

23 April 2010

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO BOX 204
Collins Street West VIC 8007

Email: standard@asb.gov.au

Dear Kevin

ED 192 Revised Differential Reporting Framework

CPA Australia and the Institute of Chartered Accountants in Australia (the Institute) are pleased to respond to the Exposure Draft ED 192 *Revised Differential Reporting Framework* and the Consultation Paper *Differential Financial Reporting – Reducing Disclosure Requirements*.

CPA Australia and the Institute are the two largest professional membership bodies representing professional accountants in Australia. We represent over 190,000 members and student members who work in diverse roles across public practice, commerce, industry, government, and academia throughout Australia and internationally.

The Australian Government's stated objective of establishing Australia as a financial services hub rests on lifting the productivity and competitiveness of the sector by the removal of impediments to business through harmonisation of business regulation and access for financial services in Asia. A world-class financial services sector has accountants at its core. The Australian accounting sector's embrace of an international outlook has contributed significantly to the sector's prominence in the Asia-Pacific region and beyond. The ease of transition of skills between jurisdictions is an important factor in this continued growth of the sector; without such growth, Australia's position as a financial services hub is not likely to be a reality.

CPA Australia and the Institute have jointly considered the exposure draft and we attach our detailed comments (see Appendix A). Over the last 5 years, CPA Australia and the Institute have separately engaged with their membership on the topic of differential reporting. Member Committee discussions, field testing, presentations, roundtables and surveys are some of the approaches used to gather information. In 2010 we commissioned two national mid-tier accounting firms to assess the relative financial burden impacts of the requirements of the reduced disclosure regime (RDR) proposals in ED 192 and the IFRS for SMEs Standard on Tier 2 entities (as described in the ED) that are currently producing Special Purpose Financial Statements (SPFSs). The research findings are included in Appendix B. We are most willing to privately brief the AASB on this research to supplement the AASB's own research in this area. We also supported some academic exploratory research into the current financial reporting practices of Australian entities. Appendix C contains our comments on some parts of this work.

Nonetheless, we have been challenged gathering data and analysis with the unusually compressed timeframe since the release of the ED. This comment is particularly relevant as compliance with the AASB proposals in ED192 is highly likely to materially increase the cost burden of a significant number of the many private entities currently producing SPFSs. This appears to be an outcome inconsistent with the Australian Government's policy settings. Given the above, it is important that a comprehensive regulatory impact statement be published along with empirical data outlining why the current financial reporting regime is in need of a major overhaul.

Representatives of the Australian Accounting Profession



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The Institute of
Chartered Accountants
in Australia

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Since 2005, Australia has been challenged by its IFRS branding and positioning in the global accounting community. This challenge has come from the reference to 'Australian Accounting Standards' in contrast to the use of the term 'International Financial Reporting Standards'. While this challenge has been partly addressed, looking ahead at the proposals in ED 192 that adopt an IFRS oriented Australian specific standard, those past branding and positioning issues could re-emerge. This gives us cause for concern for Australia's reputation around the globe as well as the ease of transition of skills between jurisdictions. We believe that providing an existing international standard, IFRS for SMEs, as an available option for entities to adopt will enable Australia to have more than one framework on which financial statements can be based which will consequently allow the market to determine the preferred solution for Australian private entities.

We acknowledge that the reporting entity is not a mechanism used globally to enable differential reporting and that the recent IASB proposals use this same term in a different way. Therefore, this clearly needs to be addressed in Australia if our standards and accounting framework are to be consistent with international standards. However, the Australian community has effectively operated for many years with the reporting entity concept and the use of SPFSs for differential reporting purposes. There is no published empirical evidence that the current requirements have been damaging to business, the activities of not for profits, or the Australian public. Further, many of our members have expressed their disappointment and frustration at the changes proposed in ED 192 to the reporting entity concept. SPFSs have allowed entities to meet the specific needs of users by picking and choosing and applying only relevant standards and ignoring irrelevant standards.

We accept that intuitively for some entities, this 'pick and choose' approach poses a greater risk than having one or two standard approaches apply. However, we do not believe the AASB has made a substantive case to support the change to the reporting entity concept. We consider this area to be a matter for government policy makers with the input from various regulators, rather than those involved in setting accounting standards.

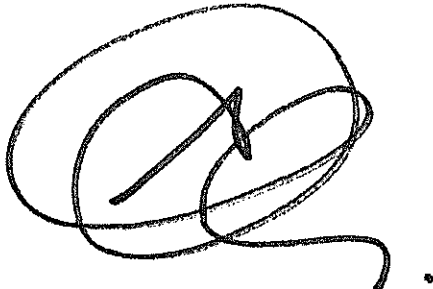
We are unable to support the proposals as outlined in ED 192, which propose that private entities requiring compliance with 'Australian Accounting Standards' **must** adopt full IFRS recognition and measurement requirements with limited disclosures. While we acknowledge that the RDR will suit the needs of some very large entities, in our view RDR alone is not an adequate solution to Australia's differential reporting needs. IFRS for SMEs **must** be allowed as an option, alongside RDR or a similar alternative, for private entities preparing general purpose financial statements. Without it, based on the current proposals, at worst there is a real danger that a culture of non-compliance with accounting regulation may develop as entities, particularly small not-for profits, already have difficulties complying with full IFRS recognition and measurement due to their limited accounting expertise and lack of resources. The proposals ignore the benefits of IFRS for SMEs thereby prejudicing entities by depriving them of options available to their equivalents overseas. We appreciate that transaction neutrality is a laudable objective from a theoretical standpoint, but as this is neither the international approach nor that of the standard setters of other countries it may no longer be practical.

It is unclear how these proposals, combined with the requirements in relation to financial statement preparation and lodgement contained within the Law, relate to the Australian Government's current policy about the single economic market regime between Australia and New Zealand. Both countries seem to be continuing on separate paths in regards to the Law and accounting standards for private entities.

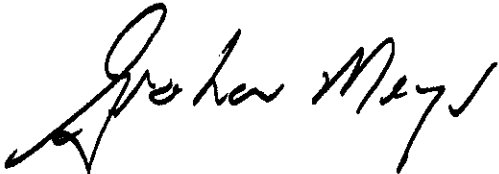
As the two leading accounting professional bodies we clearly commit, regardless of the changes that are eventually introduced in Australia, to ensuring that accounting professionals are provided with the appropriate training, peer learnings and developments to ensure the ease of transition. Some members in the larger public practice areas have presented to us the burdens associated with enabling an IFRS for SME framework in Australia, which included the possibility of two tiers of accounting professional and increased training and development costs. Whilst we understand these issues, we consider that the cost of providing training on IFRS for SMEs will be significantly lower than providing ongoing training on RDR, given the changes and complexity involved in full IFRS recognition and measurement.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at 03 9606 3903 or Mark.Shying@cpaaustralia.com.au or Kerry Hicks (the Institute) at 02 9290 5703 or Kerry.Hicks@charteredaccountants.com.au.

Yours sincerely



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**Chief Executive Officer
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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?

We strongly support differential reporting and the introduction of a second tier of reporting requirements for the GPFs of the above entities.

We consider that this second tier and the classifications provided would be a good basis for consideration of sector-specific standards, as is currently being considered by the New Zealand Accounting Standards Review Board. We also consider it important that the Single Economic Market Initiative of Australia and New Zealand inform all work of standard setters of both countries, including differential reporting.

- b) **whether you agree that entities within the second tier should be able to apply the proposed reduced disclosure regime (RDR), 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?**

We are unable to support the proposals as outlined in ED 192, which propose that private entities requiring compliance with 'Australian Accounting Standards' **must** adopt full IFRS recognition and measurement requirements with limited disclosures unless they adopt full IFRS. We are concerned that the RDR will materially increase the cost burden for a significant number of entities currently preparing Special Purpose Financial Statements (SPFSs). While we acknowledge that the RDR will suit the needs of some very large entities, in our view RDR alone is not an adequate solution to Australia's differential reporting needs.

IFRS for SMEs **must** be allowed as an option, alongside RDR or a similar alternative, for private entities preparing GPFs. Without it, based on the current proposals, at worst there is a real danger that a culture of non-compliance with accounting regulation may develop as entities, particularly small not-for profits, already have difficulties complying with full IFRS recognition and measurement due to their limited accounting expertise and lack of resources. The proposals ignore the benefits of IFRS for SMEs thereby prejudicing entities by depriving them of options available to their equivalents overseas. Further, the inclusion in the IFRS for SMEs Standard of a few Aus paragraphs to cater for particular needs of entities from the private and public not-for-profit sectors (e.g., the option to revalue property, plant and equipment assets) could be undertaken with minimal time and cost to the Board.

We appreciate that transaction neutrality is a laudable objective from a theoretical standpoint, but as this is neither the international approach nor that of the standard setters of other countries it may no longer be practical.

Mandatory compliance with recognition and measurement of full IFRS introduces complex and ever-changing measurement requirements that many SMEs (and their practitioners) will be unable to cope with. IFRS recognition and measurement standards have been designed for global capital markets and not intended for non-publicly accountable entities. Further, we would not like to see Australian SMEs, owned by overseas SME parents, put in a position or not being able to adopt IFRS for SMEs in Australia if their overseas parent requested this in order to facilitate consolidation.

We support the availability of IFRS for SMEs in Australia, due to the following benefits that will ensue to SMEs:

IFRS for SME advantages

- It is a self-contained complete standard with no reference required to full IFRS
- It is less than 10% of the size of full IFRS.
- It contains a maximum of 310 disclosures in contrast to 625 potential disclosures under RDR and over 1500 in full IFRS.
- It is already supported by implementation guidance consisting of illustrative financial statements and a presentation and disclosure checklist and free to download training material developed by the IASC Foundation, so costs of implementation are minimal.
- International acceptance and adoption (the IASB has indicated that 60 countries have already adopted or are planning to adopt the IFRS for SMEs) including the extensive due process under which the standard was developed.
- The increasing complexity of full IFRS will be separately considered and determined if appropriate by the IASB prior to being incorporated into the standard.
- It will only change every three years, which will slow down the pace of change for practitioners already struggling to keep up to date with compliance work.
- There is already a taxonomy available to enable users to do Standard Business Reporting from the IFRS for SMEs.
- Measurement rules are simplified, such that members working in smaller practices and business should be able to perform the computations required themselves without having to engage costly experts.
- It is specifically designed for users of private entity accounts and not those entities operating in the global capital markets where full IFRS is more suitable.

We realise that the IFRS for SMEs is not perfect. Application of IFRS for SMEs in the absence of a product such as RDR would disadvantage large listed groups with 100% owned subsidiaries as it would force additional consolidation adjustments. The income tax requirements, which were based on IASB's ED on income tax, now discontinued, are also generally agreed to be unsatisfactory. However, the IASB does acknowledge that the IFRS for SMEs is a work in progress and accordingly is setting up the SME Implementation Group. This group will be charged with answering implementation questions by means of published questions and answers and considering and making recommendations for changes to the IFRS for SMEs.

Another concern from some members and commentators about IFRS for SMEs is that it is prescriptive. Apart from financial instruments, it does not allow users to revert to a full IFRS treatment if they prefer it. For example, some entities would prefer (or may even be required) to revalue assets. This is not an allowable accounting treatment under IFRS for SME; thereby these entities may choose not to adopt the standard. Again, this is an area that could be raised with the SME Implementation Group.

Some members in the larger public practice areas favour strongly one recognition and measurement model for Australia, being full IFRS. They are concerned with creating two tiers of accounting professional and increased training and development costs. Whilst we understand these issues we consider that a full IFRS recognition and measurement model is far too complex and impractical for many smaller practitioners and their clients (particularly outside the major cities), as they mainly prepare SPFSs in the current environment. Often the SPFSs prepared today for these types of clients do not adopt the complex recognition and measurement of IFRS. Therefore, there is a large section of the accounting community not familiar with IFRS recognition and measurement so the cost of training and education of the RDR will be significant. The cost of providing appropriate training for IFRS for SMEs will be significantly lower than providing training for RDR. With IFRS for SMEs being widely adopted around the world any recruitment of overseas accountants into Tier 2 entities requiring the RDR will require significant training or will exclude those individuals from being able to be involved in the financial reporting process.

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

Our review of individual recognition and measurement differences reveals that in most cases the IASB has chosen the 'simpler' approach, and often an approach that is closer to cost than fair value measures. We support this approach and see this as generally advantageous in order to determine suitable recognition and measurement criteria for SMEs. We have provided some specific comments on some individual recognition and measurement differences below.

- While the amortisation of goodwill requirement in IFRS for SMEs has been criticised by some, we consider that many SMEs (some of which claim that their SPFSs are prepared using full recognition and measurement and have never consolidated any subsidiaries) would prefer this option to an annual requirement to fair value the business including the goodwill (which would often require external valuation support).
- As stated above, some SMEs would prefer or are required to revalue their PP&E. Therefore we would prefer IFRS for SMEs to have a link back to the full IFRS on revaluation of PP&E for entities to choose if they wanted.
- The tax requirements in IFRS for SMEs do not represent full IFRS nor are they simpler. We would have preferred an easier method to be included in IFRS for SMEs, such as the tax payable method. We note that many not-for-profit entities are exempt from income tax. Accordingly, any deficiencies in the tax requirements section are not a problem for them.

- 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;**

We support the examples given in paragraph 26 to amplify the definition of public accountability in paragraph 24.

- 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;**

We agree with the Tier 1 public sector entities suggested in paragraph 18(e) of ED 192. Some of our public sector members have indicated that the AASB proposal should have included additional guidance for categorising public sector entities as Tiers 1 or 2. We believe that such guidance is necessary to ensure a consistent approach across the government sector.

The reporting requirement of public sector entities is a topic under review in New Zealand. New Zealand proposals indicate a size approach in addition to requiring entities that are levers of coercive revenue as Tier 1. We consider that under the Single Economic Market Initiative this is a topic on which the accounting standards boards and regulators of both jurisdictions should work together.

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

We acknowledge that the reporting entity is not a mechanism used globally to enable differential reporting and that the recent IASB proposals use this same term in a different way. Therefore, this clearly needs to be addressed in Australia if our standards and accounting framework are to be consistent with international standards. However, the Australian community has effectively operated for many years with the reporting entity concept and the use of SPFSs for differential reporting purposes. There is no published empirical evidence that the current requirements have been damaging to business, the activities of not for profits, or the Australian public. Further, many of our members have

expressed their disappointment and frustration at the changes proposed in ED 192 to the reporting entity concept. SPFSs have allowed entities to meet the specific needs of users by picking and choosing and applying only relevant standards and ignoring irrelevant standards.

We accept that intuitively for some entities, this 'pick and choose' approach poses a greater risk than having one or two standard approaches apply. However, we do not consider the AASB has made a substantive case to support the change to the reporting entity concept. We consider this area to be a matter for government policy makers with the input from various regulators, rather than those involved in setting accounting standards.

Given that we consider the 'who is required to report GPFs' to be a matter of policy for lawmakers and/or regulators, changes in this area should be undertaken through normal due process mechanisms by these lawmakers and/or regulators. We acknowledge the recent work of some lawmakers to reduce the number of entities required to lodge statutory reports. However, as that work occurred in the current environment that gives primacy to the reporting entity concept it is not possible to determine whether due process was properly informed, as the expectation of many lodging entities would be a continuation of lodgment of SPFSs. We believe it likely that their response to the proposals of the lawmakers would have been different if they had been cognisant of a proposal to remove the reporting entity concept.

Some of the information in the consultation paper specifically relates to companies, such as the reference to proprietary companies in the Regulation Impact Statement in respect of the *Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007*. If it is determined that evidence exists that companies current reporting is inadequate, we would expect to see a change to the Corporations Act rather than a change to Accounting Standards that impact a range of other organisations. Further, the accounting bodies will work with the AASB to rectify some of the problems that have been identified with the current reporting mechanisms.

Further, if the changes proceed as proposed, we see some confusion with paragraphs 27 and 28 of the Exposure Draft. Paragraph 27 contains the 'publicly available' criteria, whereas paragraph 28 contains the criteria where the accounts indicate they are 'prepared in accordance with Australian Accounting Standards'. The wording of these paragraphs and how they inter-relate are confusing – leading to questions about associations, trusts and grandfathered companies. Many have read these two paragraphs only to conclude that only accounts that are publicly available are caught within the proposals. However our understanding is that paragraph 28 broadens the entities that the proposals will apply to, and that 'publicly available' is not the key criteria.

In relation to grandfathered companies, we are unsure where they fit within these proposals. One would expect if financial statements for a grandfathered company are prepared, not lodged and filed in the bottom drawer (i.e. not provided to any party) the entity could prepare SPFSs. However if the entity provided these accounts to any shareholder they would be required to prepare GPFs. It would seem inconsistent if all 'lodging companies' had to prepare GPFs but some 'non lodging' companies who also had the requirement to prepare accounts in accordance with 'Australian Accounting standards' were able to continue to prepare SPFSs. However given these accounts are never lodged, the exact form of accounts produced is unable to be determined. We seriously question whether this is a necessary decision of the AASB, or whether this relates to government policy and therefore should be left in the hands of the regulators. We would favour the latter approach in this regard.

Further, we understand that new Clarity Auditing Standards, applying for years commencing 1 January 2010, will require the auditor essentially to give an opinion on the accounting policies chosen by the entity. By making the auditor's engagement acceptance obligations more explicit in relation to an entity's accounting policies we understand this will increase the responsibility of the auditor. They will require the auditor

to assess the acceptability of the financial reporting framework prior to acceptance of an audit and report on the appropriateness of accounting policies in the audit report. These requirements are contained in ASA 210 *Agreeing the Terms of Audit Engagements* and ASA 800 *Special Considerations – Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks*. In contrast, under the current standards, the auditor has been able to express no opinion on whether the accounting policies used are appropriate to meet the needs of the members.

- 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;**

As stated above, we consider that Tier 2 should include an option to adopt IFRS for SMEs including its associated disclosures. Therefore, entities that do not need to adopt full IFRS recognition and measurement could alternatively adopt IFRS for SMEs. Some members have said that the disclosures in IFRS for SMEs are too onerous. IFRS for SMEs contain a maximum number of 310 disclosures. This compares to the current minimum number of disclosures that companies must comply with of 185¹. We agree that IFRS for SMEs disclosures could be reduced further, particularly in the area of reconciliation requirements. This is an area that could be explored with the IASB's SME Implementation Group.

We note that the disclosures proposed in the RDR framework total 625. However, the increases from the IFRS for SMEs proposals are mainly in the areas where full recognition and measurement are in accordance with full IFRS in contrast to IFRS for SMEs recognition and measurement. We are supportive of the rationale for the disclosures and the use of IFRS for SMEs as a base. Given this analysis, generally we support the level of disclosure proposed in ED 192, although note that the related party paragraphs would seem excessive for entities reporting within a wholly owned group context.

We agree that RDR would be effective in reducing the disclosure burden of entities currently preparing GPFs. However, we consider that it will substantially increase the disclosure burden for those entities currently producing SPFs, which will end up in Tier 2 under the AASB proposals.

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

See comment in f) above. Those of our members that would choose RDR rather than IFRS for SMEs are generally satisfied with the level of disclosure apart from the disclosure of related party transactions. In the case of wholly owned subsidiaries, we question the need to disclose details of the intercompany balances and transactions.

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

The transitional provisions outlined in paragraph 40 of ED 192 appear quite complex. We are unsure of the rationale why an entity would be required to apply AASB 1 *First-time Adoption of Australian Accounting Standards* for a second time in circumstances of any entity moving from Tier 2 to Tier 1 but having applied full IFRS recognition and measurement (and hence AASB 1) from 2005 when the entity first transitioned to the new standards.

¹ Includes the requirements of AASB 101 *Presentation of Financial Statements*, AASB 107 *Statement of Cash Flows*, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* and AASB 1048 *Interpretation and Application of Standards*

We also note that IFRS for SMEs contains transitional provisions to enable entities to move in and out of the scope of IFRS for SMEs. On the basis that alternative approaches were provided to Tier 2 entities (i.e. RDR or IFRS for SMEs), some thought would need to be given to transition between these approaches.

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

We have been challenged gathering data and analysis with the unusually compressed timeframe. This comment is particularly relevant as compliance with the AASB proposals in ED192 is highly likely to materially increase the cost burden of a significant number of the many private entities currently producing SPFSs. This appears to be an outcome inconsistent with the Australian Government's policy settings. Given the above, it is important that a comprehensive regulatory impact statement be published along with empirical data outlining why the current financial reporting regime is in need of a major overhaul.

Initially, we found difficulty determining support or otherwise for some of the changes proposed, given the apparent lack of published empirical research into the needs of users of private company accounts. Therefore in order to assess whether the proposals were developed in response to a perceived need articulated in earlier submissions, we reviewed the public submissions received on ITC 12 *Request for Comment on a Proposed Differential Reporting Regime for Australia and the IASB Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities*.

As a result of our review of the published ITC 12 submissions, we concluded that the ED 192 proposals were not generally reflective of those respondents.

Analysis of our findings

There were 71 submissions on ITC 12 published on the AASB website. Of these:

59	83%	Wanted to keep the reporting entity concept (i.e. retain SPFRs) for various reasons
11	15%	Wanted to be able to use the IFRS for SMEs
9	13%	Dislike the IFRS for SMEs ED because of the differences in recognition and measurement
5	7%	Thought the IFRS for SMEs ED was still too complicated
5	7%	Wanted the reporting entity concept abolished
2	3%	Proposed schemes not dissimilar to RDR

Note – these numbers will not add up to 100% because a number of letters made more than one major point.

From this analysis, we can see that the majority of respondents were seeking simplicity in both measurement and disclosure and still support the reporting entity concept.

Interaction with other legislation

As a regulatory impact statement has not been provided, we are unable to determine if the AASB has given practical consideration to how its proposals interact with other legislation. Page 8 of the Consultation Paper states that:

“the AASB encourages other regulators ... to review their positions to ensure that those requirements remain compatible with the revisions to the Australian differential reporting framework and GPFSS”.

However, given the variety of state and federal regulation that includes reference to financial reporting we consider this is an exercise that should be included as part of a regulatory impact statement.

We note that the change in the applicability of standards to GPFs, whilst described in the proposals as a 'clarification', results in all entities governed by legislation or a constitution that uses the words 'Australian Accounting Standards' to be included within the scope of the ED 192 proposals. We understand that across Australia those entities within Tier 2 would include:

- 4393 large proprietary limited and 1714 "grandfathered" proprietary limited companies (based on information lodged with ASIC in the 12 months to 30 June 2007 [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Corporations_Act_entities_with_financial_reporting_obligations_1.pdf/\\$file/Corporations_Act_entities_with_financial_reporting_obligations_1.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Corporations_Act_entities_with_financial_reporting_obligations_1.pdf/$file/Corporations_Act_entities_with_financial_reporting_obligations_1.pdf));²
- 7064 unlisted public companies other than those limited only by guarantee (source as above);
- approximately 5500 unlisted public companies limited by guarantee (based on our assessment of the proposals to be included in the Corporations Amendment [Corporate Reporting Reform] Bill 2010);
- approximately 7800 incorporated associations (based on our assessment of the current reporting requirements of the states and territories [with the exception of New South Wales and Victoria] and the proposals being developed in New South Wales and Victoria);³ and
- 35 to 850 cooperatives (based on our assessment of the range of proposals for reduced reporting requirements in the Ministerial Council on Consumer Affairs proposed cooperatives national law).

We note that the number of Australian unit trusts not subject to the application of the Corporations Act and having trust deeds that require financial reporting in accordance with Australian Accounting Standards is not known, nor do we know the number of public sector and other entities that might be within Tier 2.

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

As stated in i) above we consider that compliance with the AASB proposals in ED192 is highly likely to materially increase the cost burden of a significant number of the many private entities currently producing SPFSs. This appears to be an outcome inconsistent with Australian Government policy settings.

We agree that the costs for entities currently producing GPFs are likely to reduce under the RDR proposals. This impact is mainly in the area of financial instrument disclosures and business combination disclosures. However, we are not aware of any pressure from these entities for concessions from disclosures in any form.

We also foresee additional indirect costs to users of the proposals. The RDR is a purely Australian project that will involve the AASB in constant review and decision making as to which changes introduced by the IASB should not apply to Tier 2. IFRS for SMEs will only be updated once every three years; consequently the AASB will not be able to rely on the decisions and due process undertaken at an international level in this regard. Such indirect costs will affect the resourcing and funding of standard setting in Australia.

In preparing our response to ED 192, we commissioned two national mid-tier accounting firms (from different states, with one operating out of a capital city and the other a major regional city) to assess the cost impact of RDR versus IFRS for SMEs. They each chose

² As stated in e) above we believe the applicability of the new proposals to grandfathered companies is dependent on whether the prepared financial report is distributed to shareholders.

³ It is not clear what will be the future financial reporting position of another 37700 incorporated associations who currently lodge on the public record financial statements that are prepared in accordance with statutory requirements such as proper accounting standards, fair presentation or properly recording assets and liabilities and income and expenses.

three clients preparing SPFSs with 'simplified' recognition and measurement that will be impacted by the current proposals. The firms found that typically those clients would incur a materially greater cost burden when applying the more onerous requirements under RDR than would be the case if they had applied the simplified recognition and measurement requirements and the reduced disclosures of the IFRS for SMEs Standard. We also note that regardless of which of the two sets of accounting standards are used the studied entities will need to expend more time and effort in the preparation of GPFS and incur an increased cost of audit. Details of the findings are attached in Appendix B.

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

CPA Australia and the Institute do not consider the proposals are in the best interest of the Australian economy as a whole and appear contrary to the government's commitment to reducing red tape. In many cases, the proposals will increase compliance costs and complexity on the SME market compared with international equivalents and our members have indicated that the users do not need the additional information. Without a detailed regulatory impact statement, the impact cannot be properly assessed.

Since 2005, Australia has been challenged by its IFRS branding and positioning in the global accounting community. This challenge has come from the reference to 'Australian Accounting Standards' in contrast to the use of the term 'International Financial Reporting Standards'. While this challenge has been partly addressed, looking ahead at the proposals in ED 192 that adopt an IFRS oriented Australian specific standard, those past branding and positioning issues could re-emerge. This gives us cause for concern for Australia's reputation around the globe as well as the ease of transition of skills between jurisdictions. We believe that providing an existing international standard, IFRS for SMEs, as an available option for entities to adopt will enable Australia to have more than one framework on which financial statements can be based which will consequently allow the market to determine the preferred solution for Australian private entities.

Method

CPA Australia and the Institute approached several medium-sized practices to participate in a comparative study of the AASB's proposed reduced disclosure regime (RDR) and the IFRS for SMEs Standard to ascertain the difference in levels of potential burden on entities currently preparing Special Purpose Financial Statements (SPFSs).

Participants

Two national mid-tier accounting firms agreed to undertake this field testing, each practice testing three clients that would fall into Tier 2 under ED 192. One of the firms was located in a capital city, the other operated out of a major regional city in another state. Structures tested included large proprietary companies, trusts whose trust deeds require the application of applicable accounting standards and not-for-profits with lodgement requirements that require the use of applicable accounting standards.

Each firm had three partners handling audit work and the audit fee income from that section of each practice is approximately \$2m.

The composition of the fee base was different between the two practices: Practice A's audit practice was mostly companies, while Practice B was 82% associations, by number of clients. Both practices do a significant percentage of SPFSs. Of these SPFSs, Practice A has 61% that do not comply with the full recognition and measurement requirements of IFRS and Practice B has 100%. We have no reason to believe that the client demographic of these practices is not representative of the clients of medium sized practices more generally.

Results

Application of accounting standards in the financial reports

None of the 6 entities selected for testing currently apply full IFRS recognition and measurement on the grounds of cost/benefit and user needs.

There was variety in the recognition and measurement standards that entities had chosen not to adopt, as each operated in different industries. However some common themes emerged. Both practices had a client that chose not to account for long-term employee benefits at present value and both practices had clients that had chosen not to consolidate or not to adopt equity accounting as the users were satisfied with separate financial statements for their investments.

Similarly, there was variety in where each client had chosen to reduce disclosures, but both firms had clients that omitted disclosures required by AASB 7 *Financial Instruments: Disclosures*, AASB 112 *Income Taxes* and AASB 124 *Related Party Disclosures*. AASB 7 disclosures were considered excessive for SMEs and in fact have been largely omitted from RDR.

Practice A had clients that account for taxes on the tax payable basis. Practice B clients appear to comply with AASB 112, but taking into account the other recognition and measurement simplifications adopted, compliance with AASB 112 may be less arduous than it would be under full IFRS recognition and measurement.

AASB 124 disclosures were generally omitted on the grounds that they would not provide management with useful information and the cost of preparation outweighs the benefits. Management were also concerned about privacy issues. ED 192 has mainly cut out those paragraphs of AASB 124 that apply to disclosing entities.

Practice B also had a client involved in agriculture. It had chosen to apply a historic cost approach rather than AASB 141 on the grounds that the client finds it easier to determine actual costs than fair values.

Appendix B (Continued)

Research into the impact of RDR commissioned by CPA Australia and the Institute

Cost implications of changing the disclosure regime

Both firms estimated the additional hours required of preparers and their auditors to conform with the requirements of IFRS for SMEs and RDR. These results can be summarised as follows:

	IFRS for SMEs Additional Hours	Reduced Disclosure Additional Hours	RDR % increase	Client's preference⁴
Practice A				
Client 1	89 (of which 60 is accounts preparation)	104 (of which 70 is accounts preparation)	17%	Undecided
Client 2	126 (of which 84 is accounts preparation)	131 (of which 87 is accounts preparation)	4%	Undecided
Client 3	45 (of which 15 is accounts preparation)	65 (of which 35 is accounts preparation)	44%	IFRS for SMEs
Practice B				
Client 1	65 (of which 45 is accounts preparation)	67 (of which 47 is accounts preparation)	3%	IFRS for SMEs
Client 2	21 (of which 13 is accounts preparation)	33 (of which 24 is accounts preparation)	57%	IFRS for SMEs
Client 3	78 (of which 35 is accounts preparation)	122 (of which 57 is accounts preparation)	56%	IFRS for SMEs

Conclusion

Our field testing gives us reason to believe that a significant number of Australian entities would be exposed to a materially greater cost burden when applying the more onerous requirements under RDR than would be the case if they applied the simplified recognition and measurement requirements and the reduced disclosures of the IFRS for SMEs Standard. We also note that regardless of which of the two sets of accounting standards are used the studied entities will need to expend more time and effort in the preparation of General Purpose Financial Statements (GPFS) and incur an increased cost of audit, particularly in regards to the preparation and auditing of consolidated financial statements (Practice A – Client 2 and Practice B – Client 3). It is not clear from ED 192 what benefits either the entities or the community as a whole would derive from incurring these extra costs.

From these results we can see that the non-reporting entities studied are making decisions on the applicability of accounting standards based on user needs. These entities are interpreting the reporting entity concept as allowing them to adopt simpler recognition and measurement techniques than are available in full IFRS, even entities reporting and lodging under the Corporations Act.

⁴ The option of retaining the status quo was not offered in the question. Testers had to choose between RDR and IFRS for SMEs

CPA Australia, the Institute and the National Institute of Accountants supported the exploratory research conducted by Karen Handley "The Differential Reporting Survey" and in February and March 2010 gave her access to their membership. Of the 241 completed responses, 47 respondents do not prepare financial statements for Australian purposes. Of the remaining 194 respondents, 35% are CPA Australia members, 50% members of The Institute of Chartered Accountants in Australia (the Institute) and 15% members of the National Institute of Accountants (NIA).

The research instrument required self-identification by respondents as being either in public practice or not. There are 77 public practice respondents and 117 respondents who are not. The high-level demographic profile of the type of entities that the 117 respondents worked in includes for-profit entities 65% and public not-for-profit entities 19%. 60% of public practice respondents identified as Partner/Director and the same percentage of the not-public practice category identified as Senior Management.

The not-public practice respondents were asked, "Would you be likely to use IFRS for SMEs accounting standard as an alternative to full IFRS for reporting entities, if the AASB allowed it as an option?" The ratio of respondents answering in the affirmative as compared with those answering in the negative is 1-6:1. When the assessment of answers was by 'awareness of the requirements of IFRS for SMEs' the ratio of respondents answering in the affirmative compared with those answering in the negative is 2-2:1. When the same type of question was put to public practice respondents with an awareness of IFRS for SMEs, the ratio of affirmative to negative responses is 6-4:1.

Another significant finding of the exploratory study is respondent confusion over the current use of current terminology, for example the reporting entity concept. Handley's sample suggests that 'there is not a uniform application of the reporting entity concept in Australian entities at present'. These preliminary findings indicate a different position to that articulated by the AASB in the Consultation Paper. One of the reasons the AASB does not support IFRS for SMEs is because they consider it a retrograde step given the adoption of full IFRS already in Australia. The findings of this study indicate no wholesale adoption of full IFRS in Australia.

More detail on this survey can be obtained directly from the submission prepared to the AASB by Karen Handley.