. A then Grant Thornton internal estimate was that moving to IFRS for SMEs would cost around \$4,000 including audit costs. Savings if the RDR disclosures were adopted were estimated to be about 20% say \$2000 as the main cost was the full IFRS recognition and measurement requirements.*

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