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ITC 39

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Kris Peach
Chairman and CEO
Australian Accounting Standards Board
PO Box 204
Collins Street West VICTORIA 8007

Dear Kris,

Request for Comment on Phase 2 of the Consultation Paper "Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems"

Ernst & Young Australia is pleased to comment on the above Consultation Paper. We welcome the opportunity to contribute to the future of financial reporting in Australia. The focus of our response is from the for-profit sector point of view, given the decisions reached at the AASB's September 2018 Board meeting.

We believe the issuance of the Revised Conceptual Framework ("RCF") creates an opportunity for the AASB to consider Australian specific amendments in its adoption in Australia, including the maintenance or removal of the Australian concept of the "reporting entity". Determining whether an entity is a reporting entity can result in varying interpretations and inconsistent application of the concept. We believe the AASB is considering appropriate options for resolving this matter. We consider it necessary for the RCF to be implemented in Australia by 1 January 2020.

We support the maintenance of two tiers of reporting within the General Purpose Financial Statements ("GPFS") framework. This assists the AASB strike a balance between the costs of financial statement preparation and the benefits users derive. We think in general the Policy Framework outlined in ED 277 provides a robust approach for determining reduced disclosure requirements for Tier 2 entities and we would support the completion of this project.

As we stated in our Phase 1 submission, we largely support the same recognition and measurement principles for all entities preparing financial statements.

Our detailed responses to the questions raised in Phase 2 in the Invitation to Comment are provided in the appendix to this letter. We would be pleased to discuss our comments further with either yourself or members of your staff. If you wish to do so, please contact Frank Palmer on (02) 9248 5555 or Tony Hanrahan on (03) 9635 4036.

Yours sincerely

Ernst + Young

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Specific matters for comment on Phase 2

Q11 – Do you agree with the AASB's Phase 2 approach (described in paragraph 166)? *Why or why not?*

Consistent with *The AASB's For-Profit Entity Standard-Setting Framework*, we believe the issuance of the revised Conceptual Framework (RCF) creates a need for the AASB to consider Australia-specific amendments in its adoption in Australia, specifically the maintenance or removing of the existing Australian concept of 'reporting entity'. Determining whether an entity is a reporting entity has resulted in varying interpretations and sometimes inconsistent application of the concept. Additionally, giving preparers the judgement for determining the applicable accounting standards is unique compared to international jurisdictions. We believe the AASB is considering appropriate options for resolving this matter.

We believe that the benefits to the Australian economy of a single set of accounting recognition and measurement rules across the for-profit sector and all entities outweighs potential benefits that may flow from adopting differing recognition and measurement rules for different entities. As a result we do not support option 2 (to operate two conceptual frameworks) of the Consultation Paper as this could, over time, lead to inconsistent accounting policies. Also, we do not support option 4 (do nothing and lose IFRS compliance) as outlined in the Consultation Paper as this would result in non-compliance with IFRS.

We support the maintenance of 2 tiers of differential reporting within the GPFS framework as this assists the AASB strike an appropriate balance between the costs of financial reporting and the benefits that users derive. For the Tier 2 reporting, we think there is merit in considering a cost /benefit analysis for consolidation as there may be circumstances where users of these reports may not be interested in consolidated results due to their interests held.

Q12 – Which of the AASB's two GPFS Tier 2 alternatives (described in paragraphs 167-170) do you prefer? *Please provide reasons for your preference.*

As we indicated in our response to ED 277 *Reduced Disclosure Requirements for Tier 2 Entities* (ED 277), overall we support the AASB's efforts to enhance Tier 2 reporting requirements. We think in general the Policy Framework outlined in ED 277 provides a robust approach for determining reduced disclosure requirements (RDR) for Tier 2 entities, and therefore this work should continue.

Under ED 277 the key disclosure areas were identified as (1) current liquidity and solvency of the entity and (2) transactions and other events that are significant or material to an understanding of the entity's operations as represented by the financial statements. We believe the proposed Specified Disclosure Requirements (SDR) will mean some disclosures of ED 277 in relation to the liquidity and solvency of the entity will be missed, such as:

- details of breaches of covenants during the year which triggered accelerated repayment which were remedied before year end; and
- qualitative disclosures of liquidity risk arising from financial instruments.

In addition, we disagree with requiring full disclosure of the four significant matter areas identified, unless these areas were all considered material to the entity. In other words, the extent of an entity's activities / circumstances would be a better indicator of the extent of disclosure for any particular matter.

Q13 – Do you agree that we only need one Tier 2 GPFS alternative in Australia (either Alternative 1 GPFS – RDR or the new Alternative 2 GPFS – SDR described in paragraphs 167-170)? *Why or why not?*

We agree that one Tier 2 GPFS alternative is ideal in Australia. We do not see the merits of further differential reporting unless clear principles could be articulated that differentiate the disclosures. We note the Board's current challenges in establishing a robust approach for determining one set of disclosures for Tier 2 entities.

Q14 – Do you agree with the AASB's decision that GPFS – IFRS for SMEs (outlined in Appendix C paragraphs 18 to 36) should not be made available in Australia as a Tier 2 alternative for entities to apply? *Please give reasons to support your response, including applicability for the for-profit.*

We agree. The reasons for this are outlined in our response to ITC 12 and ED 192 and are consistent with the reasons set out by the AASB in the Consultation Paper.

The IASB has added a feasibility study to its research pipeline regarding SMEs that are subsidiaries. The project's objective will be to assess whether to permit subsidiaries that meet the definition of a SME to use the recognition and measurement requirements in IFRS and the disclosure requirements in the *IFRS for SMEs*. The AASB should monitor this project as it may provide a path for Australia.

Q15 – If the AASB implements one of the two proposed alternatives (described in paragraphs 167-170) as a GPFS Tier 2, what transitional relief do you think the AASB should apply (in addition to what is available in AASB 1)? *Please provide specific examples and information.*

We believe the principles in AASB 1053 *Application of Tiers of Australian Accounting Standards* should be maintained. That is, no additional transitional relief is needed because we consider the application of AASB 1 *First-time Adoption of Australian Accounting Standards* is sufficient. We are not aware of any significant issues that have arisen in the application of AASB 1.

Q16 – What concerns do you have on consolidating subsidiaries and equity accounting associates and joint ventures as proposed in the AASB's medium-term approach? What transitional relief do you think the AASB should apply? *Please provide specific examples and information.*

No amendments have been proposed to AASB 10.Aus4.2. Since this paragraph was initially created with reference to a 'reporting entity' in the context of Australia's current SAC1 (ie the existence of users), we think this paragraph needs consideration:

Notwithstanding paragraphs 4(a) and Aus4.1, the ultimate Australian parent shall present consolidated financial statements that consolidate its investments in subsidiaries in accordance with this Standard when either the parent or the group is a <u>reporting entity</u> or both the parent and the group are reporting entities, except if the ultimate Australian parent is required, in accordance with paragraph 31 of this Standard, to measure all of its subsidiaries at fair value through profit or loss.

Where consolidated financial statements are prepared for the first-time (regardless of the tier of reporting), we believe the current transitional requirements of AASB 1 are appropriate.

Q17 – If the new Alternative 2 GPFS – SDR (described in paragraphs 167-170) is applied, do you agree that the specified disclosures would best meet users' needs? *If not, please explain why and provide examples of other disclosures that you consider useful.*

Please see our response to Q12, where we identify certain disclosures with respect to current liquidity and solvency that will be missed. In addition, we disagree with requiring the disclosures of all four significant matter areas identified, unless these areas were individually considered material to the entity.

Q18 – Do you have any other suggested alternative for the AASB to consider as a GPFS Tier 2 and whether this would be applicable for for-profit ~~and not-for-profit sectors~~? *Please explain rationale (including advantages and disadvantages and the costs and benefits expected).*

As per our response to question 12 above, we favour the GPFS – RDR approach as further developed by the AASB to enhance Tier 2 reporting requirements in its finalisation of ED 277.

Q19 – ~~Do you think service performance reporting, fundraising and administration cost disclosures for NFP private sector entities should be included as part of the chosen GPFS Tier 2 alternative?~~ *~~Please explain rationale (including advantages and disadvantages).~~*

Q20 – Are you aware of any legislation that refers to SPFS that might be impacted by these proposals? *If yes, please provide specific information.*

We are not aware of any such legislation.

<u>General matters for comment</u>

Q21 – *Whether The AASB's Standard-Setting Frameworks for For-Profit ~~and Not-for-Profit Entities~~ have been applied appropriately in developing the proposals in Phase 2 regarding the reporting entity problem (note the AASB will consult further on other NFP amendments required for the RCF).*

We believe the AASB's standard-setting frameworks have been appropriately applied in developing the proposals in Phase 2, subject to clarifying the AASB 10 matter discussed in Q16.

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

We are not aware of any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals. We strongly encourage those who set the requirements to prepare financial reports for different sectors and types of entities in Australia to consider the needs of users of financial information in their determination as to 'who' should prepare financial statements in accordance with AAS.

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

We believe the issuance of the RCF creates a need for the AASB to consider Australia-specific amendments in its adoption in Australia, specifically the maintenance or removing of the existing Australian concept of 'reporting entity'. To the extent Tier 2 GPFS are prepared we believe the ED277 project should be finalised.

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

We believe the issuance of the RCF creates a need for the AASB to consider Australia-specific amendments in its adoption in Australia, including the question of maintenance or removing the existing Australian concept of 'reporting entity'. We consider it the standard setter's responsibility to provide a framework for the preparation of financial statements in accordance with Australian Accounting Standards (AAS). We encourage others determining the need for preparing financial reports - across all sectors and types of entities in Australia - to consider the needs of users for entities to prepare financial reports in accordance with AAS.

Q25 *– Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.*

Please refer comments above.

Other comments

Appendix B comments:

- Throughout Appendix B we note that the application paragraphs continue to refer to entities required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act. Given the Corporations Act requires compliance with Australian Accounting Standards, we cannot see the need for distinction between paragraphs (a) and (b) in these application sections.