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9 November 2018

Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204, Collins St West
MELBOURNE VIC 8007

By online submission:- www.aasb.gov.au

Dear Kris

Invitation to Comment – ITC 39 Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems (Phase 2)

CPA Australia represents the diverse interests of more than 163,000 members working in 125 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia welcomes the opportunity to provide comments in response to the above AASB Consultation. We appreciate the efforts of the AASB in conducting a number of outreach activities to engage with stakeholders to both inform and obtain feedback on the project. CPA Australia's submission has benefited from these outreach activities, and also reflects feedback received from members and other stakeholders.

CPA Australia supports the phase 2 approach to maintain, in the long term, IFRS compliance for all publicly accountable entities and entities voluntarily claiming IFRS compliance. In our earlier submission made on 14 August 2018 in response to phase 1 of the Consultation, we stated our support for the AASB's short-term phase 1 approach to adopt the IASB Revised Conceptual Framework (RCF) for entities that state compliance with IFRS in their financial statements. Our support was predicated on the basis that this approach provides a pragmatic stop-gap solution to incorporating the RCF into the Australian Accounting Standards (AAS) framework. We had also raised some concerns about some potential unintended consequences that may arise from the pragmatic approach proposed under Phase 1. We note the AASB has commenced considering the issues highlighted by stakeholders in relation to its phase 1 proposals, and no doubt any stakeholder concerns will be suitably addressed in finalising the phase 1 proposals.

CPA Australia does not support either of two alternatives proposed under a Tier 2 framework applicable to non-publicly accountable entities. This project initiated by the AASB will result in major changes to the Australian financial reporting framework that will have a significant economic impact and is expected to remain in place for many years to come. Given the importance of this initiative, it is our recommendation that a much more comprehensive analysis of the issues is required, more options for reporting need to be considered and the involvement of all lawmakers, regulators and standard-setters involved in the financial reporting supply-chain is essential. Our reasons for not supporting the AASB's phase 2 proposals are set out in detail below, and in the attachment to this letter.

Better articulation of the problem

In our previous submission, we highlighted a number of key factors that the AASB should give further consideration to, before proceeding further with its phase 2 proposals. These were:

- The need for clear, unequivocal evidence of the existence of users and their information needs that align with the proposed requirements.
- Empirical evidence based on more up to date research to make a more informed assessment of the current reporting framework.
- Major changes to corporate financial reporting are incomplete, and possibly inadequate, without proper consideration of financial reporting thresholds within Corporations Act 2001.
- A recommendation that the AASB gathers and provides evidence on the potential impact of the proposals on AAS based financial reporting for non-statutory purposes.
- The need for a more comprehensive consideration of all relevant statutory financial reporting requirements by NFPs, in addition to the financial reporting requirements of charities registered with the Australian Charities and Not-for-profits Commission (ACNC).
- Recommendation for a comprehensive and objective cost/benefit analysis before proceeding further with the proposals.
- Better articulation of the "reporting entity" definition clash identified as one of the problems that has required the AASB to develop these proposals.

We highlight some additional points in respect of the above factors for your consideration:

In respect of points 1 and 2 above, we note that the AASB has conducted further research and provided additional information to stakeholders with some evidence relating to user needs and its research on application of the reporting entity concept. However, we believe much further work and evidence is required in these areas before progressing the project further.

A cooperative effort between the AASB and Treasury is required to address the third point above. To assist with this, in conjunction with Chartered Accountants ANZ, we have written to Treasury seeking their review of the reporting thresholds in the Corporations Act 2001 as a matter of priority. Our letter to Treasury is attached to this submission.

In respect of the fifth point above, since issuing the Consultation, the AASB has stated that the proposals are being considered only in the context of for-profit entities and any financial reporting framework considerations applicable to not-for-profit (NFP) entities will be considered at a later stage. We appreciate the practical considerations that have led to the AASB's postponement decision. However, we recommend the AASB continues development of its proposals for the for-profit and NFP sectors concurrently as originally planned, for the reasons stated below:

- It is our view that the financial reporting needs of the NFP sector and their contributions to the Australian economy and society are of similar if not of more importance than the for-profit sector under current consideration.

- We are led to understand that the AASB may seek to develop different reporting requirements for the NFP sector compared to the for-profit sector, to accommodate the lower thresholds for financial reporting in the NFP sector. This approach may not align with the transaction-neutral approach at the heart of the AASB's standard-setting activities and may lead to a loss in comparability and consistency of financial reports. For example, under the *Aged Care Act 1997* Accountability Principles 2014 s35A, all approved providers of residential care services are required to prepare general purpose financial statements. As both for-profit and NFP entities are registered under this Act, the AASB's proposed approach could potentially give rise to different financial reports being prepared dependent on whether entities are classified as for-profit or NFP entities.

Feedback we have received since our previous submission has highlighted a further factor to be taken into consideration in addition to the above. Australian businesses operate through a number of structures including trust structures, and there is some concern that focusing the financial reporting reforms only on corporate entities and others with statutory financial reporting requirements does not adequately address the attributes of comparability, consistency and transparency that underpin the public interest objective. For statutory financial reporting requirements to serve the needs of the Australian economy as intended, it is necessary for a substance over form approach, where entities that operate through a particular business structure and enjoy similar benefits to a company (e.g. limited liability) are required to comply with uniform financial reporting requirements. Further, the impact of the proposals on entities that prepare financial reports for non-statutory purposes, but in compliance with Australian Accounting Standards (AAS) should also be considered before progressing the project further

We appreciate that a significant amount of effort is required to address the factors highlighted above, and the AASB will need the cooperation of other regulators and lawmakers to achieve satisfactory outcomes in respect of some of the factors. In developing its proposals, the AASB has identified two problems, however given the magnitude of the proposals and their probable impact on the Australian financial reporting framework, we believe it is essential that the factors highlighted above are also taken into account in better articulating the financial reporting problem/s.

Although the AASB has articulated the "SPFS problem" in its Consultation, a much clearer articulation of the problem(s) that also take into account the above factors will assist in developing a robust, fit for purpose solution that stands the test of time and is sufficiently flexible to meet the evolving needs of the Australian economy.

We would also like to highlight that the success of a revised financial reporting framework will also require suitable regulatory oversight by the appropriate regulators, and we look forward to interacting with relevant regulators to identify how they intend to recalibrate their oversight functions to accommodate any revised financial reporting framework that eventuates.

Contributing to the solution

Feedback CPA Australia has received from members and other stakeholders indicates that constituents have a range of views on the proposals applicable to entities that are not required to, or do not intend to voluntarily state compliance with IFRS in preparing their financial statements. These views range from retaining the status quo, support for both reduced disclosure alternatives proposed in the Consultation, and consideration of a reduced recognition and measurement framework. We expect a better articulation of the problem/s and factors relevant to this initiative, combined with more options for consideration by stakeholders will reduce the diversity in stakeholder views.

We see merit in the underlying desire to discontinue the current model of financial reporting based on the reporting entity concept facilitated through Statement of Accounting Concept 1 *The Reporting Entity Concept* (SAC 1). Obtaining sufficient support for this initiative however, in our view, is hampered by three key issues:

- Insufficient but essential involvement of Treasury in the change process
- A lack of clear articulation of the issues and unequivocal evidence supporting the project narrative and proposals
- Options being proposed are limited to reductions in disclosure, with no options relating to reductions in recognition and measurement being proposed for stakeholders' consideration and comment

We have provided commentary on the first two points in the previous section "better articulation of the problem".

In respect of the third point, some of our members and stakeholders have expressed concern that the "top down" approach of utilising the full recognition and measurement requirements of IFRS, a framework that has been developed by the International Accounting Standards Board (IASB) for entities with public accountability, will give rise to unnecessary regulatory burden if applied to all AAS based Australian financial reporting. Constituents should be presented with a simplified financial reporting framework option that includes reduced recognition and measurement requirements, in addition to the currently proposed options for reduced disclosures.

The AASB has given consideration to the IASB's IFRS for Small to Medium Sized Entities (IFRS for SMEs) and has decided not to pursue this option for the reasons stated in the Consultation. We are however of the view that there is merit in giving further consideration to the development of a simplified financial reporting framework for non-publicly accountable entities based on the IFRS for SMEs standard. We note that many jurisdictions around the world incorporate a simplified financial reporting solution for SMEs within their reporting frameworks, and around 80 of these are based on the IFRS for SMEs.

In addition to the above comments, we have provided responses to the questions raised in the Consultation as an attachment. If you require further information on our views expressed in this submission, please contact Ram Subramanian, Policy Adviser – Reporting, on +61 3 9606 9755 or at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

Ram Subramanian
Policy Adviser, Reporting
CPA Australia

Craig Laughton
Executive General Manager
Policy, Advocacy and Public Practice
CPA Australia

Attachment

Specific questions/ comments

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

For the reasons stated in the cover letter, whilst we agree with the proposed approach in the long term for publicly accountable entities, we do not agree with the proposed approach for non-publicly accountable entities.

This project initiated by the AASB will result in major changes to the Australian financial reporting framework that will have a significant economic impact and is expected remain in place for many years to come. Given the importance of this initiative, we reiterate our recommendation that a much more comprehensive analysis of the issues is required, more options for reporting need to be considered and the involvement of all lawmakers, regulators and standard-setters involved in the financial reporting supply-chain is essential.

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

As stated in the cover letter, we do not support either of the proposed alternatives. Further options that include a reduced recognition and measurement framework must also be considered and offered to stakeholders for their feedback.

In the event the AASB decides to pursue its current proposed two-alternative approach, feedback we have received indicates more support for the existing RDR framework.

13. 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 are of the view that stakeholders should be given further options that may include more than one Tier 2 GPFS alternative. For example, we envisage a scenario where non-publicly accountable entities are able to choose from either the existing RDR framework, or a new reduced recognition and measurement framework based on the IFRS for SMEs.

We appreciate the AASB's concerns set out in the Consultation as to why it has decided not to pursue an option based on the IFRS for SMEs. We also note that the AASB has limited resources and may be unable to maintain more than one Tier 2 framework. One of the concerns raised in the Consultation is that stakeholders who are already preparing financial statements based on the RDR framework, or Special Purpose Financial Statements (SPFS) applying full recognition and measurement requirements, may not wish to adopt a new reduced recognition and measurement framework. To address this, we suggest an approach that provides three options for preparing financial statements by non-publicly accountable entities:

1. Entities that choose to apply the Tier 1, full IFRS framework can do so
2. "Freezing" the current RDR framework so that stakeholders who are already applying this framework and others who may choose to apply the RDR framework can do so
3. Others can choose to apply a newly developed, optional simplified financial reporting framework that includes reductions in recognition and measurement requirements.

We consider this approach a viable proposition for the following reasons:

- With completion of some of the major standard-setting projects by the IASB, there are unlikely to be further significant new standards in the near future for which an RDR version will need to be considered. Hence "freezing" the existing RDR framework could be a viable proposition.
- The IASB is currently considering a research project for an RDR framework called "SMEs that are subsidiaries" that may lend itself to a future permanent solution in Australia to replace the existing RDR framework.

One of the AASB's concerns with the above approach would be a potential loss of comparability between two Tier 2 frameworks. Empirical evidence that supports user needs that require such comparability will be required to support any such concerns.

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

No, for the reasons stated in the cover letter and in responses to the previous questions, we do not agree with the AASB's decision that a financial reporting framework based on IFRS for SMEs should not be made available in Australia as a Tier 2 alternative. At the very least, the AASB should develop and propose a suitable option that is based on the IFRS for SMEs for consideration by stakeholders.

To address some of the concerns raised by the AASB, rather than adopting the IFRS for SMEs as is, the AASB could seek to build upon this standard using requirements from full IFRS, and any other reporting requirements considered appropriate to the Australian environment. It is possible that such an approach may also lend itself to developing a simplified reporting solution for the NFP sector. The United Kingdom has taken a similar approach with its SME standard FRS 102, which is based on the IFRS for SMEs and is applicable to both the for-profit and NFP sectors.

15. 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.

Transitional relief could include relief from consolidation, and other challenging standards such as AASB 16 *Leases*. We suggest the AASB undertake specific outreach activities to identify what transitional reliefs are beneficial to stakeholders.

16. 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.

See our response to Q15 above. User needs and the costs/benefits of adopting consolidation and equity accounting remain in our view, the primary considerations in adopting these requirements.

17. 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.

Feedback we have received indicates less support for the SDR approach.

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

As stated in our response to Q14, the AASB should develop and propose a suitable option that is based on the IFRS for SMEs for consideration by stakeholders. To address some of the concerns raised by the AASB, rather than adopting the IFRS for SMEs as is, the AASB could seek to build upon this standard using requirements from full IFRS, and any other reporting requirements considered appropriate to the Australian environment. It is possible that such an approach may also lend itself to developing a simplified reporting solution for the NFP sector. The United Kingdom has taken a similar approach with its SME standard FRS 102, which is based on the IFRS for SMEs and is applicable to both the for-profit and NFP sectors.

19. 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).

Yes, we agree that further consideration should be given to the additional reporting requirements described above for NFP private sector entities. We agree with the general view expressed that the information arising from these reporting requirements better fulfil the user needs of stakeholders in the NFP sector.

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

While we are not aware of any legislation that specifically refers to SPFS that might be impacted by these proposals, we suggest the AASB be mindful of any unintended consequences that may arise. The current requirements, established a few decades ago, have been based on a framework that allows SPFS. While SPFS may not have been specifically mentioned in legislative requirements, there is likely to have been an understanding, or acceptance that entities, in particular small and medium sized enterprises, may prepare SPFS in certain circumstances.

General matters for comment on phase 2

21. **What are your views on whether *The AASB's Standard-Setting Frameworks for For-Profit and Not-for-Profit Entities* (the Framework) have been applied appropriately in developing the proposals in Phase 2 regarding the reporting entity problem (note the AASB will consult further on other NFP amendments required for the RCF).**

As highlighted throughout our submission, CPA Australia does not believe a project of this magnitude that seeks to fundamentally change the Australian financial reporting framework can be adequately addressed through the AASB's standard-setting activities alone. We also do not believe considerations relating to user needs and the cost of complying with AAS that are stated as important criteria in the standard-setting frameworks have been adequately addressed. Consideration of a simplified reporting framework that includes a reduction in recognition and measurement requirements may lead to lower costs for businesses.

We note and agree with the requirement for entities with public accountability to state compliance with IFRS in their financial statements. This is also the intention of the IASB in the development of the IFRS framework. However, the AASB has decided to diverge from the IASB's view that non-publicly accountable entities can have a different set of reporting requirements, as reflected in the IFRS for SMEs standard. The IASB has used public accountability as the dividing line between those entities that should adopt full IFRS and others that can adopt the IFRS for SMEs. Whilst the AASB is using the same public accountability criteria as a dividing line, we do not agree with its decision to depart from IASB's standard-setting ideology based on public accountability.

22. **What are your views on whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?**

We do not believe the consequences, including any potential increases in regulatory burden arising from adopting the current proposals set out in the Consultation have been fully analysed and reflected in a way that can be fully appreciated by those that are likely to be affected. Any analysis should also consider the future impact of new IFRS such as AASB 16 *Leases* on affected stakeholders. For example, users of financial statements of small-to medium sized enterprises may not be interested in information about lease assets and liabilities relating to rented office and/or retail space included on balance sheets. The costs of measuring and recognising such information by non-publicly accountable entities should also be taken into consideration.

23. **What are your views on whether, overall, the proposals would result in financial statements that would be useful to users?**

Feedback we have received indicates that whilst preparers and auditors may have the necessary knowledge and expertise to adopt the proposed new requirements, we have seen limited evidence to indicate that users of financial statements exist who specifically require such financial statements to be prepared in accordance with the full recognition and measurement requirements of IFRS. It would also be useful if the AASB could establish what appetite exists in the user community for financial statements based on a simplified financial reporting framework based on IFRS for SMEs.

24. What are your views on whether the proposals are in the best interests of the Australian economy?

For the reasons stated previously in this submission, we do not believe sufficient evidence has been gathered and presented to demonstrate that the proposals are in the best interests of the Australian economy. We reiterate our previous comments that the proposals could potentially increase costs for the Australian economy by imposing a recognition and measurement framework intended for listed companies or publicly accountable entities, on all other entities that are required to, or choose to prepare financial statements in accordance with AAS.

25. Unless already provided in response to specific matters for comment above, what are your views on the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or nonfinancial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

We have no further comments.

LETTER TO TREASURY FROM CPA AUSTRALIA AND CHARTERED ACCOUNTANTS ANZ

22 October 2018

Mr Adam Bogiatzis
Senior Advisor, Corporations and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: adam.bogiatzis@treasury.gov.au

Dear Adam

Treasury Review Proposal - Australian Accounting Standards Board consultation on the conceptual framework and special purpose financial statements (ITC 39)

As the representatives of over 200,000 professional accountants in Australia, Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ) and CPA Australia would like to jointly raise a matter with the Australian Treasury in relation to the above consultation currently being undertaken by the Australian Accounting Standards Board (AASB).

We are writing to you jointly to request that the Australian Treasury prioritise and conduct a comprehensive review of the financial reporting thresholds applicable to proprietary companies under section 45A of the Corporations Act 2001.

It is the long-held view of both Chartered Accountants ANZ and CPA Australia that these thresholds should be subject to a periodic and regular review to ensure that the regulatory framework they underpin is fit for purpose. Since improving the Australian financial reporting framework is the key objective of the AASB's current consultation, the issue of thresholds has once again been brought to the fore as we, and our members, give consideration to the content of the AASB's proposals. Our members work in diverse roles across public practice, commerce, industry, academia and the public and not-for-profit sectors throughout Australia and therefore have a significant interest and stake in the framework reform agenda.

We are concerned that the AASB's desire to unilaterally use its standard setting mandate to achieve financial reporting reform is only a partial solution to a more complex problem. In the context of companies and other entities regulated under the Corporations Act 2001, we believe that this problem needs to be addressed via consideration of both the lodgment thresholds and the AASB financial reporting framework. As noted in paragraph 67 of ITC 39, the AASB shares this view and while it indicates that legislative reform is being discussed as part of its Australian Financial Reporting Framework project, it has chosen to pursue an approach purely based on modifying its financial reporting framework for the private sector first.

We are strongly of the view that the AASB's reform of the Australian financial reporting framework should not occur in isolation but should coincide with a Treasury review of the financial reporting thresholds and associated requirements within the Corporations Act 2001.

We hold this view because one of the groups most impacted by the AASB's proposals will be large proprietary companies who have statutory reporting requirements under the Corporations Act 2001. These companies are the significant clients of, or employers of, many of our members.

In its consultation, the AASB is proposing to withdraw Statement of Accounting Concept 1 *Definition of The Reporting Entity* (SAC 1). If this occurs, all large proprietary companies will be required to prepare general purpose financial statements (GPFS). For those large proprietary companies nearer to the current reporting thresholds, this is likely to require the production of a level of financial information for which there is no clearly identified user need. The proposals include preparing consolidated financial statements that include their controlled entities, a substantial increase in the reporting burden. This information would be substantially in excess of what large proprietary companies currently produce and lodge now as special purpose financial statements.

We believe a Treasury review of thresholds now would be particularly timely for two reasons. These are:

- the financial reporting thresholds were introduced into the Corporations Act 2001 more than 10 years ago and have not been subject to a review since that time.
- current and ongoing research informing the AASB's reform project can be utilised by Treasury to review and reset the thresholds at an appropriate level that effectively meets user needs without imposing additional regulatory burden.

Without such a review, the AASB's proposals could result in an unreasonable regulatory burden being placed on smaller large proprietary companies for no other reason than that they fall within outdated thresholds. This burden is likely to increase further over time as new accounting standards, such as AASB 116 *Leases* operative for financial reporting periods beginning on or after 1 January 2019, bring onto the balance sheet assets and liabilities that were previously only disclosed as commitments. This makes it possible for an entity to breach the asset thresholds only due to a change in the accounting standards, rather than as a result of any changes in the underlying business or the user needs for their financial information.

We believe that a joint effort between the AASB and Treasury is necessary to produce a framework reform outcome for companies that will be in the best interests of all stakeholders. The result has the potential to provide all users of lodged financial statements with the information they need while ensuring that the reporting burden placed on preparers is not disproportionate. Such an approach is being adopted for reform in the not-for-profit sector, through the ACNC legislative review, and so we encourage Treasury to adopt a similar approach for the for-profit sector.

Chartered Accountants ANZ and CPA Australia are willing to engage with Treasury to explore possible options and assist with any deliberations. Please do not hesitate to contact either Ram Subramanian CPA (CPA Australia) at ram.subramanian@cpaaustralia.com.au or Jeanette Dawes (Chartered Accountants ANZ) jeanette.dawes@charteredaccountantsanz.com or if you would like to discuss the contents of this letter.

Yours sincerely

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