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Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West
Melbourne VIC 8007

via the AASB website

Dear Ms Peach

Conceptual Framework for Financial Reporting - Comments on Phase 2

Crowe Horwath is pleased to respond to the Australian Accounting Standards Board's (the AASB's) invitation to comment number 39 (ITC 39) and provide comments on specific matters in relation to Phase 2.

We support the AASB's proposal to simplify the current reporting framework and enhance the consistency, comparability, transparency and usefulness of financial statements. Our preference is to maintain the existing Tier 2 Reduced Disclosure Requirements as a way of balancing the benefits of financial information to users and costs to preparers of providing that information. At the same time, we see this as an opportunity to revise Tier 2 disclosures which are still viewed by many as burdensome and not sufficiently different to Tier 1. At the same time, we would not rule out the possibility of Tier 3 or a different framework altogether for not-for-profit entities even if introducing a separate framework would go against the long-established principle of Australia having only one set of accounting standards.

Our responses to the specific questions posed in ITC 39 are attached as Appendix 1 to this letter.

Crowe Horwath appreciates the opportunity to express our views and trust that you will find our comments useful in deciding the future direction of the *Australian Financial Reporting Framework* project.

Yours sincerely

Jara Dean
National Technical Senior Manager

Encl.

Crowe Horwath.
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APPENDIX

Crowe Horwath's detailed responses to specific questions on Phase 2

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

We agree with the approach as it maintains the two Tiers of reporting requirements for general purpose financial statements (GPFS) as a way of balancing the benefits of financial information to users and costs to preparers of providing that information. Furthermore, the approach also means that there is only one set of accounting standards in Australia.

Question 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.

We support Alternative 1: GPFS – RDR.

One of the problems with the current regime, as identified by the AASB, is the lack of comparability for entities of similar economic circumstances due to their ability to self-assess what type of financial reporting is required. In our view, this problem would not be solved if Alternative 2: GPFS – SDR was adopted because entities would be allowed to choose which disclosures from non-mandatory Accounting Standards to include in their financial reports. For example, AASB 16 *Leases* requires a lessee to disclose specific information which is useful in understanding the effect of leases on the financial position, performance and cash flows of the lessee. While entities would be required to measure and recognise lease liabilities and corresponding right-of-use assets, under Alternative 2: GPFS – SDR, one entity could choose to disclose some or all information required under AASB 16 while another entity could choose not to disclose any information altogether. This would, in our view, reduce comparability and transparency of the financial reports. Under Alternative 1: GPFS – RDR, those disclosures would be consistent and comparable and would enhance the transparency of financial reporting.

Question 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?

Yes, we are of the view that only one Tier 2 GPFS alternative should be adopted in respect of for-profit entities to avoid situations where two similar entities can prepare financial reports under different frameworks. The reasons why we believe that only one alternative should be available are the same as in our response to Question 12, namely comparability and transparency of financial reporting.

However, we would not rule out the possibility of Tier 3 or a different framework altogether for not-for-profit entities. Although introducing a separate framework would go against the principle of having only one set of accounting standards.

Question 14 – 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 with the AASB's decision on the basis that the disadvantages of IFRS for SMEs outweigh their advantages as outlined in paragraphs 21 to 35 of Appendix C to ITC 39. The adoption of IFRS for SMEs has been slow and sporadic compared to the adoption of IFRS. In addition, preparers and users of financial reports in Australia are used to having one set of accounting standards. To introduce a different set of recognition and measurement rules would unsettle the industry and would require a significant investment by the industry to upskill preparers, users and auditors on a new framework.

Question 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.

We believe that AASB 1 *First-time Adoption of Australian Accounting Standards* adequately deals with transitioning from special purpose financial statements to financial statements prepared under the reduced disclosure requirements. It is paramount that entities are given sufficient time to transition and exemptions from the presentation and disclosure requirements relating to comparative information be expanded to, for example related party transactions, financial instruments and fair value disclosures.

We contemplated whether some relief should be available in the application of consolidation and equity accounting, as this appears to be an area of concern for entities that currently prepare special purpose financial statements. However, providing any relief from consolidation or equity accounting beyond the exceptions set out in AASB 1 would, in our opinion, undermine the project's goal of consistent, comparable, transparent and useful financial statements

Question 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.

In our opinion, the option available to non-reporting entities that opt to prepare special purpose financial statements without applying consolidation or equity accounting is the key problem of the existing regime. Addressing this issue will, without doubt, impact entities that are not currently consolidating or equity accounting. The main concerns include the availability, reliability and auditability of information that would be used on initial application of relevant standards and the ongoing financial and administrative burden on subsidiaries, associates and joint ventures to prepare information used in the consolidation and consolidated financial reporting. Some entities would also face technological challenges and the lack of consolidation skills.

Question 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.

Financial reports are an important means of communicating relevant information to users. Information that may be relevant to users in one sector or industry may not be relevant to the needs of users in other sectors or industries. For this reason, we believe that Alternative 2: GPFS – SDR does not meet the objective of general purpose financial reporting. Furthermore, the specified disclosures would be regarded by many entities as all that is required with no need to make disclosures beyond those prescribed (but which may be necessary for the financial report to be useful to users). In our opinion, there could be other disclosures relevant to users of financial statements prepared under Alternative 2: GPFS – SDR, such as (but not limited to):

- Property, plant and equipment
- Fair value measurements
- Financial instruments
- Leases.

On the other hand, there are disclosures in the mandatory standards under Alternative 2 GPFS - SDR that are not required under the current Tier 2. These disclosures include for example, the need for a third statement of financial position in AASB 101.40A. Those disclosures are not mandatory under Tier 2, presumably on the basis of the 'user need' and 'cost-benefit' principles. If Alternative 2 GPFS – SDR is adopted, we believe that those principles should continue to be applied in reducing disclosure requirements of the mandatory standards.

Question 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).

Given the low take-up of Tier 2 among for-profit-entities, we believe that this may be an appropriate time to revisit Tier 2 disclosures which are still viewed as burdensome and not sufficiently different to Tier 1. We also believe that a possible alternative would be an introduction of a separate Tier applicable to not-for-profit entities.

Question 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).

No response is provided to this question due to the shift in focus of ITC 39 to only cover the for-profit sector. However, we believe that the proposed additional disclosures have merit.

Question 20 – 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 aware of any such legislation. However, there may be instances where enabling legislation of some public sector entities requires the preparation and specifies the content of financial reports that may be inconsistent with the proposed requirements. Under the proposed changes, by definition, those entities would be regarded as publicly accountable entities and as such would be required to prepare Tier 1 GPFS.

Q21 – Whether the AASB's Standard-Setting Frameworks for For-Profit and Not-for-Profit Entities 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).

We have no concerns with the way in which the AASB developed the proposals.

Q22 – Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

We are not aware of any such issues.

Q23 – Whether, overall, the proposals would result in financial statements that would be useful to users.

We believe that the proposed changes will lead to more consistent, comparable and transparent financial reporting that may be more useful to users. The proposed changes would assist the preparers and auditors by removing the option to self-assess whether an entity is a reporting entity and subsequently the type of financial reporting.

Q24 – Whether the proposals are in the best interests of the Australian economy.

Harmonising the Australian reporting framework will assist entities in meeting their reporting obligations in other jurisdictions and promote Australia's international influence in relation to the development of accounting standards.

Q25 – Unless already provided in response to specific matters for comment above, 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 anticipate that preparers will incur additional cost in preparing financial reports, largely due to the application of consolidation and equity accounting. The increased cost will result from the preparation of consolidated financial reports and their audits, including for example obtaining fair value measurements for the testing of goodwill that has not been previously recognised because the entity did not apply consolidation accounting. There will also be one-off cost resulting from redesigning financial reports, upgrading existing financial reporting systems and upskilling accounting staff in consolidation and consolidated reporting.

The benefits will come in removing the inconsistencies in self-assessing what type of reporting to apply and thus improving the comparability, transparency and usefulness of financial reporting. Entities eligible to report under Tier 2, but which opted to continue reporting under Tier 1 because they did not view the reduced disclosure requirement to be sufficiently different may reconsider their decision if the new Tier 2 frameworks provides a better alternative.