

27 April 2010

Mr Kevin Stevenson
 Chairman
 Australian Accounting Standards Board
 Level 7
 600 Bourke Street
 Melbourne VIC 3000

Dear Kevin

Revised Differential Reporting Framework

The National Institute of Accountants (NIA) is pleased to respond to the ED 192 *Revised Differential Reporting Framework* issued by the Australian Accounting Standards Board (AASB) for public comment.

Our response in the attached submission follows an extensive due process, which has involved consulting a range of stakeholders and our members. It has included direct consultations with four NIA faculties, two round table discussions, phone interviews conducted by NIA policy staff with accountants in accounting firms and companies and presentations over an extended period of time to NIA members at suburban discussion groups. Our members work across all sectors of the Australian community and we have sought to communicate with a range of members through various channels to understand their perspective.

The NIA notes the public policy imperatives driving the AASB and we hope that the analysis that follows assists the AASB in furthering its deliberations.

Reduced Disclosure Regime

Respondents to the NIA's consultation process had a mixed reaction to the AASB's Reduced Disclosure Regime (RDR) as outlined in the exposure draft. Perspectives on the RDR can be broadly characterised as follows:

- Some constituents prefer the status quo with the General Purpose Financial Statements and Special Purpose Financial Statements (SPFS) regime in place, which relies on having the existing domestic conceptual framework as its base;
- Some commentators support having IFRS for SMEs as an option in addition to RDR as proposed by the AASB;
- Some commentators support only having Full IFRS and IFRS for SMEs apply with no reference to RDR as proposed by the AASB; and
- Other commentators prefer RDR as the only differential reporting option. It should be noted that commentators that supported RDR did so on the basis of consistency of measurement and recognition principles.

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Qualified support for RDR

While a vast majority of individuals, organizations and firms consulted by the NIA agreed with the principles of RDR, this support was qualified. Supporters of RDR raised the following matters:

- Lack of clarity on the issues and concerns which the AASB is seeking to address and why the AASB is 'rushing' the solution to market;
- Impact of the proposals on entities that were not presently consolidating for the purposes of lodgment with the corporate regulator;
- Neither RDR nor IFRS for SMEs deals with a general problem of a lack of comprehension by company directors and other stakeholders of contemporary financial reporting practice;
- Concern that both advocates of RDR and IFRS for SMEs were asserting that there were cost reductions across the board without any visible quantification; and
- Questioning of the need for change at this time given the reporting entity concept was generally sound. Supporters of the reporting entity concept as currently exists in Australia indicated a preference for RDR over IFRS for SMEs if change was to take place.

NIA recommendation

The NIA supports the underlying principles of the RDR. It is a solution to the challenge of dealing with accounting standards overload for some entities. However, it is not without its challenges for a range of entities. The NIA, therefore, recommends the AASB proceed with the RDR regime but defer its application for financial years beginning on or after 1 July 2013 rather than 1 July 2012 to allow entities previously reporting on a different basis time to adjust their systems and upgrade their knowledge where required.

Role of IFRS for SMEs in Australia

We note there was some support expressed for the notion of permitting IFRS for SMEs as an option for entities that are not publicly accountable. The NIA has on a previous occasion in response to the AASB's consultation process indicated a preference for a differential reporting regime that is based on consistency with full recognition and measurement under IFRS but reduced disclosure. We said at that time there appeared to be no case to introduce IFRS for SMEs into Australia. Nothing has come to our attention during the past two months that has caused us to change that view.

If you have any queries or require further information on our submission, please don't hesitate to contact Tom Ravlic on 03 8665 3143 or tom.ravlic@nia.org.au.

Yours sincerely



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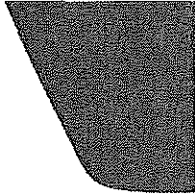
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The National Institute of Accountants

ED 192 "Revised Differential Reporting Framework"

Submission to the Australian Accounting Standards Board

April 2010



NIA

**NATIONAL
INSTITUTE OF
ACCOUNTANTS**

Every member counts

The National Institute of Accountants

First formed in 1923 Australia's National Institute of Accountants (NIA) has been actively involved in the profession for nearly 90 years.

The NIA has grown to be one of the three recognised professional bodies for accountants in Australia. It now represents the interests of over 23,000 members and students both here and in over 50 countries around the world. The NIA has been a full member of the International Federation of Accountants (IFAC) since 2004 and is represented on more than 120 government and departmental boards or committees in Australia.

Abbreviations

AASB	Australian Accounting Standards Board
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IFRS for SMEs	International Financial Reporting Standards for Small to Medium Enterprises
RDR	Reduced Disclosure Regime

Foreword

The National Institute of Accountants (NIA) has over the past two months conducted its own due process on the proposals to revise Australia's financial reporting framework. This due process involved consultation with accountants in small and large practices, experienced trainers, academics, accountants working in corporations and the government sector. It also involved face to face meetings, phone interviews with accountants as well as feedback sourced through social networking forums and written correspondence. Recommendations in this submission are based on the feedback received by the NIA from the broad range of firms and individuals consulted in recent months.

The current differential reporting debate in Australia takes place during a time when issues surrounding smaller entities and reporting compliance have accumulated following the decision to adopt the full suite of International Financial Reporting Standards (IFRS). The enforcement of IFRS across a broader range of entities than was ever contemplated in the European market place led to a range of practitioners and entities asking whether the approach of adopting full IFRS 'number crunching', presentation and disclosure requirements, was too heavy a load for a large number of entities to bear. It is fair to say that Australian entities and the accountants that prepare their financial statements in accordance with full IFRS have performed extremely well since IFRS was adopted in this jurisdiction for financial years beginning on or after 1 January 2005.

Australia has a different regulatory environment to that which operates in Europe and elsewhere. Our law works in a way that exempts a large number of entities already from needing to lodge full sets of financial statements that are audited and compliant with full IFRS. One analysis of the entities with reporting obligations under the *Corporations Act 2001* that was drawn to our attention during the consultation period notes that of almost 1,574,339 entities registered only 32,814 were expected to have reporting obligations. This analysis provides the debate with a sense of perspective and a clear indication that the law – at least in this country – has already done much to reduce the compliance burden in financial reporting.

There are also a range of reforms to the *Corporations Act 2001* that have been designed to reduce even further the number of entities required to report. In particular the reforms relieving smaller public companies limited by guarantee from reporting and audit obligations. At the time of writing these reforms were due to be introduced into the Federal Parliament for passage during the Budget session. These developments also assisted in informing the NIA's exploration of the differential reporting debate with a range of stakeholders.

While we have found limited support for the introduction of the differential reporting framework developed by the International Accounting Standards Board (IASB) known as 'IFRS for SMEs', the proposal of the Australian Accounting Standards Board (AASB) known as the 'reduced disclosure regime' (RDR) has received qualified support from practitioners and preparers consulted by the NIA. The reasons for the qualified support are detailed in our submission. This process has also exposed the tensions between matters of public interest, good public policy and a range of commercial considerations that always emerge during any rigorous debate over regulatory reform.

The NIA has used its Faculties as part of the consultations held during the policy decision making process on the proposals canvassed in ED 192. The chairs of the Faculties of Accounting Regulation, Corporate Governance, Small Business and Public Sector each had involvement during the consultation process. The NIA particularly wishes to thank Professor David Boymal FPNA, the chair of the Faculty of Accounting Regulation, for making the time to be present for both round table discussions. These discussions clearly demonstrate the contribution the NIA is able to make to the accounting profession, the public service, the standard setters and the community at large by helping shape policy through transparent consultation processes designed to promote an understanding of differences of view.

This process has been extensive and the NIA hopes the members of the AASB find the contents of the submission useful in finalizing deliberations on proposed revisions to Australia's financial reporting framework.

The NIA would be pleased to provide any further information on our submission. Should you have further queries please contact our Head of Research, Tom Ravlic, on tom.ravlic@nia.org.au or 03 8665 3143.

Executive Summary

The NIA launched a consultation process related to the proposed introduction of the RDR as outlined by the AASB in ED 192 in February 2010. This process was initiated by the NIA to determine what a range of members and stakeholders felt about the proposed revisions to the financial reporting regime in Australia.

Qualified support for RDR

The consultation process revealed most individuals or organizations supported the principles underlying the RDR and a tiering of reporting requirements. Some respondents supporting the principles of RDR questioned the need for change. A lower level of support was evident for the implementation of IFRS for SMEs being introduced as either an option or as the mandatory reporting regime for Tier 2 entities as defined by the AASB in the proposals.

Some respondents indicated support for the concept of a 'smaller book' but only if the book was consistent with recognition and measurement options available in full IFRS.

Issues raised by constituents

Key issues raised by constituents during the consultation period in relation to RDR were:

- Public policy imperatives in ensuring financial statements that were subject to financial reporting requirements under the Corporations Act are prepared in accordance with one framework;
- The potential impact of the changes to the accounting requirements on entities that had previously not complied with full recognition and measurement requirements when lodging financial statements with the corporate regulator;
- The absence of detailed research on the costs and benefits of the current reporting regime and the proposed regime in order to provide for a clearer understanding of the need for change. Academics have indicated to the NIA a willingness to explore the issues of costs and benefits further;
- Costs and benefits of forced consolidation for entities that previously prepared financial statements not in accordance with AASB 127, the accounting standard on consolidation of financial statements;
- Confusion that would result from the implementation of a 'third set' of guidance in Australia if IFRS for SMEs was permitted for entities that are not publicly accountable;
- Concerns about the interpretation of IFRS for SMEs and the lack of guidance in IFRS for SMEs when compared with the larger book of standards;
- Concerns about the training of accountants in two regimes rather than one single regime in a situation where a firm's clients may deal with both sets of accounting standards;

- General issues of education of accounting undergraduates and post-graduates in an environment where two sets of standards apply;
- Ethical discomfort for auditors considering the implications of signing off on financial statements of entities as fairly representing an entities financial position and financial performance using two different frameworks for the purpose of reporting;
- A view that neither RDR nor IFRS for SMEs address the criteria of usefulness of financial statements for directors and others involved in the governance of an entity;
- A view that neither RDR nor IFRS for SMEs provide sufficient relief from disclosure burdens – both regimes are seen as lacking flexibility when compared with the current regime by members and stakeholders consulted; and
- Concerns about additional costs for entities that have not consolidated in accordance with accounting standards and what benefit is to be derived from consolidating in accordance with either IFRS for SMEs or RDR as proposed by the AASB.

NIA recommendation

Based on the feedback received over the past two months and previously the NIA supports the introduction of the RDR regime but with a 12 month deferral of the effective date to allow entities that have previously not reported in accordance with all recognition and measurement requirements a period of grace to adjust their systems. Early adoption should be permitted. The quantum of disclosure under the RDR should be reconsidered given the common criticism of the RDR has been that the disclosure level remains onerous for entities without public accountability.

Deferral of the date at which RDR becomes mandatory would allow for:

- Entities that need to organize their affairs to comply with recognition and measurement sufficient time to bring their systems into line;
- Allow the AASB time to review the disclosures it has mandated under RDR and also allow it to have regard for any changes the IASB may make to the scope of disclosures in IFRS for SMEs following its first review of the standard; and
- Allow for a review of the RDR following feedback from early adopters and refine any aspect of RDR that does not compromise the initial undertaking the board has given to ensure its disclosures are consistent with the quantum and tone set internationally in IFRS for SMEs.

It is noted that the AASB has made provision for IFRS for SMEs to be introduced at a future point in time should current concerns – such as consistency with recognition and measurements – with that standard be resolved. The NIA supports the AASB's approach in this regard following feedback from constituents.

Introduction

The NIA has been consulting with constituents over the past two months regarding the proposed changes to the financial reporting framework in Australia released by the AASB on February 26. Feedback was received from constituents via several channels. The NIA held two round tables, sought views from accountants globally using social networking sites and NIA representatives have spoken directly with practitioners from small to mid-tier accounting firms, regulators and public servants in presentations as well as one-on-one phone interviews. This feedback and other independent research have informed the position of the NIA on the proposals put to the community for comment by the AASB.

While most of the feedback outlined in this submission related directly to the principles underlying the proposals and the practical impact of the regime as outlined by the AASB in ED 192 there are a range of generic matters regarding financial reporting regulation that were raised in feedback. These issues were raised as a result of long-standing concerns respondents have with aspects of financial reporting regulation in Australia.

Issues outside of the scope of ED 192

The differential reporting debate is a recurring phenomenon and the themes are consistent over time. It is a debate revisited by accountants and regulators as community values change, technology advances and a range of global influences begin to emerge. It exposes the tensions between the preference of preparers in a range of circumstances to reveal nothing or as little as possible and the general pursuit by regulators and others of the public interest each time the issue is debated. The current debate is essentially around the same issues.

Discussions on differential reporting were also used to highlight a range of other issues that are either out of the scope of the activity of the standard setter or are areas in which the AASB may not have direct influence. NIA members and other stakeholders emphasized a range of issues that are frequently discussed regarding the complexity and usefulness of financial reporting to boards of directors and senior managers. Many of these remarks relate to the underlying public policy issues related to the lodgment and audit of financial statements with the corporate regulator. Other criticisms are related to the general objectives of financial reporting and are not exclusive to the current discussion related to RDR. These matters can be summarized as follows:

- *Relevance for decision making:* Respondents noted that statutory financial statements were seen by owners and boards of companies as being a compliance exercise rather than being useful for management decision making. This point was made in the context of boards of directors and of owners of SMEs that were concerned about paying for financial statements, which to them represent a compliance exercise with little or no benefit to driving the future of the business. The lodgment of financial statements that have been audited with a registrar or a corporate regulator are a result of public policy decisions. While the AASB sets the requirements for what appears in financial statements the legal regime that requires the lodgment of financial statements is ultimately the responsibility of the Federal Parliament.

- *Understandability of financial statements:* Some commentators argued the financial statements were no longer comprehensible because of the complexity inherent in the accounting standards. A contrary view, however, was also put. Complexity in financial statements is merely a reflection of the way in which business transactions have become more complex. In other words, complexity in accounting standards and interpretations is a response to business developments themselves. The IASB has commenced work on reviewing the principles of disclosure and the NIA is monitoring these developments to ensure enhancing understandability is a part of the IASB's objectives in revising the level of disclosure.
- *Disclosure is too voluminous:* While relevant to RDR in the context of reduced disclosures the general remark about the size of full financial statements and their incomprehensibility extends beyond the debate on differential reporting. Respondents referred to the way in which companies provide materials customized to the needs of analysts as evidence that statutory financial statements fail to meet the needs of users. The submission makes reference to volume of disclosure below but only in the context of RDR itself. It is noted that the IASB and consequently the AASB are in the process of reviewing disclosure requirements and management commentary. The general issue of financial reporting disclosure is more appropriately addressed in that context.
- *Grandfathered entities under the Corporations Act 2001:* Some respondents noted the public policy issues surrounding companies that were grandfathered in the mid-1990s and were exempted from lodging financial statements with the corporate regulator during the discussion about RDR and financial reporting requirements. This is a matter beyond the AASB's mandate but constituents raised the inconsistency between requiring a large number of entities to report publicly in accordance with RDR and still having entities that are of substantial economic significance that are shielded from an equivalent level of public scrutiny.
- *Change weariness:* The consultation process also saw the emergence of change weariness. Accountants in practice and in companies expressed a general concern about the rate of regulatory change in the area of accounting regulation. Small practitioners in particular expressed concerns about the proposed changes as being another obligation they and their clients need to consider in addition to tax, superannuation and other laws. While not all small practitioners consulted will be affected by the RDR changes as they tend to service sole traders and small proprietary companies that are exempted from reporting, they are still concerned about the rate of change in accounting regulation.

Options for differential reporting

Four different regimes were discussed by the respondents to the NIA's consultation process. This is a reflection of the diversity of views that is present within the business community regarding the appropriate basis for setting financial reporting requirements in Australia. The four regimes most discussed by respondents are as follows:

- *Maintenance of status quo:* Those holding this view preferred the current regime to RDR on the basis that the reporting entity concept as applied in Australia provided the best solution for financial reporting. The reporting entity concept was described

as giving preparers the flexibility to prepare special purpose financial statements in those cases where it is clear they are not a reporting entity. While the status quo was supported by most respondents in conversation it was universally acknowledged that the reporting entity concept as it applied in Australia was going to be subject to revised requirements.

- *Full IFRS and IFRS for SMEs*: This approach would result in the IASB's standard being the differential reporting alternative. Those supporting this perspective tended to oppose the establishment of RDR on the basis that Australia had adopted IFRS. IFRS came from the IASB and IFRS for SMEs was also issued by the IASB and therefore Australia's solution should have been to harmonise with IFRS for SMEs. This perspective received limited support.
- *Full IFRS, RDR and IFRS for SMEs*: Advocates of this perspective argue that while the RDR may have benefits for some entities it is too complex for some companies required to lodge with the corporate regulator. It is argued that having a shorter, compact standard makes the task of compliance easier. Supporters of this position argued that the market ought to decide the relevance and usefulness of the accounting requirements for non-publicly accountable entities. This perspective received limited support.
- *Full IFRS and RDR*: Supporters of the RDR highlight the issue of consistency with recognition and measurement, which means the regime has scalability at its core, and supporters also approve of the general principle of reduced disclosure for those entities that are not deemed publicly accountable. It also has one book as its central reference point rather than two.

The NIA has found that most constituents demonstrated qualified support for the principles underlying RDR, particularly given the basis for RDR is consistency with recognition and measurement. There was concern expressed about the lack of available research or field testing of the RDR so that the impact of RDR on a range of entities with different levels of compliance with accounting standards could be assessed independently. The NIA has been contacted by academics that are willing to examine the impact of the RDR on a range of entities to obtain a better understanding of the costs and benefits of the regime as outlined by the AASB.

Use of the term 'SME'

It should also be noted that the use of the abbreviation 'SMEs' in the title of the IASB's document has continued to cause confusion in the market place. Small practitioners have been unnecessarily alarmed by the changes because of lobbying efforts that made it appear that their client base – mostly small proprietary companies or sole traders – would be impacted by the proposals issued by the AASB. The NIA has reassured members in smaller public practices that most of their clients remain unaffected by the proposals. This appears to have colored the initial response given by some people to both the RDR and IFRS for SMEs. It has also indicated that the analysis of the proposals put forward by the AASB has been considered by some respondents in isolation of the work that has been undertaken by the Federal Treasury to relieve a large number of small public companies limited by guarantee from the reporting obligations in the *Corporations Act 2001*.

Feedback on the RDR concept

It should be noted at the outset that the principles underlying the RDR regime as proposed for Australian purposes are not new. The idea has been tested and used as a way to achieve differential reporting over the years in New Zealand and the United States through its domestic standard setter, the Financial Accounting Standards Board (FASB). The FASB's approach¹ as outlined in a discussion paper released in 1989 by the Australian Accounting Research Foundation was that "the burden of reporting imposed on small companies is generally justified and that the appropriate solution to the overload problem, where it exists, is that of differential disclosure". The FASB stated at that time its approach was to consider small company needs when it considered accounting standard setting issues and exempt small companies from particular requirements where considered necessary. The RDR approach proposed in Australia follows a similar logic.

It is noted that a range of countries have either mandated or permitted the use of IFRS for SMEs or a similar type of reporting framework for entities that fall out of a definition of public accountability. This includes countries such as South Africa, which has used full IFRS and IFRS for SMEs over the past few years. South Africa is also developing a third tier of reporting for non-publicly accountable entities. While IFRS for SMEs has been adopted in South Africa feedback from respondents indicates that the use of IFRS for SMEs is at best limited as the standard has not been taken up by many entities. Australia has a range of jurisdictional differences to countries such as South Africa. Most respondents have indicated a reluctance to entertain the provision of IFRS for SMEs as an option in Australia because of the way in which company law in Australia operates.

The principles underlying the RDR as outlined in the AASB exposure draft received general support from most stakeholders consulted during the two month exposure period. Key among the reasons for their support for the RDR is the use of the same recognition and measurement criteria. This was the major point highlighted by most constituents who provided feedback on the basis that it:

- Provided for the continued use of a single set of guidance rather than two sets of guidance if IFRS for SMEs were allowed as an option;
- Created a scalable regime in which an entity could become publicly accountable and not have to transition to full IFRS using IFRS 1. Also, it would be applying measurement and recognition principles consistently;
- All options for accounting are available under RDR, which provides greater flexibility for reporting for directors and senior management of an entity. IFRS for SMEs imposes recognition and measurement restrictions and creates limitations rather than provide options for directors and managers to determine relevant accounting policies;
- RDR provides for a reduction in disclosures for those entities that have reported in accordance with full IFRS up to this point for the purposes of producing audited financial statements for lodgment with the corporate regulator, the Australian Securities and Investments Commission; and

¹ McCahey, J E and Ramsay, A L (1989) Differential Reporting: Nature for the Accounting Standards Overload Problem and a Proposal for its Resolution, Australian Accounting Research Foundation, Caulfield.

- RDR's design means there is only one source of guidance for accounting under the *Corporations Act 2001*, which means there is one place to source accounting requirements for both the size test as it applies to proprietary or private companies under section 45A of the *Corporations Act 2001* and the general financial reporting requirements as they apply through that same Act, particularly section 2M.

Some respondents were unsupportive of the move to RDR as it removes the flexibility some entities had been used to under the present financial reporting framework. It is clear the AASB has drafted RDR to ensure a base level of disclosure exists in financial statements lodged with the corporate regulator even if entities that lodge those financial statements previously lodged financial statements they called special purpose financial statements (SPFS). Practitioners in particular highlighted a range of impacts of RDR such as a requirement to consolidate financial statements for those that did not previously consolidate in accordance with financial reporting standards. Entities in this position would have filed financial statements they considered as being 'special purpose financial statements'. Other entities have also used simplified accounting treatments in lodgments to the regulator on the basis that the financial statements were 'special purpose'. It should be noted, however, that most of those responding to the NIA's various calls for comment favored the application of the RDR over IFRS for SMEs if a change in reporting was to take place.

Feedback from the two round tables held by the NIA on March 24 and April 13 indicates there will be a range of entities that will need to increase the quantum of disclosure they provide to the market place in lodgments to the corporate regulator. It was suggested by some respondents that the AASB could consider further research into the impact of the regime so that the breadth of the impact of the proposals is better understood by the standard setter and the community at large.

Mid-tier firm Moore Stephens conducted a field test of the original 'IFRS for SMEs' exposure draft on behalf of the professional accounting bodies in 2007. Concerns were expressed about the unviable nature of IFRS for SMEs at the time, which included the absence of detailed guidance on accounting issues. These concerns still remain in the context of the final standard as approved by the IASB.

The NIA is aware of suggestions from some commentators that introduction of the RDR without permitting IFRS for SMEs as an option would lead to the likelihood of the development of a culture of non-compliance with accounting requirements. The NIA has at no time received evidence that accountants and the entities they serve through the provision of either consulting or audit services would deliberately seek to not comply with RDR were it to be introduced without IFRS for SMEs as an accompanying option. Several constituents cited anecdotal evidence of entities they believed should have been complying with the full set of accounting standards because they were 'clearly' reporting entities and have noted concerns with the current level of compliance with accounting standards based on their consulting experience. At best it can be argued that a degree of non-compliance can always be expected within any regulatory environment and the Australian environment post-implementation of RDR would be no different than at any other time in the history of regulatory change in this country. At no time should assertions about the prospective level of compliance or otherwise be viewed as a credible or valid argument against change without a greater body of evidence to support such a conclusion.

Several respondents noted that the RDR provided a chance to realign reporting obligations with public policy articulated in the *Corporations Act 2001*. Public policy requires that financial statements which are lodged become information available to a wide range of users. Those financial statements should be prepared in accordance with all accounting standards. While acknowledging that some entities would need to amend their reporting practices of the past most respondents supported the aims of the RDR and saw it as a confirmation of a logical reporting model. It was also acknowledged that the AASB recognized in the design of the model that non-publicly accountable entities would have a lower disclosure burden. A respondent also noted that entities incorporated under the *Corporations Act 2001* were accessing a legal privilege and not a 'right'. The view expressed was that the privilege of incorporation under law demanded some degree of accountability to the community. They believed all companies incorporated under the *Corporations Act 2001* – public or private – enjoyed the privilege of limited liability and as a consequence they should have some accountability to the public to demonstrate they are able to pay their debts as and when they fall due. These remarks are tempered with support for the current and proposed thresholds that provide financial reporting and audit relief to entities considered from a public policy perspective to merit a reduction in the cost of compliance because of their size and the degree of public interest in their activities.

Feedback on the structure of the two tiers of reporting

The AASB proposal to reduce disclosure for entities deemed to fall out of public accountability received general support, particularly given the underlying intent of reducing the size of financial statements lodged by entities. However, a range of remarks were made during the consultation period about Tier 2. Feedback on the reporting entity concept and the modification of its use appears below. The general feedback on the regime and its reporting tiers can be summarized as follows:

- The concept of a second tier is supported by most constituents and the principle of reducing disclosure but maintaining consistent recognition and measurement between Tier 1 and Tier 2 is also supported by most constituents;
- A limited number of constituents supported the use of IFRS for SMEs by Tier 2 entities. Reasons cited by supporters of IFRS for SMEs included consistency with an IASB document that was gradually being reviewed and adopted by other countries and a perceived lower level of compliance cost resulting from some simplified accounting methods. No empirical evidence, however, relating to the assertion of a lower cost of compliance was brought to our attention during the consultation period;
- While the demarcation line appears clear in the for-profit and not-for-profit sectors concern was raised about the level of compliance for small government agencies that might fall into Tier 2. A suggestion was made by some constituents for the creation of an additional tier for smaller government agencies with further reduced disclosure requirements. The AASB may wish to consider this during its deliberations on the RDR; and
- Concerns were raised about the lack of flexibility within both RDR and IFRS for SMEs where consolidation of subsidiaries and related entities was concerned. Feedback from practitioners indicates there has been a practice, which is said to reflect the management of those entities, of not applying the consolidation standard.

The benefits of enforcing the application of the consolidation standard were questioned by some constituents in the context of these entities that are typically large private companies.

The NIA is aware of the general criticism of the quantum of disclosure that remains in both IFRS for SMEs and RDR. While it is understood individual respondents are analyzing the exposure draft in detail to provide comments on the quantum and usefulness of disclosure the NIA had not received extensive feedback on the appropriateness of the degree of reduction for entities that are deemed to be not publicly accountable. It was noted that in some cases financial statements have been lodged which contain less disclosure than envisaged in the AASB's consultation document. These entities will face an increase in the cost of preparation of financial statements. In other cases it has been said there will be a reduction in disclosure and preparation costs for entities that fall out of Tier 1 reporting because they do not meet the definition of public accountability.

An issue discussed by some respondents in the context of disclosures to be provided by non-publicly accountable entities is servicing the needs of users. It is clear from our consultation that assurance about an entity's solvency or liquidity should be considered as the primary drivers for the prescription of disclosure under a differential reporting framework such as the RDR. Primary users in this instance were characterized as being suppliers, customers and regulators rather than owners, potential investors or financiers. It was suggested that disclosures providing information directly relevant to matters related to profitability, solvency and liquidity should be the focus of the RDR or a similar regime. An example raised during the consultation process was share-based payments in the context of a private company issuing shares or share options to directors or executives of the entity. Users of the financial statements may need to know the impact of any shares, share options or similar instruments on the entity's profitability during the reporting period and whether the share-based payment could be settled in cash and have an impact on liquidity. It can be questioned whether users assessing an entity's liquidity or solvency needed access to information related to numbers of shares, the strike price, vesting periods and other matters that may have greater relevance in the context of an entity that has public accountability.

The NIA will supply any further feedback it receives from constituents on the disclosures in a supplementary submission should such feedback arrive after the due date for comments.

General Purpose Financial Statements and Reporting Entity

Many stakeholders expressed concern about the removal of the reporting entity concept as it has been established in Australia since the 1990s when the four Statements of Accounting Concepts (SAC) were issued by the AASB. The conceptual framework defined the reporting entity as an entity where it is reasonable to expect the existence of users dependent on general purpose financial statements for economic decision making. This is generally interpreted in a regulatory sense as entities in which there is a public interest. The logic underlying the conceptual framework's use of the notion of the reporting entity concept is supported by a majority of respondents. It is considered a conceptually valid model for determining what entities ought to prepare general purpose financial statements but also which entities should be regarded as non-reporting entities; and as such not have to prepare financial statements in accordance with financial reporting standards. The manner in which the concept has been interpreted by some practitioners, thought leaders and directors or managers of entities, however, has been the subject of heated debate. While the principle

itself is sound the NIA is aware from its consultations that it has at times been used as a way of avoid compliance with recognition and measurement requirements of accounting standards even though the financial statements were being lodged on public record. Irrespective of the debate about whether those statements are regularly accessed or used by the community the type of entities that lodge financial statements remains a key public policy issue for government. The AASB is presently seeking to clarify the manner in which the notion of the reporting entity ought to be viewed in today's context, particularly in light of concerns about the application of the notion of special purpose financial statements to accounts lodged with the corporate regulator. It is a matter of public record that the corporate regulator, the Australian Securities and Investments Commission, has an expectation that lodgments ought to comply with recognition and measurement principles of accounting standards. The AASB's RDR formalizes this concept and provides firm guidance on what type of financial statements are suitable for public lodgment.

While RDR has general support amongst respondents to the consultation process they are concerned about the consequent effect on the flexibility in applying financial reporting standards. This includes the challenges of convincing some private groups to apply consolidation accounting in circumstances where previously they have not. There is also a degree of concern about the quantum of disclosure that remains and a continued wish for further flexibility that was acknowledged as a benefit of a regime with a lesser degree of prescription than that applying under the RDR. Some of the feedback from practitioners suggests there are entities that currently lodge financial statements that contain fewer disclosures than are contained in either RDR or IFRS for SMEs. The same is true for the notion of a general purpose financial statement being deemed under the RDR as something that is publicly available rather than compliant with a full set of accounting standards. The change is understandable but will cause a degree of confusion as members and their clients or employers start to get used to the changes.

It should also be noted that the manner in which Australia has traditionally referred to the reporting entity concept will also cause confusion in the context of the work being done by the IASB on the international conceptual framework. Australia's framework has used the notion of a reporting entity as a way of determining an entity that must comply with all of the accounting standards. The IASB performs that same function with the notion of 'public accountability' and the 'reporting entity' in IASB terms is the scope of the entity that reports rather than a general concept of an entity in which there is a public interest – the traditional notion of a reporting entity in Australia. The work of the IASB adds a degree of confusion in the domestic discussion and it is a distinction that needs to be borne in mind by all participants in the debate. We have experienced first hand the confusion that the two uses of the term reporting entity can cause during our consultation and acknowledge that this is an area for further education of the profession generally so that preparers of accounts and accountants in public practice are clear on what they need to be doing.

We received limited feedback on the impact of the definition of public accountability, particularly with the notion of entities that had as a core part of their business a fiduciary responsibility to other entities or individuals for funds in their control. While it was clear that this applied to banks and similar entities there was concern about a lack of clarity regarding the way in which the concept might apply in other situations. It was suggested during the consultation process the AASB may consider the provision of further guidance on how this definition may be applied to avoid further confusion.

Feedback on RDR compared with IFRS for SMEs

The NIA received feedback from members and other stakeholders regarding the technical and practical differences between IFRS for SMEs and the proposed RDR. Key concerns are:

Simplification of financial reporting and IFRS for SMEs

Concern was raised at the notion that simplification of accounting appeared to denote at least in the minds of some, the acceptability or allowability of differences in measurement and recognition requirements. Some stakeholders had ethical and practical difficulties with differences in recognition and measurement requirements. These stakeholders argued introduction of IFRS for SMEs as an option in Australia would create a situation that would cause the erosion of financial reporting.

Specific instances raised with the NIA include but are not limited to the preparation of a small to medium enterprise for listing on a stock exchange and the increase in costs incurred by such an entity having to convert its financial statements into full IFRS to list on a domestic or even foreign stock exchange where full IFRS is an acceptable framework for lodging financial statements for the purposes of capital or debt raising. Further examples include, in audit situations where the potential exists to advise clients of a similar size that sit within Tier 2 of the AASB's reporting regime that they could, for example, apply different accounting for goodwill depending on which framework they chose to apply. Feedback stated a preference for one framework to apply consistently rather than the creation of multiple frameworks. Responses from small practitioners consulted during this process indicated a concern with the creation of choice rather than the creation of the clarity one framework provides.

International experience from a multinational corporation with an office in Australia from which its global IFRS convergence is conducted provided useful feedback on the relevance of IFRS for SMEs in the context of a larger corporation. While the UK arms of the entity in question wanted to entertain the use of IFRS for SMEs, the emerging view is that the vast differences between IFRS for SMEs and the full book of IFRS are such that it is highly unlikely that this multinational corporation will allow any country to use IFRS for SMEs. The only exception in this context would be if the methods of accounting in IFRS for SMEs produced an advantageous tax outcome within a specific jurisdiction. While the tax benefits would be gained the entity would still have to convert the IFRS for SMEs figures into full IFRS in order to ensure the subsidiaries of the multinational could be consolidated properly. IFRS for SMEs in the circumstance was characterized as being inefficient.

Concern about additional 'red tape'

Some practitioners consulted by the NIA expressed concern about the potential introduction of a second reporting framework, which would add to the number of documents with which they would need to be familiar. Not all accounting firms have the resources to ensure they monitor every single development and the NIA received feedback from practitioners concerned about the need to understand the differences between the two sets of requirements in order to be able to advise clients appropriately. Similarly, the understanding of two sets of financial reporting standards would create an issue for those accountants that compile financial statements for clients. It is not unknown for accountants to have clients that require compilations to be done in accordance with full IFRS and other clients merely requiring a simple set of figures for the purposes of tax lodgment. Some practitioners have

indicated a preference for one set of guidance. It should be noted the NIA was also in receipt of feedback from a smaller group of practitioners that stated IFRS for SMEs should be permitted, not required, and the market should be the ultimate determinant of the set of guidance that becomes more popular.

Absence of guidance in IFRS for SMEs

Concern was expressed by constituents about the difference in size between the full suite of IFRS and IFRS for SMEs, particularly in the context of consistent interpretation of accounting standards. Reducing IFRS related requirements from under 3,000 pages to something approximating 260 pages involves a range of compromises. Some respondents to the NIA indicated concerns with the following issues related to guidance:

- Issues not specifically catered for in IFRS for SMEs will require preparers to default to the IFRS for SME framework for guidance. Some respondents indicated that they were concerned preparers and their advisers had demonstrated an inability to form appropriate accounting policies using framework principles. They expressed a concern that this would get worse in an environment where there was even less guidance on accounting matters;
- Enforceability of the framework by a corporate regulator or similar authority is questionable as what is 'true and fair' could be perceived to have been extended beyond enforceable limits; and
- Auditors may be forced to refer to full IFRS on matters not covered by IFRS for SMEs as they would associate reliance on the full book of IFRS with a lower level of compliance risk given the volume of accounting guidance. Arriving at a result under the IFRS for SMEs framework that differs from full IFRS may be perceived as an unacceptable risk.

Knowledge gap and IFRS and IFRS for SMEs

Most respondents saw the knowledge gap in understanding of accounting remaining if IFRS for SMEs was introduced as an option. It was noted during the consultations by several respondents that a client will continue to rely on their external accountant to guide them in account preparation, interpretation and development of accounting policies for complex transactions. In other words, most respondents saw arguments for the introduction of IFRS for SMEs as a greater complication for the practitioners needing to become familiar with two sets of books in order to advise clients rather than making the process easier. Few respondents argued in favor of implementing IFRS for SMEs in the context of knowledge gaps.

Erosion of net asset position of entities

Several respondents pointed to the erosion of an entity's asset base if IFRS for SMEs were to be permitted as an option in Australia. These respondents referred to the current proposals for the removal of the requirement to pay dividends out of profits as outlined in recent proposals from the Federal Government. The proposal to ensure entities only pay dividends based on their assessment of solvency, or net asset surplus available, highlighted to some respondents the need to ensure entities were able to reflect the true value of the

entity in its financial statements. IFRS for SMEs prohibits revaluation of property, plant and equipment, forces the expensing of research and development costs, requires the expensing of borrowing costs and also forces amortization of intangible assets and goodwill. Full IFRS has requirements embedded within it that provide directors and senior management of an entity with the ability to choose the appropriate accounting treatments that reflect the entity's ability to pay dividends.

Not for Profit and public sector issues

Some respondents noted the limitations of IFRS for SMEs where not-for-profit entities and public sector entities are concerned. The AASB's model allows the domestic board to deal with not-for-profit and public sector matters. IFRS for SMEs fails to address these issues. The RDR received general support for the intent to be comprehensive with one set of accounting requirements.

Many public sector entities and not-for-profit entities are asset rich and IFRS for SMEs would not suit the entities that fall into Tier 2 as they rely on revaluation in order to demonstrate their governance to stakeholders. Some respondents argued the AASB's proposals achieve this in having all of the requirements within one regime.

Interpretation of IFRS for SMEs

It is also unclear to most respondents which authority or body would interpret or provide guidance on IFRS for SMEs. What is clear is that disputes related to full IFRS are going to be resolved by the International Financial Reporting Interpretations Committee. There has been little discussion within the accounting profession about how interpretation of a 'second book' of guidance would be done. One respondent indicated a reluctance to commit resources to providing interpretational support for IFRS for SMEs given that their organization had already invested heavily in training and the provision of internal guidance on the full book of IFRS. Other respondents questioned the use of a shorter book when the IASB had a full suite of guidance on a range of issues available as a reference point for the resolution of interpretation issues. It was noted by some respondents that the IASB was providing additional material to assist in the implementation of IFRS for SMEs that was creating a body of literature beyond the few hundred pages that is cited by some commentators as the appeal of much shorter IFRS for SMEs.

Full IFRS, IFRS for SMEs and complexity

Some respondents stated they saw the arguments about the complexity of full IFRS as an opportunity to seek clarification or a streamlining of full IFRS in the future, which would be achieved through the IASB continually improving its standards. Respondents supporting the RDR said that the issue of complexity and financial reporting should not be seen as a reason to introduce an additional framework that might be concise but through its brevity, economic use of language and different recognition and measurement requirements alters the substance of the underlying accounting principles.

RDR and disclosures

Several respondents supported the RDR because they stated the AASB may still be able to tailor the quantum of disclosure based on constituent feedback without fundamentally altering the underlying accounting principles that apply in full IFRS. There was concern expressed about the quantum of disclosure in RDR – a concern expressed because some respondents are aware of entities that currently prepare financial statements that may comply with recognition and measurement but with fewer disclosures than those prescribed in RDR as exposed for comment by the AASB.

Some commentators articulated a different perspective on the development of a reduced disclosure regime in addition to debating the merit of the proposals put forward by the AASB. A respondent to the NIA consultation process suggested an alternative approach to the setting of disclosure levels with the use of IFRS for SMEs as a base but for the AASB to use the method of 'graying out' or shading disclosures that are deemed excessive in the Australian context. One proposed 'hybrid' model was that the adoption for IFRS for SMEs could take place in Australia with Australian-specific amendments permitting use of recognition and measurement requirements in full IFRS. An advantage of this structure would be that entities would be permitted to continue to use IFRS recognition and measurement if they wished and also have reduced disclosure requirements in place.

Training and education issues

Academics and practitioners expressed a range of views regarding the education and training of accountants in the context of the proposed differential reporting regime contemplated by the AASB. Most respondents from accounting practices expressed concern about additional training costs for accounting firms that would need to understand the principles underlying both sets of standards in order to apply one or both with some degree of proficiency. One set of standards tended to be the preference of most respondents from the perspective of having to train accounting staff in only one set of standards and it also allows the practice to focus on one set of standards from a quality control perspective. While this was a view expressed by most respondents, other stakeholders emphasized that some firms may only require knowledge of IFRS for SMEs because most of the simpler transactions are covered in IFRS for SMEs.

University educators expressed concern about the development of curriculum on the financial reporting framework. At the heart of the concerns was the difference in recognition and measurement requirements between IFRS and IFRS for SMEs and the choice faculties would need to make if two reporting frameworks operated in Australia.

Conclusion

The NIA acknowledges the contributions of all of the individuals and entities in the development of the final position on differential reporting presented in this submission to the AASB. While limited support was found for the implementation of IFRS for SMEs as an option in Australia, the proposed RDR received qualified support. Nothing has come to the NIA's attention that would cause us to believe the RDR would be detrimental to the interests of the Australian economy and the NIA supports the implementation of the RDR pending the AASB's further deliberation on the issues and concerns outlined above.

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