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Dear Kevin

ED 192 Revised Differential Reporting Framework

BDO is pleased to respond to the Exposure Draft ED 192 *Revised Differential Reporting Framework* and the Consultation Paper *Differential Financial Reporting - Reducing Disclosure Requirements*.

BDO has grave concerns that the proposed reduced disclosure regime (RDR) will significantly increase the cost of the financial reporting burden on a large number of Australian SMEs, the principle areas of increased costs being;

- 1) Mandatory consolidation
- 2) Significant increased disclosure for those entities currently preparing special purpose financial statements (SPFSs)
- 3) Modification of principles on transition from Tier 2 to Tier 1
- 4) Rejection of IFRS for SMEs.

At the same time, we acknowledge that for those unlisted entities currently preparing general purpose financial statements (GPFs) using full IFRS, the proposals will reduce costs. It should be recognised however, that the current burden placed on these entities (i.e. full IFRS) is far in excess of their international counterparts in the UK and Europe. BDO believes that the RDR should have been refined to have reduced this unnecessary cost burden even further by reducing unnecessary disclosure and allowing simpler measurement principles to be applied.

Mandatory Consolidation

Under existing Australian practice, consolidation has been treated as a presentation standard. These proposals determine that consolidation is a measurement requirement.

This change will lead to a serious cost burden on a large number of private groups, including large grandfathered groups.



Many companies, or sub groups that form part of large private groups, never hold themselves out to be members of a larger group, and do not avail themselves of cross guarantees etc. Many of these large private groups may have very separate sub groups operating in very different industries (e.g. a private group that contains property, media, transport etc.). There may be minimal transactions across group companies and consolidated financial statements may simply not be produced as there are no users of the consolidated numbers either by owners, financiers, customers or suppliers.

The proposals now make consolidation mandatory for all large private groups reporting under the Corporations Act and hence mean that by law these groups must consolidate. We believe that the role of mandating who should produce consolidated financial statements is that of the regulator and not that of the AASB. AASB 127 should be there to be complied with if consolidated GPFs are produced, it should not be used to mandate consolidation.

Significant increased disclosure for companies currently preparing SPFSs

Whilst we strongly support the principle of reduced disclosure, we believe that the proposed RDR contains too much disclosure, which represents an unnecessary cost burden on Australian SMEs, particularly on those entities currently preparing SPFSs that are required to comply with Chapter 2M.3 of the Corporations Act.

BDO believes that the development of IFRS for SMEs was flawed with its “top down” approach to disclosures. This approach retained a lot of unnecessary disclosures particularly “reconciliation” notes (e.g. fixed asset reconciliations).

As the AASB has used the disclosure in IFRS for SMEs as a “backstop” for RDR, this flaw and consequent excessive disclosure has been carried over.

BDO believes that the correct approach to developing the RDR should have been to adopt a “bottom up approach”, having properly considered who the users of the GPFs were. This bottom up approach should have started with the basic skeleton of the primary financial statements plus accounting policies (the current SPFSs) plus appropriate related party disclosure, then only truly necessary disclosures.

Truly necessary disclosures could only be determined if the users of these financial statements had been properly identified. To this end, we believe that the required information is for those people that rely on information presented in the GPFs who do not have direct access to financial information. These users would not include owners, financiers or potential investors, but instead would typically represent suppliers, customers and regulators. The information required by these users typically centres around solvency. Had this principle been followed, we believe that much of the proposed disclosure around fair value in the RDR does not provide information that is required by users of GPFs, but is rather “nice to know” information.

Included in Appendix B of the submission is our assessment of the proposed disclosure.



Modification of principles on transition from Tier 2 to Tier 1 Reporting Requirements

All Australian companies applying AIFRS went through a costly transition process on first time adoption and application of AASB 1 in 2005. Since that time those entities preparing SPFSs which have applied full measurement principles of IFRS have simply switched over to preparing GPFSSs by increasing the level of disclosure to that required by full IFRS. The RDR proposes that these entities switching from Tier 2 to Tier 1 now need to transition again through AASB1. Whilst we recognise that this is what the current wording of AIFRS requires we question whether this is necessary and are concerned about the cost and complexity of these proposals.

It will add confusion and complexity e.g. resetting Foreign Exchange reserves to zero again and causing early adoption of new standards. It would appear to go against the principle for striving for comparability of Australian entities.

Rejection of IFRS for SMEs

BDO considers there are two weaknesses in IFRS for SMEs, these being:

- not allowing full IFRS measurement as an alternative measurement basis;
- excessive disclosure.

we believe that adoption of IFRS for SMEs as at least an alternative to the RDR, would reduce the cost burden for a large number of SMEs, these benefits being:

- less complex measurement options;
- more accountants available to perform financial reporting for SMEs; and
- generally reduced training costs.

IFRS, and the measurement principles contained within it, is complex. Current IFRS text runs to over 2,800 pages compared with IFRS for SMEs at 210 pages. With the current IASB work program, complexity is set to increase even further. The complexity of IFRS is designed for the capital markets, it is simply too advanced for the average SME.

Compliance with these complex measurement requirements imposes significant costs and produces results and financial statements that are difficult to understand by sophisticated analysts, and are certainly not designed or appropriate for the users of SME GPFSSs.

Currently over 60 countries allow adoption of IFRS for SMEs. It appears hard to justify why an Australian SME should be different to its international counterparts. With the likely future increased complexity to IFRS (financial instrument impairment, leases, revenue recognition, etc.) we cannot see the cost benefit of insisting on applying unnecessarily complex measurement principles on Australian SMEs.



The adoption of IFRS in Australia in 2005 has resulted in a significant polarisation of the accounting profession, those accountants that are involved in the preparation and auditing of GPFs (full IFRS) and those who only prepare and audit SPFs. Many of the latter would never claim to have a detailed understanding of IFRS, and cannot justify the investment in time to keep up to speed with the ever increasing complexity of IFRS. At 210 pages long and being kept stable for 3 years, IFRS for SMEs is far more “accessible” to Australian accountants whose role is not primarily financial reporting. Lowering the barrier to entry will lead to reduced costs for SMEs.

BDO’s proposed solution to differential reporting

BDO proposes that an “AIFRS for SMEs” should be developed for Tier 2 reporting. This should effectively be an enhanced version of IFRS for SMEs but should differ from IFRS for SMEs in that it should:

- allow IFRS measurement principles to be used as an alternative to those mandated in IFRS for SMEs; and
- allow reduced disclosure compared with IFRS for SMEs.

The starting point for Tier 2 reporting would be IFRS for SMEs, rather than full IFRS as used in the proposed RDR. IFRS for SMEs would then be modified as follows:

- Insert “Aus” paragraphs to allow full IFRS measurement options (impairment model for goodwill, capitalise development costs, capitalise borrowing costs, etc.);
- Insert limited “Aus” disclosure paragraphs in respect of the different measurement basis adopted; and
- Selectively review and “grey out” excessive disclosure required by IFRS for SMEs.

If an entity did not use any of the “Aus” paragraphs nor omitted “greyed out “ disclosure, it would be able to say its GPFs were prepared in accordance with IFRS for SMEs.

The greying out of disclosure should follow a “bottom up approach”, focusing on truly essential disclosures.

The proposed AIFRS for SMEs would then have the following advantages over IFRS for SMEs:

- Would be available to subsidiaries of full IFRS reporters without the requirement to maintain two sets of books.
- Would allow more “sensible” measurement principles to be applied for certain entities operating in specific industries.
- Would allow IFRS measurement principles to be applied by an entity considering a future IPO.
- Would have disclosures closer to those currently used in SPFs rather than full IFRS.



These benefits would be accompanied by a number of costs savings.

If you have any questions regarding this submission, please do not hesitate to contact Wayne Basford at 02 9286 5452 or wayne.basford@bdo.com.au.

Yours sincerely

BDO Audit (NSW-VIC) Pty Ltd



Wayne Basford

Director



APPENDIX A: RESPONSES TO THE AASB'S QUESTIONS IN ED 192

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; and
 - (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?

Response

BDO agrees strongly with the principle of introducing a second tier of reporting requirements for preparing general purpose financial statements for all non-publically accountable entities including those non-publically accountable entities in the public sector.

For those entities determined to be reporting entities under the Australian differential framework, but which are not classified as publically accountable under IFRS, the introduction of full IFRS in 2005 meant that they were subjected to a significant cost burden compared with similar entities in Europe.

For those entities not deemed to be reporting entities who prepared special purpose financial statements (SPFSs) to satisfy their requirements under Chapter 2M.3 of the corporations Act, the very limited number of standards applicable to them, and the lack of clarity as to which measurement standards applied, had three significant weaknesses:

- It allowed a significant number of Australian accountants and auditors to “opt out” of AIFRS adoption, meaning that the Australian skill base in terms of applying and understanding IFRS is limited to a relatively small number of Australian accountants.
- Certain disclosures required by users were typically omitted from SPFSs.
- It allowed inappropriate measurement principles to be used.

We are of the opinion that the reporting requirements of not-for-profit entities should be dealt with in a specific standard designed for not-for-profit entities.



(b) whether 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?

Response

Whilst BDO believes that IFRS for SMEs is flawed in two respects, i.e:

- Not allowing full IFRS measurement as an alternative measurement basis, and
- Excessive disclosure,

We are strongly of the opinion that IFRS for SMEs or an appropriately modified AIFRS for SMEs is a much more desirable option than the reduced disclosure regime (“RDR”) proposed by the AASB for a number of Australian SMEs, particularly Australian owned SMEs and those SMEs currently producing SPFSs.

Specific advantages of IFRS for SMEs over the proposed RDR are:

- Accessibility
- Appropriate measurement rules for SMEs
- Stable platform
- Costs of training.

Accessibility

The method of introduction of IFRS to Australia in 2005 has meant that only a relatively small number of Australian accountants and auditors are proficient with the interpretation and application of IFRS.

Many Australian accountants simply have not applied the full measurement requirements of IFRS and are daunted by the volume and complexity of the IFRS text.

At over 2800 pages, the text is simply not accessible to the average Australian practitioner involved in the SME market, for which financial reporting forms only a relatively small part of their role as an accountant.

Recognising that even the 2,800 pages is insufficient to explain the complex principles required under IFRS, most of the competent users of IFRS maintain a library of technical accounting publications, published by the major accounting firms, to assist in application of IFRS. In Australia, where both accounting standards and auditing standards have the force of law, the requirement for an accountant or auditor of a non publically accountable entity to comply with the full IFRS measurement requirements is far too onerous. At 210 pages long, IFRS for SMEs is accessible.



The requirements to measure conventional transactions is contained within a single standard, rather than spread throughout a maze of IASs, IFRSs and IFRICs. Therefore we believe that the starting point for any RDR should have been IFRS for SMEs, or alternatively IFRS for SMEs should be allowed as an alternative to the RDR.

Appropriate measurement rules for SMEs

Whilst from a purest technical perspective the measurement requirements contained within IFRS are “superior” to those contained with IFRS for SMEs, they are in many cases too complicated for the SME sector. This imposes unnecessary cost in preparation and auditing, examples being impairment testing for goodwill, capitalisation of borrowing costs, etc. The degree of complexity in full IFRS is set to increase (revenue, leases, impairment of financial instruments etc) further in the near future.

Internationally it has been recognised that these measurement requirements are too complex for SMEs, we cannot see any justification for imposing such high standards and costs on Australian SMEs.

Stable platform

With the drive towards international harmonisation and the ever complex needs of global capital markets, IFRS is about to go through a period of significant change (revenue, leases, financial instruments etc). This change will place a significant burden on the limited resources of those involved in the SME sector. In addition, some of the new measurement principles may simply not be appropriate for the SME sector. IFRS for SMEs represents a stable platform which will only change every three years and is designed to reduce the burden of training and compliance.

Cost of training

For those accountants involved in both Tier 1 and Tier 2 reporting, the cost of training will obviously increase. However, many accountants will only ever be involved in Tier 2 reporting. The costs of providing appropriate training for IFRS for SMEs will be significantly lower than providing training for the RDR. With IFRS for SMEs being widely adopted around the world, any recruitment of overseas accountants into the Tier 2 space will require significant additional training or will exclude these individuals from being able to be involved in financial reporting.

The cost of training the proposed RDR could well represent a significant barrier of entry to smaller accounting firms.



- (c) the definition of public accountability (which is used to identify those for-profit entities that must apply Tier 1) and whether there are categories of entities in the Australian environment that should be cited as examples of publicly accountable entities other than those already identified in paragraph 26;

Response

We believe that the definition is appropriate and that if tier 1 is to be extended to other types of entities, that is the role of the appropriate regulator to determine and not the AASB.

- (d) whether you would require any other classes of public sector entities, such as Government Departments, Government Business Enterprises or Statutory Authorities, to be always categorised as 'Tier 1' reporting entities and, if so, the basis for your view;

Response

We believe that the role of determining which entities are "Tier 1" is the role of the appropriate government department and not the AASB.

- (e) the clarification of the meaning of GPFs and modifying the way the reporting entity concept is used;

Response

BDO questions why Australia should not simply apply the concept of public accountability and GPFs as put forward by the IASB.

- (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 GPFs;

Response

Whilst the reduced disclosures proposed will reduce the burden of disclosure for entities preparing GPFs, we do not believe the proposals go far enough to sufficiently reduce the disclosure burden.

BDO believes that the required disclosures should have been determined using a "bottom up" approach rather than the "top down" approach applied by the AASB in drafting the proposed RDR and the IASB when developing IFRS for SMEs.



We believe that the starting point should have been a base skeleton of the primary statements plus accounting policies (similar to that which has evolved in preparation of SPFSs) and an appropriate level of related party disclosure. Then, any additional disclosure should have been thoroughly questioned in terms of need to the user vs. the cost/benefit of preparing and auditing the disclosure.

BDO believes that the disclosures proposed in the RDR are flawed in two respects:

- 1) The RDR fails to address who the users of the financial statements are; and
- 2) It has used IFRS for SMEs as a backstop for minimum disclosures.

Identification of users

The purpose of preparing Tier 2 GPFs would appear to be to provide information to users of these financial statements who cannot command information in other ways.

To this end, the primary users would appear to be suppliers, customers and regulators, rather than owners, potential investors and financiers (who would typically have direct access to required financial information).

The key information therefore required by the likely user group is surrounding profitability, but, in particular solvency and liquidity. Disclosures that go beyond satisfying this base requirement are “nice to know” or simply there to satisfy curiosity.

For example, a private company issues shares or share options to its key executives. What are the required disclosures?

A user would need to quantify the impact of the share-based payment on the entity's result for the year (particularly if it was a credit to income). The user would also require to understand if the share-based payment had the ability to be settled in cash and impacted liquidity. The user of the financial statements would, however, not require to see the exact details of the share based payment in terms of number of options, strike price, vesting period etc, etc.

Use of IFRS for SMEs as a “backstop”

IFRS for SMEs contains a large number of disclosures that simply fail to pass the “cost/benefit” test, particularly the required “reconciliation notes”. The proposed RDR has simply carried over these superfluous requirements.

(g) any particular disclosure requirements that:

- (i) have been retained in the RDR that you consider should be excluded from the RDR, and your reasons for exclusion;

Response

There are a significant number of disclosures that have been retained which we believe should be excluded. These can be largely separated into two categories:

- 1) Unnecessary aggregations and reconciliations (e.g. fixed asset reconciliation table); and
- 2) Unnecessary information involving non cash account impacts on the income statement. (e.g. share based payments).

- (ii) have been excluded from the RDR that you consider should be retained, and your reasons for retention;

Response

We do not consider that there are other disclosures that should have been retained.

(h) transitional provisions for entities applying Tier 1 or Tier 2 for the first time and moving between Tiers;

Response

We question whether entities that have met all measurement requirements of IFRS, but not all of the disclosure requirements should have to comply with the requirements of AASB 1, for example, entities that have produced SPFSs but have applied all relevant IFRS measurement requirements since adoption of A-IFRS. Transition to Tier 1 should not require adoption of AASB 1.

Similarly for those entities transitioning from Tier 2 to Tier 1, this should not be regarded as a first time adoption of IFRS. Instead, guidance should be given to prepare appropriate disclosures complying with IFRS for comparative purposes.

We note that the proposed transition rules for moving from SPFSs to Tier 1 is not consistent with practice in Australia adopted since 2005, nor would it appear in the interest of the users of financial statements to effectively be able to adopt AASB 1 twice.

These transitional requirements will both increase costs and produce less meaningful information to users.



- (i) whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals;

Response

We are not aware of other regulatory issues.

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

Response

The current proposals will impose a significant cost burden on preparers through increased costs of preparation and audit for the following entities:

- Those currently regarded as large non reporting entities that are required to prepare financial statements under Chapter 2M.3 of the Corporations Act and which currently prepare special purpose financial statements; and
- Any large non reporting entity required to prepare financial statements under Chapter 2M.3 of the Corporations Act, that currently does not apply AASB 127 and therefore does not prepare consolidated financial statements.

The proposal will also lock Australian SMEs to continue to automatically apply complex measurement principles designed for the needs of the users of listed company financial statements.

The IASB is currently working on a number of projects that will introduce a number of complex measurement requirements (e.g. revenue, financial instrument measurement, lease accounting etc). The proposals mean significant additional costs in preparing and auditing financial statements under the RDR, compared with IFRS for SMEs (or AIFRS for SMEs).

The question compares where we are now, being one of the few countries that has applied full IFRS to its non listed companies, to the slightly reduced disclosure regime as proposed in this exposure draft. So the answer to the question asked is “yes”, the proposals will reduce costs compared with the current position. Similar costs savings could have been achieved for most entities by merely reducing the scope of AASB 7 to only listed entities.

If the question had been phrased more appropriately to ask, “Do the proposals represent the most efficient way of minimising the costs of preparing GPFs that would remain useful to users?”, the answer would be “no”.

The AASB should have started with the IFRS for SMEs and then inserted full IFRS measurements as an option and then undertaken a “bottom up exercise” to determine the minimum level of disclosure.

If this exercise is deemed to be too onerous, then the AASB should allow IFRS for SMEs as an alternative to the proposed RDR.



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

Response

BDO has serious concerns as to whether the proposals as they stand are in the best interest of the Australian economy because of the considerable cost burden that will be imposed on a number of Australian entities compared with the current reporting regime, together with imposing a far greater level of complexity on the SME market compared with international equivalents.

Increased cost burden

The current proposals will impose a significant cost burden on preparers through increased costs of preparation and audit for the following entities:

- Those currently regarded as large non reporting entities that are required to prepare financial statements under Chapter 2M.3 of the Corporations Act and which currently prepare special purpose financial statements;
- Any large non reporting entity required to prepare financial statements under Chapter 2M.3 of the Corporations Act, that currently does not apply AASB 127 and therefore does not prepare consolidated financial statements; and
- Those entities currently applying full IFRS measurement principles but preparing SPFSs and transitioning to Tier 1 (private company going for IPO).

Impact of not adopting IFRS for SMEs

Whilst BDO believes IFRS for SMEs is flawed in two respects:

- Not allowing IFRS measurement as an alternative measurement basis; and
- Excessive disclosure.

The availability of a self contained standard for SMEs in 210 pages does offer a very practical alternative to full IFRS standing at over 2,800 pages of standards and guidance.

With the world quickly adopting IFRS for SMEs (including the United States of America), it is hard to understand why IFRS for SMEs is not being allowed to be used by Australian SMEs.

Applying IFRS for SMEs as at least an alternative to the proposed RDR would significantly reduce costs of preparation and audit compared with the proposed RDR, particularly for Australian owned companies that are not required to report to overseas parents applying full IFRS.

Application of IFRS for SMEs would reduce the costs of preparation and audit of Tier 2 financial reports primarily through:

- It being more accessible to preparers and potential auditors, allowing greater access to the market;
- Removal of complex (and expensive measurement options; and.
- Access to an overseas skill base (for preparers and auditors).



Australia was largely unique in 2005, forcing adoption of complex IFRS measurement principles to the preparers of GPFs whilst in the EU, IFRS was only applied to listed consolidated financial statements. The IASB has spent five years developing IFRS for SMEs for non-publicly accountable entities. It would appear that the proposals not only aim to continue the cost burden imposed by complex measurement principles, but also intend to expand the cost and complexity to large propriety companies currently preparing special purpose financial statements.

With the next IFRS “big bang approaching” with significant changes to revenue, financial instruments measurement, leases etc, it would appear that these proposals will continue to impose an unnecessary cost burden on a very large number of Australian SMEs through the reduced disclosure regime.

The introduction of IFRS into Australia has seen a significant reduction in the skill base available to prepare the current GPFs, with the vast majority of preparers and auditors in Australia only being involved with “special purpose” financial statements, either prepared under the Corporations Act or for some other reason.

There will be a significant cost burden in properly training preparers and auditors re the extended requirement to apply complex IFRS measurement requirements. The burden of training will continue as more complex measurement principles are applied in the proposed revisions to IFRS. Further, the proposals will involve the retraining of an overseas skill base, (accountants specializing in SMEs from Europe, South Africa, USA etc) which will be trained on IFRS for SMEs rather than full IFRS.