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Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
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9 November 2018

Dear Kris

ITC 39 - Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems - Phase 2: Medium-term approach

We are pleased to have the opportunity to comment on Australian Accounting Standards Board (AASB) Consultation Paper ITC 39 – *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (ITC 39) – Phase 2: Medium-term approach.

We note the direction agreed in the September 2018 AASB meeting to only apply the ITC proposals to for-profit entities. We have therefore contained our comments to these entities.

We agree with the AASB's Phase 2 approach as described in paragraph 166. We consider that continuing with two conceptual frameworks would require a strong case, which we do not believe exists. Our view is consistent with that of the AASB in that a single framework for all for-profit entities is the preferred option. It has been a number of decades since the implementation of the existing approach. We note that the current environment has an increased emphasis on transparency, comparability and consistency.

Of the two alternative proposed by ITC 39 we favour Alternative 1 GPFS – RDR. However, we advocate reducing the disclosures further than the current GPFS Tier 2 (RDR). Our alternative approach is set out in Question 12 in our Appendix.

We further support that the current financial reporting thresholds set by Treasury should be revisited as part of this reporting framework project.

Please refer to the Appendix for our detailed comments on the specific matters for which feedback was requested.

We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact myself on (02) 9455 9744 or Julie Locke on (02) 6248 1190.

Yours sincerely

Michael Voogt
Director

Appendix

Specific matters for comment

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

We agree with the medium-term approach outlined in paragraph 166 of ITC 39. We support the revised Conceptual Framework for Financial Reporting being applicable to all for-profit entities required by legislation or otherwise to comply with Australian Accounting Standards.

We support introducing new reporting requirements with those entities that have traditionally meet the special purpose financial reporting requirements. We consider that continuing with two conceptual frameworks would require a strong case, which we do not believe exists. Our view is consistent with that of the AASB in that a single framework for all entities is the preferred option.

We see the application of two frameworks being problematic, primarily for the following reasons:

- It would be inefficient and impractical to maintain two conceptual frameworks –and by doing so has the potential to cause further confusion for stakeholders as to which framework to consider for their circumstances and what the differences between the two frameworks are.
- The potential for confusion around the reference to reporting entity concept in SAC 1 *Definition of a Reporting Entity*.
- Complexities for standard setters in maintaining two frameworks and the flow-on effects when amendments to Australian Accounting Standards occur.

The Australian reporting entity concept was implemented approximately three decades ago. Over this time, expectations of investors and users of financial statements having evolved and progressed. Given the current era of deficiency of trust in corporate Australia and the ongoing call for transparency, we find no compelling evidence to persist with self-assessment of a reporting entity status (SAC 1 reporting entity concept) for those entities required by legislation or otherwise to comply with Australian Accounting Standards.

We believe that the two Tier framework in AASB 1053 *Application of Tiers of Australian Accounting Standards* is appropriate.

Q12 – Which of the AASB's two GPFS Tier 2 alternatives (described in paragraphs 167-170) do you prefer? Please give reasons to support your response, including applicability for the for-profit and not-for-profit sectors.

Of the two GPFS Tier 2 alternatives presented, we believe a modified *Alternative 1 GPFS – RDR* (RDR) is the most appropriate.

During our consultation on this question there were a number of different views on the purpose and use of financial statements for non-publicly accountable for-profit entities. Some view the financial statement exercise as a compliance process with minimal additional value created by the financial statements. Others see the financial statements as a useful document that is used for a number of ongoing business purposes – for example, providing financial information in tender documents. Striking a balance will require further consultation with the wider Australian community.

'Compliance process' preparers seem to prefer an RDR approach with a list of required disclosures that provide information readily available from financial reporting systems. They prefer to simply compile a document.

At the other end of the scale there was consistent comment around the view that the current RDR disclosures require disclosure of too much information. A suggested alternative to a GPFS Tier 2 was set out in our submission to ED 277 *Reduced Disclosure Requirements for Tier 2 Entities*. An alternative could be a developed approach that starts with the only required disclosures being a summary accounting policy and one level of disaggregation of a balance sheet item described in a note. All additional disclosures are then left to the discretion of the preparers who are best placed to apply to their specific entity. If applied correctly this could provide the users of the financial statements the most relevant financial information whilst allowing preparers of financial statements an efficient and relevant method of reporting.

We anticipate that the exact format of a revised RDR approach will be the subject of a resulting Exposure Draft on Phase 2.

We acknowledge that RDR will not provide a definitive solution in addressing all the financial reporting challenges. Judgement will still be needed in identifying what is significant and material. Furthermore, in some instances the current format of RDR may result in companies disclosing far more than the users of financial statements would require and expect.

While *Alternative 2 GPFS – SDR* (SDR) attempts to achieve a compromise between the mandatory Australian Accounting Standards under the current statutory special purpose financial statements framework and current GPFS – Tier 2, the risk is that entities will still view these standards as the only standards required to be complied with and take a 'de-minimis' compliance attitude. This would result in only marginally improved financial statements compared to those currently prepared under the special purpose financial statements framework.

In addition to the above, the following were consistently comments received in regards to the SDR approach:

- The requirement to make all disclosures for the nominated standards (revenue, impairment, related parties and income tax).
- A general view that there would be material balances and operations in most companies that would outside of the 'nominated standards' and users may form different views on requirements to disclose information around those balances and operations. For example, a commercial property entity which records investment properties.

In our experience, a number of entities have already transitioned to preparing GPFS to comply with their ATO reporting obligation. It is questionable what additional benefit these entities – and those already applying Tier 2 – would obtain in changing to SDR.

Given the direction agreed at the AASB meeting of 4 September 2018, ITC 39 proposals will apply only to for-profit entities. We have therefore not discussed the applicability for not-for-profit sectors.

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

We agree there is the need for only one Tier 2 GPFS alternative in Australia. Before making our final conclusion we have considered a number of alternatives to a RDR or SDR approach. During conversations it has emerged that a third tier may well be desirable, however, it has been challenging to identify a logical and clear objective delineator.

We are of the view that a better outcome is for Treasury to tackle the regulatory decision of which entities – using an objectively measured threshold – need to prepare and lodge financial statements. This would provide a clear and consistent outcome.

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

We agree that IFRS for SMEs should not be made available in Australia as a Tier 2 alternative for entities to apply. As set out in Appendix C paragraphs 18 to 36, *IFRS for SMEs* includes different recognition and measurement principles compared with IFRS. To allow certain entities the option to prepare under different recognition and measurement principles would, in our view, be a backward step in relation to consistent financial reporting for preparers and users in Australia.

In Australia a number of subsidiary entities are consolidated up into Tier 1 financial statements. Different recognition and measurement principals will double the effort for preparers of these financial statements.

In summary, our current view is consistent with the views expressed when this issue was debated back in 2010.

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

We support the AASB in its desire to make the adoption of new reporting requirements as easy as possible. We canvassed areas of potential relief and the majority of the feedback was in relation to providing a practical expedient to apply both consolidation and equity accounting prospectively, based on current information available to the company upon adoption of the new framework. Refer to further comments in the next question.

In general we believe that applying the first time adoption guidance set out in AASB 1 *First-time Adoption of Australian Accounting Standards* would be appropriate. Companies that have complied with RG 85 *Reporting requirements for non-reporting entities* should already be applying all the recognition and measurement requirements of Australian Accounting Standards.

A number of preparers that we consulted with would prefer a practical expedient similar to that in other new accounting standards – for example AASB 16 *Leases*. This practical expedient would apply only for the first year after the change. It would not make it compulsory to provide comparatives disclosures for information that was not disclosed in the notes to the financial statements for the year before transition.

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

We have received consistent comments around the complexities and challenges in applying consolidation and equity accounting for the first time. Overall the biggest concern is the lack of detailed historical information and records around interests in associates and subsidiaries. This is particularly so where there have been changes in ownership percentage over time.

AASB 1.IG27 currently provides guidance when a consolidation has not been previously prepared. Our initial view would be that this could be applied for the medium-term approach. A similar type practical expedient would be needed for equity accounted investments.

We anticipate that details of the transitional relief will be the subject of a resulting Exposure Draft on Phase 2.

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

Should *Alternative 2 GPFS – SDR* be applied we agree with the additional areas selected – revenue, impairment, related parties and income taxes. We would question if all the required disclosures in the respective Australian Accounting Standards should be required. The Tier 1 disclosures in these standards are extensive and based on our consultation we would question if all the information is required for non-publicly accountable for-profit entities.

Refer also back to question 12 in relation to the reservations we have over *Alternative 2 GPFS – SDR* proposal.

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

Refer to discussion above in question 12.

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

Given the direction agreed at the AASB meeting of 4 September 2018, ITC 39 proposals will apply only to for-profit entities. We have therefore not addressed this question which relates to the not-for-profit sector.

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

We are not generally aware of any legislation that refers to SPFS that might be impacted by these proposals.