

The Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins Street West  
Victoria 8007

1 June 2017

Dear Madam

### **EXPOSURE DRAFT ED 277 REDUCED DISCLOSURE REQUIREMENTS FOR TIER 2 ENTITIES**

Thank you for the opportunity to comment on the proposals to amend the reduced disclosure requirements (RDR) for Tier 2 entities.

We still remain sceptical that RDR as it currently stands, and as it is proposed to be amended in this exposure draft, passes the fundamental cost-benefit principle. RDR has been available to preparers and users for a number of years, and has received limited uptake. It would therefore appear reasonable to conclude that for a large number of entities currently preparing general purpose financial reports, RDR does not pass the cost-benefit test and it does not entice those preparing special purpose financial reports to move to RDR general purpose financial reports either.

A basic premise put forward in this paper is that the proposed disclosure framework in ED 277 has largely been developed as a result of consultation and outreach to financiers. We find the conclusions drawn from this outreach to be surprising as it is the financiers that are in the prime position to demand the preparation of RDR financial reports. Practice would appear to clearly demonstrate that these financiers have been satisfied with special purpose financial reports.

In our opinion, the way to improve financial reporting while following the principle of cost-benefit, is to determine what is lacking in special purpose financial reports, centring on what needs to be added to the basic disclosure items set out in AASB 101, 107 and 108.

To understand the performance of an entity, it is imperative to understand how accounting standards have been applied, and what estimates and judgements have been applied, together with appropriate disclosure around related parties.

If a principles-based approach had been adopted in the proposed framework with appropriate guidance and illustrative examples, we believe financial reporting would have been substantially improved, starting from the building blocks of the current special purpose financial reporting regime.

The approach taken in these RDR proposals is to effectively require disclosure where in many cases it does not add significant information to enable a user to understand the performance of an entity, and in many cases, allows the preparer to omit very useful information that would in some cases be critical to a full understanding of the entity's financial performance. A glaring example of this is the

lack of fair value disclosures contained in AASB 13, which in some instances would be key to understanding performance.

On the assumption of a continuing RDR reporting framework in Australia, our key observations are:

- We question whether all of the items listed in section (b) of the Key Disclosure Areas comprise appropriate principles that will be sustainable for use to determine RDR disclosures as Tier 1 standards change
- We do not believe that these proposed changes to RDR disclosures will result in a greater level of adoption by large proprietary companies currently preparing special purpose financial reports because the numbers of RDR disclosures required will still be significantly more than those currently required by the minimum mandatory standards, and
- We question the necessity of progressing this project at this stage given the IASB's Discussion Paper *Disclosure Initiative - Principles of Disclosure* which is due for comment by 2 October 2017. We would prefer such a project to take on board outcomes of this project for Tier 1 entities, which can then be adapted for Tier 2 entities by developing suitable Key Disclosure Principles for Tier 2 entities.

In our opinion, the basis for determining disclosure in this paper has not addressed the basic driver behind note disclosure, i.e. to assist the user in assessing the financial position and performance of an entity. To this extent, the ED only focuses on 'material transactions' rather than material balances. Describing major balances for non-current assets is largely nothing to do with the concept of solvency, but can provide useful information to a user, following the basic principle of assisting the user understand the performance of the entity

Please refer to Appendix 1 for our detailed comments.

If you have any comments regarding this request, please do not hesitate to contact Sheryl Levine at [sheryl.levine@bdo.com.au](mailto:sheryl.levine@bdo.com.au).

Yours faithfully

**BDO Australia Limited**



Timothy Kendall

Chairman, National Audit Committee

Email: [standard@asb.gov.au](mailto:standard@asb.gov.au)

## APPENDIX 1

### Question 1

Do you agree with the overarching principles on which the proposed RDR decision-making framework identified in the proposed joint Policy Statement is based (that is, user needs and cost-benefit)? If you disagree, please explain why.

#### ***BDO response***

Yes, we agree with these overarching principles. We do however believe that this principle has not been applied given the extensive disclosure proposed in this ED.

### Question 2

Do you agree with the two Key Disclosure Areas identified in the joint proposed Policy Statement as being essential for meeting user needs? If you disagree with either a Key Disclosure Area (including any of the specific disclosures about transactions and other events significant or material to understanding the entity's operations as represented by the financial statements), please explain which one(s) you disagree with and why?

#### ***BDO response***

We do not agree with the two overall Key Disclosure Areas identified in (a) and (b), being: current liquidity and solvency; and significant/material transactions or events, as being essential for meeting user needs. Please refer to our detailed comments below.

#### **(a) Current liquidity and solvency**

While we agree with the overall principle in (a), i.e. current liquidity and solvency of the entity as being a Key Disclosure Area for determining which Tier 1 disclosures should be retained for Tier 2, we note from the detailed Staff Analysis that the AASB seems to consider disclosures regarding balances (assets) as falling under the principle of solvency.

Examples of a few of these include:

- AASB 116, paragraph 73(d) for disclosure of gross carrying amount and accumulated depreciation
- AASB 141, paragraph 54(f) for disclosure of gross carrying amount and accumulated depreciation, and
- AASB 13, paragraph 93(a) and 93(i) for disclosure about fair value.

As solvency is the ability of an entity to pay its debts as and when they fall due, on a going concern basis, we do not consider disclosures about asset carrying and fair values to belong under the principle of liquidity and solvency. Refer our further comments on this in (b) below for 'Asset values'.

Our key concern with this framework is that it is not driven by the key objective of disclosure, being to enable a user to understand the performance of an entity. Any proposed framework should be driven by the principle of allowing users to understand the measurement and judgement around material balances, not just transactions. The shoehorning of disclosures about material, illiquid

balances under the heading of 'solvency' would in our opinion appear to be a workaround of the basic flaws in the proposed framework.

**(b) Transactions and other events that are 'significant' or material to an understanding of the entity's operations as represented in the financial statements**

We have the following comments on principle (b) of the proposed framework.

**'Significant'**

Firstly, as a general point, we would prefer the terminology in the framework to restrict itself to the term 'material' rather than introduce a new term, i.e. 'significant'. We are unsure of the difference in meaning between 'material' and 'significant', that is, whether there could be instances where disclosures are significant but not material, or material but not significant. In our view, both terms mean the same thing.

**Asset values**

Secondly, following on from our discussion in (a) above, we believe the framework should also include reference to 'material balances'. For users to understand the performance of the entity, we believe users require disclosure about measurement and judgements for material asset balances, not just transactions. As noted under (a) above, we do not consider asset disclosures to be covered by 'liquidity and solvency' principles.

The bullet point items in the framework, part (b)(i) to (b)(viii), appears largely to be reverse engineering the additional disclosures proposed, particularly in respect of AASB 7. The framework appears to omit the needs of users in respect of measurement of material balances, particularly in respect of balances recorded at fair value. We believe that section (b) is therefore missing the basic principle of disclosing sufficient information to enable a user to understand **material balances** rather than merely material transactions.

If the disclosure principle in (b) is to include information about all significant or material transactions or other events, we would prefer to see 'asset' and long term liability disclosures falling into Key Disclosure Area (b) rather than being subsumed into principle (a) as noted above.

**Other events**

Lastly, we also do not understand what disclosures would be contemplated for 'other events'. We do not believe that significant or material 'other events' should be captured in principle (b) as a Key Disclosure Area because it is too broad a concept, and could be used as a means to include a wide variety of disclosures for Tier 2 entities that do not otherwise fit in with any of the items in principles (b)(i) to (b)(viii). In other words, we are concerned that it could be used to 'shoe horn' the desired disclosures of a particular standard into principle (b). We would therefore recommend that 'other events' be removed from the wording in principle (b) as well as (b)(i).

***Recommended alternative wording for principle (b)***

Taking into account our three comments above, we believe that principle (b) should be reworded as follows:

***“transactions that are material to an understanding of the entity’s operations and balances as represented by the financial statements. This comprises disclosures about:...”***

**(b)(i) the nature of the transaction or event that makes it significant or material to the entity**

We understand this principle to be requiring disclosure as to why a transaction (or balance) is material (i.e. disclosures will be required for Tier 2 entities where the disclosures describe the nature of the transaction (or balance) that makes it material to the entity).

Because disclosure is always required for material transactions and balances, we are unsure why a principle is required to bring in disclosures describing why it is material. Providing information regarding material items should be sufficient for Tier 2 entities.

We note that the Staff Paper brings in many income and expense items, such as for share-based payments under AASB 2 and gains on bargain purchases under AASB 3, acquisition date fair values of consideration in a business combination under AASB 3, amounts of categories of financial assets and liabilities under AASB 9, as well as various revenue disclosures under AASB 15. These disclosures should be encompassed within the broader principle (b) and a more detailed line item for these should not be required.

We therefore recommend that (b)(i) be deleted.

**(b)(ii) associated risks specific to a transaction or an event**

We do not agree with (b)(ii) being included as part of the framework because there are a large number of risks affecting financial statement items for which there are no disclosure requirements, even in Tier 1. The inclusion of ‘risks’ in the framework would appear to be a justification for including additional AASB 7 disclosures. If this disclosure is warranted, it should be in the context of liquidity or solvency.

We therefore recommend that (b)(ii) be deleted.

**(b)(iii) accounting policy on recognition or measurement specific to a transaction or event**

We agree with this principle. Refer to further comments under Question 4 below.

**(b)(iv) significant estimates and judgements specific to a transaction or event**

We agree with this principle. Refer to further comments under General Matters for Comment at the end of this Appendix.

**(b)(v) commitments and contingencies**

We do not believe that a separate category is necessary for this specific topic. In our view, commitments are more appropriately included under the general ‘liquidity’ principle and contingencies is more appropriately included under the general ‘solvency and liquidity’ principle, or even as part of (b)(iv) - estimates and judgements.

In order to have enduring relevance, and to be consistent with Australian Accounting Standards being principles-based, rather than rules-based, we believe that the Key Disclosure Areas should enunciate principles for disclosures, rather than a list of areas considered important by financiers and other users of RDR financial statements.

In our view, the principle for Key Disclosure Area (b) for Tier 2 entities should be to disclose transactions and balances that are material to an understanding of the entity's operations as represented by the financial statements so as to enable users to understand the performance of the entity.

**(b)(vi) impairment**

We do not understand why this one measurement area has been isolated as a Key Disclosure Area when other measurement areas have not. In our view this area is covered by (b)(iv) - estimates and judgements, and a separate area is not needed.

**(b)(vii) related parties and (b)(viii) subsequent events**

In our view, these two specific areas which are presumed to be material should be separated into a third Key Disclosure Area for specific items.

**Question 3**

Do you agree with the proposed joint Policy Statement as a whole for determining RDR for Tier 2 entities? If you disagree, please explain why. In relation to the proposed joint Policy Statement, the AASB is particularly seeking to know whether the disclosures required for not-for-profit entities are appropriate relative to the disclosures required for for-profit entities.

***BDO response***

Subject to our comments for Question 2 above, we agree with the proposed joint Policy Statement as a whole for determining RDR for Tier 2 entities, including both for-profit and not-for-profit entities.

**Question 4**

Do you agree with the approach in the proposed joint Policy Statement taken by the AASB regarding disclosures about accounting policies? If you disagree, please explain why.

***BDO response***

Yes, we agree with the approach taken by the AASB to remove the requirement for Tier 2 entities to disclose specific accounting policies because AASB 101 and AASB 108 include overarching requirements to disclose significant accounting policies. However, in practice, we recognise that many preparers of RDR financial statements may use a 'checklist' approach to RDR disclosures, and erroneously omit significant accounting policies because they were not reminded in each relevant standard.

We believe this approach should have been extended to the whole project, where the key requirements of disclosure are largely those contained in AASB 101 and AASB 108.

We also note that this approach is different to that taken by the NZASB, which intends to retain the requirement for specific accounting policies in various accounting standards.

#### Question 5

Do you agree with the approach in the proposed joint Policy Statement taken by the AASB regarding guidance for disclosure requirements? If you disagree, please explain why.

#### *BDO response*

Yes, we agree with the approach taken by the AASB to delete guidance where it merely relates to presentation of information 'in a tabular format unless another format is more appropriate'.

While we acknowledge that some preparers may find the guidance helpful, the wording of these disclosures requires that the disclosures specified '**shall be provided in a tabular format unless another format is more appropriate**'. To leave these paragraphs in would mean that Tier 2 entities would be required to justify each disclosure format that is not presented in a table.

We note that this approach is different to that taken by the NZASB, which intends to retain this guidance.

#### Question 6

Do you agree with the approach in the proposed joint Policy Statement taken by the AASB regarding cross-references to other standards that are general rather than specific? If you disagree, please explain why.

#### *BDO response*

Yes, we agree with the approach taken by the AASB for:

- Cross references to specific disclosures in other standards (specific paragraph numbers) - either keep or reduce in both standards, and
- Cross references that are general in nature (to standard names only and not to a specific paragraph) - to reduce.

We note that this approach is different to that taken by the NZASB, which intends to retain all cross references of a general nature.

#### Question 7

Do you agree with the outcome of the application of the proposed joint Policy Statement to the disclosure requirements in Australian Accounting Standards to determine the disclosures that Tier 2 entities should be required to provide? If you disagree with the outcome, please identify, with reasons:

- (a) Which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide; and
- (b) Which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide.

### ***BDO response***

In general, we are in agreement with the proposed RDR reductions in disclosures as they pertain to the two Key Disclosure areas specified. However, following on from our comments regarding the principles defined for the Key Disclosure Areas in Question 2 above, please refer to our comments below about which disclosures we think should/should not be reduced.

We note from the Staff Analysis that there seem to be ‘swings and roundabouts’ where some new disclosures have been added in and some disclosures reduced.

In your Preface to ED 277, under ‘Summary of the differences between current RDR with the proposed RDR’, the AASB notes that the most substantial reductions in disclosure are proposed to, amongst others, AASB 7 *Financial Instruments: Disclosures* and AASB 12 *Disclosure of Interests in Other Entities*. We do not agree with this assumption as our detailed comparison (refer comments below) reveals a significant number of **additional disclosures** required for RDR in these two standards.

### ***Disclosures we believe should not be provided***

- The reintroduction of hedging disclosures via the removal of disclosure exemptions for paragraphs 22A, 23A, 23B, 23C and parts of 24A in AASB 7. Based on our discussions with clients we question whether the benefits of these disclosures to users of the financial statements would exceed the costs of obtaining this information.
- The reintroduction of qualitative and quantitative disclosures for financial instruments in AASB 7 via the removal of disclosure exemptions of paragraphs 33, 34, 35A, 35C, 35F, 35G and 35L. Based on our discussions with clients we question whether the benefits of these disclosures to users of the financial statements would exceed the costs of obtaining this information.
- We question the AASB’s proposal to reinstate disclosures not considered to be key disclosure areas merely because the AASB consider that the benefits would outweigh the costs, including:
  - AASB 101, paragraph 23 - rare circumstances when management concludes compliance with accounting standards to be so misleading that it would conflict with Framework but regulatory framework prohibits departure
  - AASB 101, paragraph 77 - further sub classification of line items in statement of financial position
  - AASB 101, paragraph 79 - number of shares issued
  - AASB 108, paragraph 40 - Disclosure of estimates - disclose fact that estimating amount impacting future periods is impracticable
  - AASB 112, paragraph 81(d) - explanation of applicable tax rate compared to previous period
  - AASB 127, paragraph 16 - parent elects to prepare separate financial statements, fact that financial statements are separate financial statements and exemption from consolidation has been used

- AASB 127, paragraph 16(b)(iii) - parent prepares separate financial statements - list of significant subsidiaries and proportion of voting rights held if different to ownership interest
- AASB 127, paragraph 16A - investment entity that is a parent preparing separate financial statements as its only financial statements
- AASB 127, paragraphs 17(a) and 17(b)(iii) - similar to AASB 127, paragraph 16 above
- AASB 134, paragraph 16A(i) - specific interim period disclosures
- AASB 140, paragraph 78 - investment properties measured at cost
- AASB 3, paragraph B64(a) to (c) - details of entities acquired
- AASB 7, paragraph 10 and 10A - information of financial liabilities designated at FVTPL
- AASB 12, paragraph 12(c) & (d) - proportion of ownership interest held by NCI and proportion of voting rights held by NCI
- AASB 12, paragraph 21(a)(ii) - nature of the entity's relationship with joint arrangement or associate
- AASB 12, paragraph 21(a)(iv) - proportion of ownership interest held in joint arrangement if different to voting rights held.

***Disclosures we believe should be provided***

- If impairment forms part of a key disclosure area, we fail to see why disclosures in relation to recoverable amount based on fair value less costs of disposal (FVLCD) has been reduced, but disclosures about impairment based on value in use has not been reduced (refer paragraphs 134(d) and (e) of AASB 136). This could lead to preparers erroneously using fair value less costs of disposal as recoverable amount to avoid disclosures. In both cases (value in use and FVLCD), we consider that these fall under Key Disclosure Area (b)(iv) - estimates and judgements.

**Question 8**

Which approach do you prefer for identifying RDR for Tier 2 entities:

- (a) The approach taken in this ED with the proposed Tier 2 disclosures to be included in an Australian Appendix in each Australian Accounting Standard that identifies the disclosures that Tier 2 entities are required to provide; or
- (b) Use the approach taken in the New Zealand ED to use an asterisk (\*) for disclosures that are not required and explaining partial concessions by means of a RDR paragraph? The approach taken in the New Zealand ED is illustrated in the Appendix A to this ED.

***BDO response***

We do not believe that either of these approaches are useful for preparers of Tier 2 financial statements. Instead we recommend the AASB retain the status quo of using grey shading within standards to indicate reduced disclosures.

#### **Question 9**

Do you agree that when an Australian Accounting Standard does not have separate sections for disclosure and presentation requirements, both presentation and disclosure requirements are included in the Australia Appendix to each Australian Accounting Standard that identifies the disclosures that Tier 2 entities are required to provide? If you disagree, please explain why.

#### ***BDO response***

Refer to our response for Question 8. We do not agree because we do not believe that adding an Australian Appendix for Tier 2 disclosures is the most efficient way for preparers to prepare RDR financial statements.

#### **Question 10**

Do you agree that, once approved, the amended Tier 2 disclosure requirements should be effective for annual periods beginning on or after 1 January 2019, with early application permitted?

#### ***BDO response***

Yes, we agree.

We understand that entities will be able to early adopt the revised RDR disclosure requirements on a standard by standard basis, provided that the revised Tier 2 disclosures for AASB 101, 107 and 108 are applied at the same time. This means that entities will be able to cherry pick which of the revised Tier 2 disclosures they want to early adopt.

#### **Question 11**

The Exposure Draft does not propose any specific transition requirements. Do any issues warrant transitional provisions and, if so, what transitional provisions do you suggest?

#### ***BDO response***

As noted in our response to Question 7, the ED requires disclosures in some areas where disclosures are not currently required for Tier 2 entities. If such disclosures are retained, we would like to see exemptions from having to include these comparative disclosures in the first year that these changes apply.

#### **Question 12**

Do you think that when approved, the amended Tier 2 disclosures would encourage eligible entities that currently:

- (a) Prepare special purpose financial statements to prepare Tier 2 general purpose financial statements, and
- (b) Prepare Tier 1 general purpose financial statements to prepare Tier 2 general purpose financial statements?

### ***BDO response***

We do not think that when approved, the amended Tier 2 disclosures would encourage eligible entities in (a) to prepare Tier 2 general purpose financial statements because there would still be a significantly higher number of disclosure requirements than the minimum required for entities preparing financial statements under Part 2M of the *Corporations Act 2001*, i.e.:

- *AASB 101 Presentation of Financial Statements*
- *AASB 107 Statement of Cash Flows*
- *AASB108 Accounting Policies, Changes in Accounting Estimates and Errors*
- *AASB 1054 Australian Additional Disclosures.*

For entities in (b) above, we believe that the proposed amendments would still see a significant reduction in disclosures for Tier 2 entities, compared to Tier 1 entities, preparing general purpose financial reports. However, if eligible Tier 2 entities have not adopted RDR to date, we cannot see whether these different requirements would entice such entities to adopt.

### **General matters for comment**

1. Similar to the AASB's proposal regarding relying on the overarching requirement in AASB 101 and AASB 108 include overarching requirements to disclose significant accounting policies, we also recommend that the AASB reduce disclosures for specific estimates and judgements in specific standards and rely on the overarching requirements in AASB 101, paragraphs 122 to 133.

However, in practice, we recognise that many preparers of RDR financial statements may use a 'checklist' approach to RDR disclosures, and erroneously omit disclosure about estimates and judgements because they were not reminded in each relevant standard.

2. We do not believe that these proposed changes to RDR disclosures will result in a greater level of adoption by large proprietary companies currently preparing special purpose financial statements because the numbers of RDR disclosures required will still be significantly more than those currently required by the minimum mandatory standards. In our view, take up of Tier 2 instead of special purpose financial reporting would require action by regulators to increase revenue and asset thresholds for entities lodging financial statements on the public record, and to specifically require lodgement of general purpose financial reports.