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Professor David Boymal
The chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

Dear Professor Boymal

Invitation to comment 12: Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of a proposed IFRS for Small and Medium-sized Entities

We write in response to the request for comments on Australian Accounting Standards Board (AASB) Invitation to Comment 12: Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of a proposed IFRS for Small and Medium-Sized Entities.

Overview of BDO Kendalls Position on Proposal

We believe that consistent measurement and recognition principles should be applied to all entities placing financial reports on the public record. The AASB should make available a standard setting out recognition and measurement principles that can be applied to any entity preparing financial reports that are placed on the public record. We therefore support the AASB's proposal to move to the principle of publically accountable.

It is important however that the proposed changes to the reporting regime do not unnecessarily burden SME's with unnecessary disclosure requirements and the corresponding costs associated with preparation and audit of voluminous financial reports.

The reporting entity concept has not been properly applied by the preparers of Australian financial reports and the proposed change to publicly accountable entities will allow clarification and simplification of reporting requirements within Australia. The current reporting entity concept has led to confusion in respect of applying measurement principles in the preparation of financial reports for non reporting entities, with differing views being expressed, by ASIC, the larger firms and the ICAA. We therefore support the proposal that the application focus of Australian accounting standards change from reporting entity to "general purpose financial reports".

The IASB's SME standard should form the basis for financial reporting requirements in Australia, with the AASB adopting as a minimum the recognition and measurement elements of the proposed standard and inserting specific Aus paragraphs if deemed necessary.

The SME standard should be the default standard to be applied to all Australian financial reports, with full IFRS (the "big book"), only being applied to publicly accountable entities.

We believe that it is the government's role to determine which Australian entities are publically accountable. Further applying size thresholds is too crude a test for making this determination.

The reporting regime that has operated for a number of years in Australia, whereby "special purpose" financial reports have been widely used by the SME sector, has in the whole worked. In adopting the SME standard in full or in part the AASB should be mindful as to the cost/benefit of imposing voluminous disclosure requirements on Australian companies not currently classified as reporting entities.

We believe there is an urgent need to develop a disclosure standard for entities in the not-for-profit sector, particularly charities as both full IFRS and the proposed SME standard is inadequate in respect of appropriate/relevant disclosure for those entities.

We fail to understand the logic behind the proposed size thresholds for not-for-profit entities. The proposal forces not-for-profit entities above size thresholds to report under full IFRS, which has inadequate disclosure requirements for this sector and carries minimal measurement differences compared with that prescribed in the proposed SME standard.

We have the following comments on the matters the Board is seeking comment on.

Question (a)

- (a) *Do you agree with changing the application focus of Australian Accounting Standards from 'reporting entity' to 'general purpose financial reports'?*

Answer (a)

We support the proposal changing the focus from "reporting entity" to "general purpose financial reports".

We believe that the Australian equivalent of the SME standard should be the default standard for the preparation of financial reports in Australia and that the current "reporting entity" requirements is adequately addressed by the "publically accountable" concept. We strongly believe that government is the appropriate body to determine which entities are deemed to be publically accountable. and that imposing size thresholds alone is not appropriate.

Question (b)

- (b) *if it is considered desirable to retain the reporting entity concept as the basis for differential reporting, what improvements could be made to remove related concerns (see paragraph BC6) and make it more effective?*

Answer (b)

We do not believe it is desirable to maintain the reporting entity concept, but instead believe that the public accountable definition can be developed to adequately meet the needs of users.

Question (c)

- (c) *Do you support the proposal to apply the IASB's definition of a publicly accountable entity to differentiate between for-profit entities that apply Australian equivalents to IFRSs and for-profit entities that apply an Australian equivalent to the IFRS for SMEs?*

Answer (c)

We support using the IASB definition of a publicly accountable entity in the future differential reporting, and believe that unless an entity is determined to be publically accountable then the Australian equivalent to the SME standard shall be the default standard.

Question (d)

- (d) *in respect of for-profit entities that do not satisfy the IASB's definition of a publically accountable entity, but are viewed as being important from a public interest perspective because of their large size:*
- (i) *do you agree that such entities should in the public interest apply Australian equivalents to IFRSs and that it is appropriate to use size thresholds to identify these entities?*

Answer(d)(i)

We believe that determining which Australian entities are publically accountable (including setting size thresholds) is the role of the regulator (government) and not the role of the AASB. Size thresholds are potentially one reason an entity may be deemed to be publically accountable but certainly is only one of a number of factors that may lead to an entity being publically accountable. Therefore size alone is insufficient to determine whether an entity is or is not publically accountable.

We further believe that a more detailed review of mandatory disclosure requirements is required, identifying which disclosures are truly necessary and which are just "nice to have". In undertaking this review consideration should be given to the fact that grandfathering arrangements still exist for a number of Australian entities above the size threshold proposed by the AASB, we fail to understand how these large grandfathered companies can be "publicly accountable" and to understand the reason for prohibiting them from utilising the SME standard, as the users of the financial report are not using the report for investment decisions.

If it is deemed inappropriate for non publically accountably entities above a certain size to adopt certain simplified measurement options within the SME standard, then the SME standard could easily include prohibition of certain treatments for entities above a certain size threshold. This is likely to be more desirable than imposing the “big book” on non publically accountable entities.

Question (d)

- (ii) *do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds, and why?*

Answer (d)(ii)

We believe that the concept of publically accountability rests on consideration in respect of economic significance in the context of impact on Australian society and the Australian economy. These factors include significance in respect to specific industries, regional importance, strategic importance etc. To simply insert size thresholds clearly oversimplifies a very complex issue, and could well result in entities being misclassified. Clearly if the size thresholds result in “grandfathered” entities having to prepare full IFRS financial reports, the proposed size test is flawed.

Question (e)

- (e) *since the IASB’s ED of A Proposed IFRS for SMEs has been developed with only for profit entities in mind, do you agree it is appropriate to adopt the forthcoming IASB’s IFRS for SMEs (after inclusion of Aus paragraphs similar to those included in Australian equivalents to IFRSs) in a differential reporting regime in respect of not-for profit private sector entities and public sector entities?*

Answer (e)

We believe it is appropriate to modify the SME standard in respect of the existing Aus paragraphs contained in existing standards. The inserted Aus paragraphs do appropriately addresss the specific measurement issues impacting the not-for-profit sector.

We believe that the current AASB’ are woefully weak in respect of the disclosure requirements of the not-for-profit sector, particularly charities and that a separate disclosure statement is urgently required, and simply inserting the Aus paragraphs will not adequately meet the reporting needs of entities in this sector.

Questions in respect to not-for-profit entities

- (f) *in respect of not-for-profit private sector entities:*

Question (f)

- (i) *is there a need for differential reporting in the not-for-profit private sector? If yes, do you agree with using size thresholds to distinguish between not-for-profit private sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs*

(which would include Aus paragraphs similar to those included in Australian equivalent to IFRSs)?

Answer (f)(i)

We support differential reporting in respect of not-for-profit entities, but believe this differential reporting should be in respect of disclosure requirement contained within a specifically tailored not-for-profit disclosure accounting standard. We believe that an accounting standard should be available for application of not-for-profit entities of any size. Such a standard should contain very simple measured principles and minimum mandatory disclosure. These very simplified measurement options could potentially be addressed by inserting specific Aus paragraphs. It should be the choice of government, donors or members to then determine how a particular entity applies differential reporting.

We do not believe that full IFRS contains any specific measurement issue that cannot be accommodated within the SME standard, (possibly prohibiting certain “over simplified” measurement methods for entities above a certain size threshold).

Size thresholds should concentrate on donations or grants received from the general public or government, where entities undertake “commercial” type activities performing services for members, then the size thresholds should be the same as those used for a for profit entity.

Question (f)

(ii) do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate size thresholds and why?

Answer (f)(ii)

We believe size thresholds in respect of not-for-profits are inappropriate in terms of a NFPs “commercial” activities (providing services to members). We fail to see why a for profit pub chain with turnover of \$499 million should be permitted to use the SME standard whilst an RSL with a turnover of \$26 million would be forced to use full IFRS.

If size thresholds are to be used in respect of differential reporting for not-for-profit entities then these thresholds should be based on specific not-for-profit type tests, not just revenue and assets ie:

- \$ value of donations received
- \$ value of grants received
- Number of members

In respect of a not-for-profit entities’ “commercial revenue” earned from providing services to members we cannot see any logic for these thresholds being less than those of a for profit entity.

Question (f)

- (iii) *not-for-profit entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of \$500m revenue and \$250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of not-for-profit entities. Do you agree?*

Answer (f)(iii)

No, we disagree with the proposal.

We believe that the argument for requiring not-for-profit entities above a certain size to apply full IFRS is flawed as:

- Full IFRS is not written for not-for-profits.
- Full AIFRS has had to be modified in a number of respects to cater for the specific measurement requirements of not-for-profits (impairment, inventory, accounting for government grants).
- Full IFRS lacks of adequate disclosure applicable to not-for-profit entities, particularly charities.

In respect of a not-for-profit “commercial revenue” earned from providing services to members we cannot see any logic for these thresholds being less than those of a for profit entity.

Question (f)

- (iv) *both private sector not-for-profit entities and public sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would need to prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?*

Answer (f)(iv)

No. The funds managed by the public sector are a quantum larger than those managed by the not-for-profit sector. The basic concept of materiality needs to be applied in recognising that the same size thresholds do not apply. Eg consider the public reaction to a state government “wasting” \$25 million vs a small charity “wasting” \$25 million.

We do not believe that it is the place of the AASB to set size thresholds in respect of determining which entities are publically accountable, and the role should be left with the relevant government department or regulator.

The size thresholds proposed for public sector entities would appear to be woefully small , not recognising the “size” of a normal public sector entity. Equally crudely raising size thresholds could result in public sector entities within certain regions/states being wrongly classified misclassified.

Question (f)

(v) *do you think a third tier of simpler reporting requirements should be added to cater for smaller not-for-profit private sector entities that prepare general purpose financial reports? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified?*

Answer (f)(v)

We believe that all appropriate measurement options should be contained within the SME standard, possibly by way of inserting specific Aus paragraphs.

The SME standard accommodates different measurement options in respect of accounting for associates and JVs (which allows, equity accounting, fair value or cost). This principle should follow for the measurement and recognition of financial instruments, Property Plant and Equipment etc allowing an entity to select the “simple” measurement option of cost.

We then believe that potential differential reporting is possible within the standard by prohibiting certain very simplified measurement methods from being used by entities above a certain size.

The principle of differential reporting should then be applied in respect of disclosure requirements contained within a tailored not-for-profit disclosure standard.

In respect of simpler reporting requirements we believe that a general purpose financial report should contain:

- Income statement*
- Balance Sheet
- Cash flow statement
- Accounting policies
- Related party disclosure
- Summary of accounting policies

*this statement must be in a suitably modified to show needs of a not-for-profit – particularly charities.

Then based on size thresholds the level of suitable tailored disclosure should increase, recognising cost benefit of requiring these disclosures

In respect of not-for-profits then specific disclosures would be required for information in respect of:

- Fund raising costs
- Monies spent on administration
- Monies spent directly on charitable activities

Simplified reporting would include:

- Accounting for Financial Instruments at cost (tested for impairment)
- No accounting for lease makes good provisions.

We believe that it is the role of AASB to provide standards for **all** Australian entities preparing financial reports, (not the role of the professional bodies).

Question

How would your answer to this question differ if the forthcoming IFRS for SMEs has fewer disclosures than the ED of A Proposed IFRS for SMEs?

Answer

We believe that there must be fewer mandatory disclosures in the Australian SME standard

Question Re public sector entities

(g) in respect of public sector entities:

Question (g)

(i) is there a need for differential reporting in public sector? If yes, do you agree with differentiating based on size thresholds between public sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalents to IFRSs)?

Answer (g)(i)

We support differential reporting in the public sector.

Question (g)

(ii) do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds and why?

Answer (g)(ii)

In respect of public sector entities we believe that the proposed size thresholds are far too small.

Question (g)

- (iii) *public sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of \$500m revenue and \$250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of public sector entities. Do you agree?*

Answer (g)(iii)

No we do not agree with the AASB's conclusion. Application of differential reporting within the public sector is the role of government not the AASB. Proposed size thresholds are inappropriate for public sector.

Question (g)

- (iv) *both public sector entities and not-for-profit private sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?*

Answer (g)(iv)

No. The funds managed by the public sector is a in excess of those managed by the not-for-profit sector. The basic concept of materiality needs to be applied in recognising that the same size thresholds do not apply. Eg consider the public reaction to a state government "wasting" \$25 million vs a small charity "wasting" \$25 million.

Question (g)

- (v) *do you think another tier of simpler reporting requirements should be established to cater for smaller public sector entities? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified?*

Answer (g)(v)

We believe the SME standard should be written so as to be applicable to all public sector entities with simplified measurement and disclosure options being available to smaller entities.

Question (h)

- (h) *do you think there are approaches, other than the proposed approach based on public interest and employing size thresholds, that would reasonably distinguish between entities that should apply the Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs? If there are appropriate alternative approaches, please explain.*

Answer (h)

We believe that the default standard for applying to Australian general purpose financial reports is an Australian version of the SME standard.

It is then up to regulations or other users to stipulate whether they specifically want an entity to use full IFRS. Thus if utilities, airlines, recipients of government or public funding etc are deemed to be publicly accountable entities then the appropriate regulator can make the decision.

Question (h)(i)

- (i) *do you agree that, consistent with the IASB's view of a general purpose financial report, under a revised Australian differential reporting regime:*

Answer (h)(i)

Yes, we support the AASB's view.

Question (h)(ii)

- (ii) *all financial reports that are available on a public register, such as those prepared and lodged with the ASIC under the Corporations Act, should be regarded as general purpose financial reports; and*

Answer (h)(ii)

Yes, we support the AASB's view.

Question (h)(iii)

- (iii) *all financial reports that are made available to the public at large, such as those tabled in a Parliament, also should be regarded as general purpose financial reports?*

If you do not agree, explain why.

Answer (h)(iii)

Yes we support the AASB's view. But we strongly believe that the current SME proposal contains for too many mandatory disclosure.

Question (j)

- (j) *do you agree that, notwithstanding an entity having been exempted from filing a financial report with the ASIC, its financial report should be regarded as a general purpose financial report if it is required by the Corporations Act to be prepared in accordance with Australian Accounting Standards?*

Answer (j)

The question highlights that the disclosure requirements contained within the proposed ED are far too extensive for those entities preparing general purpose financial reports. It would appear inappropriate to require grandfathered companies to prepare a financial report with so much unwarranted disclosure. At the same time a standard should be available and mandated to all entities preparing a financial report under the Corporations Act, setting out prescribed recognition and measurement.

Question (k)

- (k) *the Corporations Act includes three size thresholds respectively for revenue, assets and the number of employees to distinguish between small and large proprietary companies. The AASB's proposed size thresholds only include the monetary thresholds of revenue and assets. Do you think that, except for the case of for-profit entities that are not publicly accountable but are important from a public interest perspective, a further size threshold for the number of employees would be appropriate under the proposed differential reporting for not-for-profit private sector entities and public sector entities?*

Answer (k)

As stated previously we believe the role of determining whether an entity is publically accountable is that of government. An arbitrary size threshold contained within the standard would very likely result in overburden on a number of entities and other entities not being caught by the definition. Whether an entity is truly publically accountable is very much governed by its economic significance in respect of a particular region or industry.

An entity that is the major/sole employer in a particular location, (village, suburb, town, state, country) may be publically accountable, it would be near impossible for the AASB to incorporate these size thresholds within a standard.

Question (l)

- (l) *considering the AASB's tentative decision to base the second tier of reporting requirements on the IASB's pending IFRS for SMEs, do you consider that the IASB's ED of A Proposed IFRS for SMEs is appropriate for Australian circumstances. If not, explain how it could be improved, or what other options are more appropriate and why?*

Answer (l)

We believe that the measurement principles proposed in the SME standard are largely appropriate for the Australian circumstances but the proposed mandatory disclosure requirements are far too onerous.

Question (m)

(m) do you think adaptations, or additional guidance, are needed (in addition to Aus paragraphs that would be included consistent with Australian equivalents to IFRSs) for not-for-profit private sector entities and public sector entities if the IASB's IFRS for SMEs were adopted in Australia?

Answer (m)

We strongly believe the proposed disclosures within the SME standard do not adequately meet the needs of the not-for-profit or public sector entities. We believe a separate disclosure standard is required for these entities.

Question (n)

(n) do you think Australia and New Zealand should seek to achieve harmonisation in their reporting requirements regarding SMEs?

Answer (n)

Yes, we believe Australia and New Zealand should seek to active harmonisation in their reporting requirements for SMEs.

Question (o)

(o) *are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the preliminary views?*

Answer (o)

There are a number of entities, incorporated associations etc that through legislation other than the Corporations Act have to place their financial reports on the public record, the needs of these entities must be reports on public record, the needs of these entities must be considered in respect of SME standard.

Further a large number of Australian large propriety companies are subsidiaries of listed groups (both Australian and overseas) preparing financial reports under AIFRS. The current proposed SME standard would effectively force these subsidiaries to adopt the “bib book” and would significantly increase the burden on financial reporting on these subsidiaries.

Question (p)

(p) *do you think that the overall benefits that would arise from the proposals would exceed the overall costs? If you are an entity that prepares a general purpose financial report or would need to do so under the proposals, please advise us of any increased costs or any savings that would result from the proposals, and if possible, quantify them.*

Answer (p)

The current proposals with the extended mandatory disclosure requirements introduces a significant cost burden for those entities which currently are non reporting entities and which prepare “special purpose” reports in order to satisfy their reporting obligations under the Corporations Act. We do not believe there is any significant benefit in respect of burdening these entities with this level of disclosure. We do not however believe that providing a specific standard re measurement and recognition to these entities will simplify financial reporting for these type of entities.

Question (q)

(q) *would the preliminary views be in the best interests of the Australian economy?*

Answer (q)

We believe the preliminary views in respect of applying consistent measurement principles to all Australian entities will benefit the economy and that keeping Australia at the front of global adoption of IFRS also has long term benefits to the Australian economy. Again the potential onerous reporting prescribed in respect of disclosure may be detrimental to the economy not least because it may result in a call for more entities to be removed from a regulated financial reporting regime.

Yours sincerely

BDO Kendalls

Chartered Accountants

A handwritten signature in black ink, appearing to read 'Wayne Basford', written over a horizontal line.

Wayne Basford

Partner