

22 April 2010

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA

Email: standard@asb.gov.au

Dear Kevin,

ED 192 – Revised Differential Reporting Framework

We are pleased to provide comments on the AASB's Exposure Draft 192 - *Revised Differential Reporting Framework* and the accompanying AASB Consultation Paper entitled *Differential Financial Reporting - Reducing Disclosure Requirements*.

The Australian Institute of Company Directors is the second largest member-based director association worldwide, with over 25,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

Although the revised differential reporting framework impacts a range of entities in different sectors, the need to get the framework right is particularly important for small and medium enterprises (SMEs). SMEs, the vast majority of which are not listed, are an important part of Australia's economic backbone. Many of our members are directors of SMEs and collectively make a significant contribution, amongst other things, to employment levels, tax revenue and to general economic activity. This in turn helps Australia to continue to experience the high standards of living we have come to enjoy.

We are of the view that it is necessary to address a number of fundamental issues that relate to Australia's reporting framework before turning to particular aspects of the AASB proposal. Our comments in respect of particular questions raised by the AASB are set out in Appendix 1.

1 General Comments

In summary, the Australian Institute of Company Directors is of the view that:

- a) IFRS for SMEs should be adopted in Australia as soon as possible, as an option for unlisted reporting entities to use should they choose to do so;
- b) IFRS for SMEs should be available as an option rather than a mandatory standard;
- c) a key factor contributing to the financial reporting burden for most reporting entities in Australia, was the Australian Government's policy decision to apply International Financial Reporting Standards (IFRS) to all reporting entities;

- d) while financial reporting relief for many unlisted companies is long overdue, changes to Australia's reporting framework which increase the burden on an undetermined number of entities should not be made until a full regulatory impact statement is undertaken;
- e) the reporting entity concept has been an important tool for alleviating the reporting burden for numerous Australian entities and should be retained;
- f) the Accounting Standards applicable to the preparation of financial statements should not be determined, in whole or in part, by whether an entity lodges financial statements with a regulator or other statutory body;¹
- g) even though the AASB's proposed RDR will reduce the reporting burden for unlisted reporting entities when compared to the application of full IFRS, the RDR is likely to increase the reporting burden for many entities including those currently preparing special purpose financial statements;
- h) the reporting requirements with which "non-reporting" entities must comply should be no more onerous than those in place under the current financial reporting framework;
- i) on balance, IFRS for SMEs as an option together with the maintenance of the reporting entity concept, is the preferred alternative to the RDR;
- j) IFRS for SMEs provides a concise set of standards which is easier for smaller entities to apply, provides simplified recognition and measurement choices and potentially less disclosure than the RDR;
- k) the use of a sector neutral approach to the application of accounting standards creates difficulties where the standards themselves are designed only for "for-profit entities"; and
- l) the impact of the RDR proposal to the Australian economy cannot be properly assessed until a full regulatory impact statement is undertaken.

2 Application of IFRS to all Reporting Entities

When the IASB first released International Financial Reporting Standards, it was made clear that the standards were intended to apply only to listed entities. Despite this and the concerns raised by stakeholders during the consultation period at the time, Australia adopted IFRS and required *all* private sector reporting entities (whether listed or unlisted) to adhere to the new regime.

Since the implementation in 2005 of "IFRS as adopted in Australia" it has become clear that the application of IFRS to unlisted reporting entities has created a significant reporting burden on thousands of Australian entities. This very burden was foreshadowed by the Australian Institute of Company Directors in 2005 when we noted that:

*"AICD is concerned that the transition to IFRS will have a negative effect on smaller companies....especially the 20,000 -25,000 Australian unlisted reporting entities....Australian companies are at a disadvantage compared to their international competitors because the new international standards apply to all Australian listed companies and unlisted reporting entities. In Europe IFRS only applies to listed companies....It is these smaller Australian listed companies and unlisted reporting entities which will bear the greatest relative burden on transition to IFRS."*²

¹ We note that pursuant to the RDR, financial statements will be considered GPFs where, amongst other things, "they are made publicly available, whether under a legal mandate or voluntarily, and are required under a legal mandate to be prepared in accordance with Accounting Standards or to be GPFs." (See *AASB Consultation Paper – Differential Reporting – Reducing Disclosure Requirements* at page 24).

² Letter from AICD to Mr Jeffrey Lucy, then Chairman of ASIC titled *International Financial Reporting Standards – Relief for smaller companies* 2 July 2005

While we support the application of international accounting standards to companies that are global in nature, in our view, the decision to apply IFRS to all reporting entities in Australia (the vast majority of which do not have an international focus) was a fundamental error in Australian financial reporting policy. We note that a key driver of the change at that time was to ensure that Australian entities became “IFRS compliant.” Despite imposing the burden of transitioning entities to full IFRS in order to meet this objective, the RDR will now render many entities non compliant.

In addition, the current debate regarding the relative merits of the proposed RDR and IFRS for SMEs would largely be unnecessary had Australia limited its adoption of IFRS to listed entities, as occurred elsewhere in the world. As such, we agree that financial reporting relief is warranted for unlisted reporting entities and support reducing the financial reporting disclosure burden for these companies. While we acknowledge that the RDR will assist to reduce the disclosure burden for many non publicly accountable entities currently applying full IFRS, we are concerned that the proposal involves removing the reporting entity concept and will increase the reporting burden for an undetermined number of entities.

The Australian Institute of Company Directors is of the view that unless a rigorous, balanced and careful approach is taken to the consideration of how Australia’s reporting framework will be impacted by the proposed RDR, a similarly grave policy error to that mentioned above may well occur.

3 The need for a Regulatory Impact Statement

The Australian Institute of Company Directors is of the view that changes which increase the reporting burden on an undetermined number of entities should not be made to Australia’s financial reporting framework until a full regulatory impact statement is undertaken in respect of these aspects of the RDR proposal. While the AASB is responsible for setting Accounting Standards in Australia, many regulators, as noted in the AASB consultation paper, “are presently involved with Australia’s differential reporting framework.”³ Given the importance of ensuring that the framework is workable, user friendly, efficient and in the interests of the Australian economy as a whole we are of the view that the imposition of an additional reporting burden on some entities should be carefully assessed before such a change occurs.

In 2007 business groups released a *Business Checklist for Commonwealth Regulatory Proposals*.⁴ In respect of any regulatory proposal, the checklist asks questions such as “have the relative costs and benefits of these alternatives been thoroughly assessed”⁵ and “was an adequate Regulatory Impact Statement prepared?”⁶ The AASB’s consultation paper and exposure draft does not meet either of these items of the checklist. Instead, the consultation paper provides a brief “qualitative assessment” of the relative merits of each option presented in the paper.

The Australian Institute of Company Directors is of the view that the case for reducing the reporting burden on non-publicly accountable reporting entities has been well established by the actual experience of those entities who have applied full IFRS and incurred significant costs

³ AASB Consultation Paper *Differential Financial Reporting – Reducing Disclosure Requirements* at page 9.

⁴ A copy of the checklist is available at:

<http://www.companydirectors.com.au/Representation/Policies+And+Papers/2007/Business+Checklist+for+Commonwealth+Regulatory+Proposals.htm>

⁵ See paragraph 2.2 of the checklist.

⁶ See paragraph 5 of the checklist.

without any incremental benefits, since it was first adopted in Australia. The case for increasing the burden on entities lodging special purpose financial statements and modifying the reporting entity concept however, requires further analysis and justification. It is this component of the proposed RDR which should be the subject of a Regulatory Impact Statement.

In this regard, we note that the AASB does not employ any quantitative analysis for assessing the additional costs that will be incurred by some preparers of financial statements under the proposed RDR. Despite concerns that the RDR will significantly increase the burden for non-reporting entities that currently lodge special purpose financial statements with a regulator or statutory body, the consultation paper fails to identify:

- a list of the legislation at a federal, state and territory level which requires entities to lodge financial statements with a regulator/statutory body;
- the amount of legislation which requires financial statements to be lodged with a regulator/statutory body;
- the number of entities that currently lodge special purpose financial statements with a regulator/statutory body;
- a list of the legislation at a federal, state and territory level which requires entities to prepare financial statements in accordance with “Accounting Standards”;⁷
- the number of entities which for the first time would be considered to be preparing general purpose financial statements pursuant to the proposed RDR;
- the extent of any additional cost burden which would be incurred by these entities;
- the extent of any cost savings which may accrue to other entities;
- the impact of any additional cost burden on the productivity of small business; and
- how a proposal that in part increases the burden for an undetermined number of entities is consistent with the Australian Government’s commitment to reducing red tape.

The Australian Institute of Company Directors recommends that a regulatory impact statement be prepared which addresses these questions in respect of the RDR before a reporting burden more onerous than that in place under the current regime is imposed on any entity.

4 Reporting Entity Concept

The Australian Institute of Company Directors supports the retention of the reporting entity concept. The reporting entity concept⁸ which was introduced into Australia in 1991 has provided a useful “brake” for the excessive reporting obligations for many smaller unlisted entities.

⁷ We re-iterate that pursuant to the RDR financial statements will be considered GPFs where, amongst other things, “they are made publicly available, whether under a legal mandate or voluntarily, and are required under a legal mandate to be prepared in accordance with Accounting Standards or to be GPFs.” Pursuant to the RDR Accounting Standards, will be taken to mean, amongst other things, “full IFRS as adopted in Australia or any other reporting regime that are devised by the AASB for the preparation of GPFs.” (See *AASB Consultation Paper – Differential Reporting – Reducing Disclosure Requirements* at page 24).

⁸ A reporting entity is an entity in respect of which it is reasonable to expect the existence of users who rely on the entity’s general purpose financial statements for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.

We note the AASB's proposal states: "a commonly voiced concern is that entities are asserted to be 'abusing' the reporting entity concept by claiming to be non-reporting entities and preparing SPFS's when they should be preparing GPFs."9 We have not seen any evidence which suggests any systematic abuse of this concept and note that the consultation paper does not provide any evidence to support the concerns or the extent to which the alleged 'abuse' has occurred. In the event that reporting entities have been preparing special purpose financial statements, the issue is one of enforcement rather than a basis for removing the reporting entity concept from the Australian differential reporting framework.

In the event the reporting entity concept is removed, it is anticipated that a significant additional cost burden will be incurred by some corporate groups. Under the current regime consolidated financial statements need to be prepared if the group is a reporting entity and does not qualify for an exemption.10 If the reporting entity concept is removed, previously non reporting groups may need to prepare consolidated financial statements if the parent prepares GPFs. Further, and as set out above, entities currently preparing and lodging special purpose financial statements on a public register are also expected to face additional costs for no additional benefit.

It is the view of the Australian Institute of Company Directors that the new differential reporting framework in Australia should retain the delineation between "reporting" and "non-reporting" entities.

5 IFRS for SMEs

While the Australian Institute of Company Directors has long questioned the policy rationale for applying international standards to unlisted entities, we note that for many entities, IFRS for SMEs provides an easy to understand reporting option that would potentially reduce the burden of preparing financial statements for a range of entities.

We acknowledge that for some SMEs the accounting outcomes which result under IFRS for SMEs will not be desirable. For example, we note that IFRS for SMEs requires mandatory amortisation of goodwill over 10 years and does not permit the revaluation of property, plant and equipment. While we have serious concerns about these particular standards and expect that these requirements may deter some SMEs from wanting to adopt IFRS for SMEs until such a time as these options are allowed, we are of the view that IFRS for SMEs should be made available *as an option* for unlisted reporting entities to apply should they choose to do so. Further, we are also of the view that non-reporting entities should not be subject to more onerous requirements than those currently in place.

Despite our concerns about aspects of IFRS for SMEs as they relate to some companies, we are of the view that the adoption of IFRS for SMEs for unlisted reporting entities *as an option*, together with the maintenance of the reporting entity concept, is preferable to the RDR as currently formulated. On balance, we are of the view that IFRS for SMEs provides a concise set of standards which is easier for smaller entities to understand and apply. Further, if IFRS for SMEs is offered as a choice, it will ensure that unlisted reporting entities are not unnecessarily burdened by a new set of reporting requirements. The Australian Institute of Company Directors is of the view that the application of the recognition and measurement principles under full IFRS and the range of choices offered may still be overwhelming for many SMEs, even in circumstances where the number of disclosures from full IFRS will be reduced.

⁹ AASB Consultation Paper – *Differential Financial Reporting – Reducing disclosure requirements*, at page 11.

¹⁰ For example, where the consolidation is prepared at higher level, see AASB 127.10

In addition, we do not expect that the RDR will provide the cost savings that may be available to SMEs under IFRS for SMEs and, as acknowledged by the AASB¹¹, the RDR will impose a greater reporting burden on entities currently lodging financial statements on public registers that are not GPFSSs.

By allowing IFRS for SMEs to be available as an option for unlisted reporting entities, these entities would be able to make an assessment based on their circumstances as to which set of standards they prefer to apply (full IFRS or IFRS for SMEs). Factors an entity may consider when making such an assessment, might include the following:

- the extent to which the entity is currently applying full IFRS and the cost benefit analysis of switching to a new set of standards;
- whether the entity is a member of a consolidated group that would require the entity to apply full IFRS; and
- whether the entity has plans to expand and become a listed entity in the future (if the company does not intend to be listed, concerns about having to migrate to full IFRS at a later stage will not be warranted).

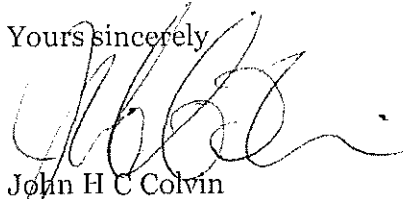
Although we understand that the AASB is taking a sector neutral approach to the application of accounting standards, this approach creates difficulties where the standards themselves are designed for for-profit entities rather than not-for-profits or public sector entities. In relation to not-for-profit entities, the Australian Institute of Directors has long held the view that over time a separate set of Accounting Standards should be developed for not-for-profit entities.

* * *

Our comments in respect of a number of the specific questions included in the Exposure Draft are set out in Appendix 1.

We hope that our comments will be of assistance to you. If you are interested in any of our views please do not hesitate to contact Rob Elliott.

Yours sincerely



John H C Colvin
Chief Executive Officer

¹¹ AASB Consultation Paper *Differential Financial Reporting – Reducing Disclosure Requirements* at page 7.

Appendix 1 – Responses to Specific Matters for Comment

The Australian Institute of Company Directors confines its comments to a number of the specific matters referred to in the AASB Exposure Draft as set out below.

The AASB would particularly value comments on the following:

a) *whether you agree with the introduction of a second tier of reporting requirements for preparing general purpose financial statements (GPFs) for:*

(i) for-profit private sector entities that do not have public accountability;

(ii) not-for-profit private sector entities;

(iii) public sector entities other than those required by the AASB to apply Tier 1?

If not, and you support differential reporting, what other classifications of entities do you think would be more appropriate for differential reporting and why?

The Australian Institute of Company Directors strongly supports the introduction a second tier of reporting requirements into the Australian reporting framework for entities required to prepare general purpose financial statements. A second tier should go some way toward remedying the problems created by the decision to apply IFRS in Australia to all reporting entities. We are of the view that the regulatory burden on non-publicly accountable reporting entities should be reduced.

We propose, however, that the appropriate differential reporting regime for for-profit companies should be as follows:

- a) only listed entities should be required to comply with full IFRS;
- b) unlisted reporting entities should have the option of complying with full IFRS or IFRS for SMEs; and
- c) non-reporting entities should not have more onerous requirements than those in place under the current regime.

In the public sector, the Australian Institute of Company Directors is of the view that it is appropriate for Federal, State and Territory Governments, Local Governments and Universities to apply full IFRS. In relation to whether these are the only public sector entities which should be required to apply full IFRS, consideration should be given, first to the extent that the public sector entity is publicly accountable² and secondly as to whether the entity directly competes with private sector entities required to prepare financial statements in accordance with full IFRS. The Australian Institute of Company Directors would not support a differential reporting regime that allows particular public sector entities to benefit from reduced reporting requirements where their competitors in the private sector receive no similar relief.

Although the AASB has adopted a sector neutral approach to the application of accounting standards this approach creates difficulties where the standards themselves are designed only

for “for-profit entities.” The Australian Institute of Company Directors has long held the view that over time a separate set of accounting standards should be developed for not for profit entities.

b) Do you agree that entities within the second tier should be able to apply the proposed reduced disclosure regime, which retains the recognition and measurement requirements of full IFRSs or would you prefer another approach (e.g. IFRS for SMEs)? If you prefer the IFRS for SMEs, what do you consider to be the specific advantages of the individual differences of recognition and measurement requirements in the IFRS for SMEs compared with full IFRSs?

The Australian Institute of Company Directors supports the introduction of reporting relief for unlisted reporting entities currently preparing financial statements in accordance with full IFRS. However, we do not support the introduction of the AASB’s reduced disclosure regime on the basis that the RDR option does not confine itself to simply introducing a second tier of less rigorous standards for non-publicly accountable reporting entities. Instead, the RDR option interferes with the reporting entity concept and seeks to increase the reporting burden for an undetermined number of entities preparing special purpose financial statements. The Australian Institute of Company Directors is concerned that the AASB’s RDR proposal will increase the reporting burden for an undetermined number of Australian entities.

In conjunction with the retention of the reporting entity concept, the Australian Institute of Company Directors supports IFRS for SMEs being made available as an option for those unlisted reporting entities that will still be required to prepare financial statements following any legislative changes that are implemented as a result of the Corporations Amendment (Corporate Reporting Reform Bill) 2010¹³. On balance, IFRS for SMEs is the preferred alternative to the RDR given that it provides a concise set of standards which is easier for smaller entities to apply, simplified recognition and measurement choices and potentially less disclosure than the RDR.

For many entities, the decision of the IASB not to amend the IFRS for SMEs standard for three years is likely to provide a welcome alternative from having to keep abreast of ever changing accounting standards.

d) Would you require any other classes of public sector entities, such as Government Departments, Government Business Enterprises (GBEs) or Statutory Authorities, to be always categorised as ‘Tier 1’ reporting entities and, if so, the basis for your view?

As set out in our response to question a) above, the Australian Institute of Company Directors is of the view that it is appropriate for Federal, State and Territory Governments, Local Governments and Universities to apply full IFRS. In relation to whether these are the only public sector entities which should be required to apply full IFRS, consideration should be given, first to the extent that the public sector entity is publicly accountable and secondly as to whether the entity directly competes with private sector entities required to prepare financial statements in accordance with full IFRS.

¹³ We note that the Corporations Amendment (Corporate Reporting Reform Bill) 2010 proposes a three tiered differential reporting framework for public companies limited by guarantee. The Australian Institute of Company Directors’ submission on this issue supported reporting and auditing relief being offered to public companies limited by guarantee but recommended that alternative thresholds to those proposed be adopted. (Australian Institute of Company Directors’ submission to Federal Treasury dated 3 February 2010).

e) the clarification of the meaning of GPFS and modifying the way the reporting entity concept is used.

The Australian Institute of Company Directors does not agree that the proposed changes to the meaning of GPFS are a clarification. We do not support any modification to the reporting entity concept. We are of the view that any second tier option included in the differential reporting framework should work in conjunction with the existing reporting entity concept.

f) the extent and nature of the proposed disclosures under the RDR (Tier 2), including whether the RDR would be effective in reducing sufficiently the disclosure burden on entities in preparing their GPFSs.

While it is expected that the RDR will reduce the reporting burden for many reporting entities currently required to prepare financial statements in accordance with full IFRS, the Australian Institute of Company Directors is of the view that many entities would appreciate having the option of being able to apply IFRS for SMEs should it suit their entity's circumstances.

The Australian Institute of Company Directors is also concerned that the RDR option goes much further than simply reducing the disclosures for entities preparing GPFSs and in fact will be likely to increase the reporting burden for an undetermined number of entities.

i) whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals in this Consultation Paper?

The Australian Institute of Company Directors is of the view that it is inappropriate for the RDR proposal to be introduced where it increases the financial reporting burden for an undetermined number of entities without the AASB preparing a regulatory impact statement. We recommend that the rationale for increasing the reporting burden on entities currently lodging special purpose financial statements and for modifying the reporting entity concept should be the subject of further analysis.

In this regard we note that the AASB Consultation Paper and Exposure Draft fail to identify the following when presenting the RDR option:

- a list of the legislation at a federal, state and territory level which requires entities to lodge financial statements with a regulator/statutory body;
- the amount of legislation which requires financial statements to be lodged with a regulator/statutory body;
- the number of entities that currently lodge special purpose financial statements with a regulator/statutory body;

- a list of the legislation at a federal, state and territory level which requires entities to prepare financial statements in accordance with “Accounting Standards”;¹⁴
- the number of entities which for the first time would be considered to be preparing general purpose financial statements pursuant to the proposed RDR;
- the extent of any additional cost burden which would be incurred by these entities;
- the extent of any cost savings which may accrue to other entities;
- the impact of any additional cost burden on the productivity of small business; and
- how a proposal that in part increases the burden for an undetermined number of entities is consistent with the Australian Government’s commitment to reducing red tape.

j) whether, overall, the proposals would result in reducing the costs of preparing GPFs that would remain useful to users

The Australian Institute of Company Directors is of the view that the option of adopting IFRS for SMEs to unlisted reporting entities would over time, decrease the costs of preparing financial statements without materially reducing the usefulness of those statements to users. As stated above, while we acknowledge the RDR will assist to reduce the disclosure burden for non publicly accountable reporting entities currently applying full IFRS, we are concerned that the proposal involves removing the reporting entity concept and will increase the reporting burden for some entities.

k) whether the proposals are in the best interest of the Australian economy.

It is difficult to assess the full impact of the RDR proposal to the Australian economy without having the benefit of a regulatory impact statement. In general terms, it is in the interests of the Australian economy not to:

- place an excessive compliance burden on Australian companies; or
- impose otherwise avoidable costs on companies for little, if any, discernible benefit.

These considerations, and the comments made earlier, lead the Australian Institute of Company Directors to conclude that IFRS for SMEs should be available as an option for non listed reporting entities and that the reporting entity concept should be maintained.

¹⁴ We re-iterate that pursuant to the RDR financial statements will be considered GPFs where, amongst other things, “they are made publicly available, whether under a legal mandate or voluntarily, and are required under a legal mandate to be prepared in accordance with Accounting Standards or to be GPFs.” Pursuant to the RDR Accounting Standards, will be taken to mean, amongst other things, “full IFRS as adopted in Australia or any other reporting regime that are devised by the AASB for the preparation of GPFs.” (See *AASB Consultation Paper – Differential Reporting – Reducing Disclosure Requirements* at page 24).