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

Our ref Submission - ED 192

23 April 2010

Dear Sir

Submission - ED 192 Revised Differential Reporting Framework

We are pleased to have the opportunity to comment on ED 192 *Revised Differential Reporting Framework* and the Consultation Paper *Differential Financial Reporting – Reducing Disclosure Requirements* issued by the Australian Accounting Standards Board.

The proposed measures certainly represent a substantial and long overdue reform in financial reporting in Australia.

Executive summary

The key issues discussed in this submission are as follows:

- We support the introduction of a second tier of reporting requirements for preparing general purpose financial statements for certain entities.
- We concur with the Tier 2 proposed reduced disclosure regime and the decision not to offer IFSR for SMEs as an alternative at this time.
- Overall we support the definition of public accountability with some additional qualifying comments.
- We do not support Government Departments, Government Business Enterprises and Statutory Authorities being automatically categorised as Tier 1 entities.
- We concur with the updated definition of general purpose financial statements.
- Our view is that additional work on reducing the disclosure burden for Tier 2 entities should be undertaken.

- We agree with the transitional requirements on initial adoption of the proposed framework, but would like further consideration of the proposed requirements when for-profit private sector entities subsequently move from Tier 2 to Tier 1.

Other comments

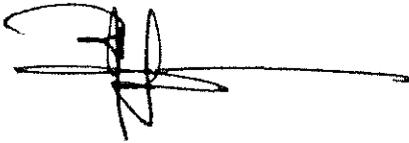
We are unsure how 'grandfathered' proprietary companies will be impacted by these proposals. It would be helpful if the AASB could clarify the impact so as to avoid a potential source of confusion.

Our comments on the specific matters raised for comment and on other issues are set out in Appendix 1.

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We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact me on (03) 9288 5423, or Michael Voogt on (02) 9455 9744.

Yours faithfully



Bernie Szentirmay
Partner, Department of Professional Practice

Appendix 1

Topics that the AASB has requested specific comments on.

Whether you agree with the introduction of a second tier of reporting requirements for preparing general purpose financial statements for certain entities.

Yes, we agree.

The introduction of a second tier of reporting requirements is welcomed and over due. There are a number of entities that prepare financial statements that would benefit from the reduction in the disclosure requirements that apply under full Australian Accounting Standards.

In our view the proposed additional tier of reporting would provide an opportunity for such entities to disclose sufficient information to satisfy public interest in profitability, solvency and liquidity without imposing unnecessary costs and disclosure obligations.

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?

Yes, we agree. We also agree that this question should be seen as independent of the change in definition of general purpose financial statements and modification of the reporting entity concept.

Given the history in Australian of applying IFRS to all entities we believe that the most effective and cost efficient approach is to not adopt IFRS for SMEs at this point in time. We concur with the reasons outlined in paragraph 5.10 of the AASB's Consultation Paper. Tier 2 builds on the decision in 2005 to apply recognition and measurement requirements of IFRS to all entities, while providing relief from all Accounting Standard disclosure requirements.

While not initially offering IFRS for SMEs as an alternative in Australia we concur that Australian entities are unlikely to be at a significant disadvantage to equivalent entities in other jurisdictions which have adopted IFRS for SMEs. Similarly we have not identified any strong advantages that the IFRS for SMEs framework has over and above the proposed Tier 2 framework.

Further, we agree that the AASB should continue to monitor developments in the IFRS for SME space and the impacts of its adoption by other overseas jurisdictions in the longer term. Should this direction help satisfy Australian financial reporting needs the decision on whether to offer this as an alternative or replacement financial reporting framework should be assessed at that future point in time.

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.

Overall we support the definition of public accountability, but offer the following comments.

We agree that a listed entity or an entity in the process of obtaining a listing should be considered to be publicly accountable. However, we have a general concern that the definition of a “public market” is not clear enough, notwithstanding existing guidance included in AASB 8 *Operating Segments* and AASB 133 *Earnings per Share*. While the example of registered management investment schemes is now dealt with by the guidance in paragraph 26 of the ED, there maybe other areas where further clarity around the definition of a “public market” would be desirable.

The process of issuing debt or equity instruments for trading in a public market can take various forms and occur over varying time periods. It would be advantageous if the AASB could provided some more guidance to indicate what factors should be considered. For example, when the directors initiate an investigation to determine whether listing is desirable/possible all the way to when an offer document is issued to the market. This process may occur over a number of reporting periods.

In respect of insurance companies we would question whether all insurance companies should be considered publicly accountable – specifically captive insurers. For example, a large group may include a subsidiary that provides self-insurance for a specific insurance risk for the entire group. There is unlikely to be a broad group of outsiders involved nor onerous regulatory requirements when compared to, for example, general insurers. What purpose is served by requiring this entity to be categorised as Tier 1?

In relation to superannuation plans registered with APRA we would question whether Small APRA Funds (SAFs) should be considered publicly accountable. While financial statements are lodged with APRA they are not publicly available. Further, APRA does not mandate that general purpose financial statements are required. Given the small number of members of the many individual funds (usually no more than three) and the limited users of the financial statements, special purpose financial statements are often prepared. It is our understanding that a large number of SAFs are similar in nature and size to self-managed super funds which are ‘regulated’ by the Australian Taxation office and would not be included in the list of types of entities deemed to have public accountability. .

In terms of an entity being ‘in the process of issuing’ debt or equity instruments for trading in a public market.

We concur with only using the definition of public accountability for the for-profit private sector.

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 would support Government Departments, Government Business Enterprises and Statutory Authorities not always being automatically categorised as Tier 1.

The above types of entities are wide and varied and could be entities with expenditures and net assets in the millions or thousands. Given this we would support an approach were these types of entities default to Tier 2, with the caveat that the public sector entity that 'regulates' the respective entities will nominate if individual entities should apply the disclosure requirements of Tier 1.

This approach would result in entities of similar natures and sizes to large proprietary companies achieving the same financial reporting requirements.

We concur with the decision to categories universities as Tier 1.

The clarification of the meaning of GPFs and modifying the way the reporting entity concept is used.

Overall we support the updated definition of general purpose financial statements. This is an improvement on the proposals contained in ITC 12 *Request for Comment on a Proposed Revised Differential Reporting Regime for Australia*.

We support the direction of this ED in that the AASB does not determine the reporting mandate for individual entities which are required to prepare financial statements. Rather the AASB provides appropriate frameworks, and a regulator may then determine which one is appropriate for specific types of entities. Where no regulator exists the key stakeholders then undertake this determination.

We support a view that all Corporations Act entities that are required to produce financial statements and lodge them with ASIC should have a level playing field. To this end, we are supportive of the ASIC view on recognition and measurement. From a practical perspective, whilst it may be that not all Corporations Act entities are currently applying all recognition and measurement requirements, it is necessary for these proposals to move forward. This should not promote or develop a culture of non-compliance. In our view, such an argument only highlights the potential shortcomings of the current reporting framework.

We concur with the long three year lead time before mandatory application of the proposals contained in this ED. This should provide adequate time for either:

- various regulators to consider the issue, complete consultation and arrange for changes to law, where necessary
- owners of individual entities which are not regulated to consider, consult with appropriate stakeholders and arrange for the amendment of governing documents, where necessary.

It is unfortunate that these one-off costs will need to be incurred, but it is necessary to receive other potential benefits from these proposals in the future.

At present, the reporting entity concept is a subjective way to categorise entities between those that may prepare special purpose financial statements and those that are required to prepare general purpose financial statements.

Finally, we do not see a strong need to retain the reporting entity concept in the Statement of Accounting Concepts. However, we do acknowledge that it may prove a useful input when regulators assess whether entities should be required to prepare general purpose financial statements.

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 GPFSSs.

Comments on particular disclosure requirements that have been retained or excluded from the RDR.

Overall we support that approach taken by the AASB as outlined in your Consultation Paper. However, when considering the 'user need' and 'cost-benefit' principle, further work should be completed. This feedback is based on discussions with a number of financial statement preparers and users.

In general, we identified two high level areas:

- Disclosure requirements where the information largely exists elsewhere in the financial statements. For example the roll forward type disclosures required the following accounting standards:
 - AASB 116 *Property, Plant and Equipment*
 - AASB 117 *Leases*
 - AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*
 - AASB 138 *Intangible Assets*.
- Disclosure requirements in complex/detailed accounting areas where most, if not all, financial statement users did not have the knowledge to use the information presented. Financial statement preparers would note that these entities do not have the same sophisticated users as a publicly accountable entity would. Further they would argue that these disclosures do not add to the understandability of the financial statements for their users and stakeholders.

Examples of such disclosures include detailed reconciliation disclosures required by AASB 112 *Income Taxes* and disclosures around defined benefit plans required by AASB 119 *Employee Benefits*.

In addition, we offer the following specific comments:

- Consolidation of intermediate parents – in a number of cases intermediate parent entities will not be in a position to claim the relief provided in paragraph 10 of AASB 127 *Consolidated and Separate Financial Statements*. For example, ultimate parent which is not publicly accountable (Tier 2) prepares consolidated financial statements. Intermediate parent is unable to utilise the relief in AASB 127.10 as the ultimate parent cannot claim compliance with IFRS due to Tier 2 disclosure relief (AASB 127.10(d)).

This will also impact similar relief in paragraph 13 of AASB 128 *Investments in Associates* and paragraph 2 in AASB 131 *Interests in Joint Ventures*.

- We generally support a level of related party transaction disclosure as important to users of Tier 2 entities financial statements. However, we do not think that the disclosure of the total key management personnel compensation provides useful information in all cases. In many entities the focus would be on transactions with owners and their related entities.

We are still in the process in working through the proposed requirements standard by standard and would be happy to contribute further specific examples.

Transitional provisions for entities applying Tier 1 or Tier 2 for the first time and moving between Tiers.

We support the transition requirements on initial adoption of the changes provided in this ED.

Where a for-profit private sector entity subsequently moves from Tier 2 to Tier 1, i.e. after initial adoption of the changes proposed in this ED, it is required to apply AASB 1 *First-time Adoption of Australian Accounting Standards*. Application of AASB 1 requires entities to re-consider the mandatory and optional exemptions contained in the standard. In some cases this will result in changes to the 'opening balances', either by choice or otherwise. Overall this:

- would be seen as a time consuming exercise and for little perceived benefit, given the entities was complying with all recognition and measurement requirements and has previously applied AASB 1 at least once
- may serve to confuse users of Tier 2 financial statements – if already applying all recognition and measurement requirements why have the financial statements changed? Why have the prepares been allowed to make changes? It may create a misconception around the understanding of the requirements for preparation for Tier 2 entities.

We are concerned with the outcome that the above proposal produces. We understand that in order to state compliance with IFRS, the current literature would require a further application of AASB 1 (Australian equivalent to IFRS 1 *First-time Adoption of International Financial Reporting Standards*).

We would support the AASB's efforts in discussing this issue with the IASB to seek an exemption. Without this some entities may consider the costs of the exercise may exceed any benefits from being IFRS compliant.

Finally, there seems to be no specific guidance where a public sector for-profit entity wishes or is required to move from Tier 2 to Tier 1, after initial adoption of the changes proposed in this ED.

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

In general, we support the proposal that a differential reporting framework be established for the not-for-profit private sector entities and public sector entities. This will assist in providing some relief to certain entities from the costs of compliance with financial reporting requirements.

However, we would encourage the AASB to take further steps to encourage and take part in a review of the broader regulatory framework for private sector not-for-profit entities. Reform of the regulatory and financial reporting environment for the not-for-profit sector in Australia is long overdue. The economic and social importance of the not-for-profit sector in Australia is

well documented, however we believe that the regulatory environment in which it operates is inefficient and in need of fundamental reform. In its 2006 Research Paper, the Institute of Chartered Accountants in Australia called for regulatory reform, including the development by state and federal governments of a uniform 'Incorporated Associations' legislation and the development of a sector-specific accounting standard that can be applied to all private sector not-for-profit entities. We support that initiative.

The not-for-profit sector comprises entities that include arrangements as diverse as church sponsored organisations, equitable trusts, entities incorporated under State based associations legislation and companies limited by shares or guarantee under the Corporations Act. This complexity, coupled with

- the size, diversity and economic significance of the operations of many participants in the sector
- the public policy issues associated with the tax exempt status and reliance on government and community financial support
- the risk of regulatory failure

has important implications for the governance, accountability and regulation of the sector.

For these reasons we believe that a broader consideration of the regulatory environment is required.

Whether, overall, the proposals would result in reducing the costs of preparing GPFSS that would remain useful to users.

We believe that overall this is hard to absolutely determine or quantify. What is clear is that the outcome will be different for different types of entities.

Under the proposals contained in this ED it could be argued that there are potential benefits for some entities in applying the reduced disclosure requirements. For example, a large proprietary company that has previously prepared general purpose financial statements.

However, as acknowledged in the Consultation Paper there will be a number of entities that may be required to disclose additional information than has previously not been required. For example, those large proprietary companies previously preparing special purpose financial statements.