

1 September 2007

Mr David Boymal  
Chairman  
Australian Accounting Standards Board  
PO Box 204  
Collins Street West VICTORIA 8007



Dear David

**Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities**

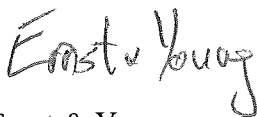
Ernst & Young Australia is pleased to comment on the above Invitation to Comment. We welcome the opportunity to contribute to the future of financial reporting in Australia.

Overall we do not consider that the proposals released by the AASB on Differential Reporting are in the best interests of the Australian economy, particularly given that Australian entities have already undertaken a significant and costly conversion process as part of preparing their first AIFRS accounts.

We see the future of financial reporting in Australia in a differential model based on the international concept of public accountability, with differentiation based only on simplified and reduced disclosure requirements. We consider that some of the improvements and simplifications proposed in IFRS for SMEs should be incorporated into full IFRS for the benefit of all entities rather than being used as the basis for a differential recognition and measurement system.

Our detailed responses to the questions raised 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 Annette Kimmitt on (03) 9288 8141.

Yours sincerely

A handwritten signature in cursive script that reads "Ernst & Young". The signature is written in black ink and is positioned above the printed name.

Ernst & Young

**(a) Do you agree with changing the application focus of Australian Accounting Standards from ‘reporting entity’ to ‘general purpose financial reports’?**

Ernst & Young agrees that the Australian ‘reporting entity’ concept needs revising. The subjectivity involved in determining whether an entity is a reporting entity has resulted in widely varying interpretations and inconsistent applications of the concept. Additionally, the concept has not been supported internationally and thus its use in determining the applicability of accounting standards is unique to the Australian reporting environment.

We therefore agree with changing the application focus of Australian Accounting Standards to ‘general purpose financial reports’.

However, please see our comments at (i) (page 8) below as we have concerns over the lack of clarity in the definition of a ‘general purpose financial report’.

**(b) If it is considered desirable to retain the reporting entity concept as the basis for differential reporting, what improvements could be made to remove related concerns (see paragraph BC6) and make it more effective?**

As noted above, we support removing the reporting entity concept as the basis for differential reporting. Additionally, we consider that the notion of ‘public accountability’ should be used as the basis for differential reporting, but with differentiation based only on simplified and reduced disclosure requirements.

The IASB defines an entity with public accountability as one that:

- files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or
- holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity.

The above definition would, in our view, provide a suitable basis for differential reporting in Australia subject to incorporating into that definition additional guidance to enable it to be sector neutral, thereby ensuring government bodies and some not-for-profit entities are also included as being ‘publicly accountable’. Further we would recommend that the AASB recommend to the IASB that they provide some further clarity around entities that hold assets in a fiduciary capacity.

**(c) Do you support the proposal to apply the IASB’s definition of a publicly accountable entity to differentiate between for-profit entities that apply Australian equivalents to IFRSs and for-profit entities that apply an Australian equivalent to the IFRS for SMEs?**

Ernst & Young supports using the notion of ‘public accountability’ as the basis for differential reporting (subject to incorporating into that definition additional guidance to enable it to be sector neutral) – but differential only to the extent of the disclosures included in financial statements.

Therefore, we do *not* support the proposal to use the IASB’s definition of a publicly accountable entity to differentiate between for-profit entities that apply IFRS versus those that would apply IFRS for SMEs.

The Financial Reporting Council’s decision to make adoption of IFRS mandatory for all Australian entities puts Australia in a unique position compared to the rest of the world. Most other countries adopted IFRS for listed entities only and maintained their local accounting standards for other types of entities, but all Australian entities have been complying with, at least, all of the recognition and measurement requirements in AIFRS since 1 January 2005. Australian entities have undertaken significant and costly conversion processes as part of preparing their first sets of AIFRS accounts. Therefore we question the public benefit of having certain classes of Australian entities – and the users of their financial reports – bear the costs of yet again converting to a new financial reporting framework, this time the IASB’s IFRS for SMEs which in many cases proposes different recognition and measurement principles compared to full IFRS.

Additionally, we believe that the overall benefits to the Australian economy of a single set of accounting recognition and measurement rules applicable across all sectors and all entities outweigh any benefits that might flow from adopting differential recognition and measurement rules. This is especially the case given that the costs of conversion to the recognition and measurement principles in full IFRS have already been incurred by Australian entities. The benefits to the Australian economy of a *single* set of recognition and measurement rules extend to:

- the mobility of accountants across entities and across industry sectors;
- the ongoing costs of training and maintaining a highly skilled accounting profession;
- the regulatory and other costs of maintaining two sets of generally accepted accounting principles; and
- the comparability of financial information across entities and across industry sectors.

As noted above, we *do* support use of the IASB’s definition of a publicly accountable entity to differentiate between entities that apply full IFRS versus those that would apply a new Australian standard specifically tailored to non-publicly accountable GPFs. However, we recommend that this standard be developed and maintained by the AASB to require all of the recognition and measurement principles of full IFRS but with reduced and simplified mandatory disclosure requirements.

We have attached to our comment letter a flowchart outlining the application of our preferred approach.

**(d) in respect of for-profit entities that do not satisfy the IASB’s definition of a publicly accountable entity, but are viewed as being important from a public interest perspective because of their large size:**

**(i) do you agree that such entities should in the public interest apply Australian equivalents to IFRSs and that it is appropriate to use size thresholds to identify these entities?**

We consider that the differential reporting criteria should be based solely on the ‘publicly accountable’ definition, but that it should not take size into account. Rather, it should focus on qualitative factors such as the nature of operations and ownership structure.

However, if size thresholds *are* adopted to extend the IASB’s definition of ‘publicly accountable’ to include entities that are of economic interest, we believe a process needs to be established to ensure that the size thresholds remain appropriate and relevant over time.

**(ii) do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds, and why?**

See our response to (i) above.

**(e) Since the IASB’s ED of a Proposed IFRS for SMEs has been developed with only for profit entities in mind, do you agree it is appropriate to adopt the forthcoming IASB’s IFRS for SMEs (after inclusion of Aus paragraphs similar to those included in Australian equivalents to IFRSs) in a differential reporting regime in respect of not-for profit private sector entities and public sector entities?**

On the basis of the FRC’s decision to adopt sector neutral Accounting Standards in Australia, we consider that the IASB’s definition of ‘publicly accountable’ should be extended to include public sector entities and certain not-for-profit private sector entities (to the extent they are required to lodge financial statements) based on the nature of their operations (see (b) above and (f)(i) below for more information).

**(f) In respect of not-for-profit private sector entities:**

**(i) is there a need for differential reporting in the not-for-profit private sector? If yes, do you agree with using size thresholds to distinguish between not-for-profit private sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalent to IFRSs)?**

We support differential reporting in the not-for-profit private sector on the basis described in (c) and (d) above. However we consider that the notion of differentiation by nature of operations has more merit than a differentiation proposal based on size alone.

We have also indicated our support for differential lodgement as indicated in our proposal submitted to Treasury on 3 August 2007. We support differential lodgement on the basis of the nature of operations rather than on size, as we do not consider size to be a suitable differentiator for not-for-profit entities given their inherent ability to raise money from the public in terms of charitable or fundraising activities.

Once an entity is required, by its nature, to lodge a financial report we consider that the nature of such not-for-profit entities would determine the appropriate financial reporting framework. This distinction could be based on an analysis of the stakeholders of the organisation combined with an assessment of needs of the stakeholders.

For example, charities and other organisations raising funds from the public require a higher degree of financial transparency and frequently use their financial reports as a means of fulfilling this need. Therefore classifying these entities as ‘publicly accountable’ thereby requiring compliance with Australian equivalents to IFRS, with full disclosures, is likely to be the most appropriate form of financial reporting for these organisations. Full disclosure is seen as ‘in the public interest’ for these types of entities that have fundraising or charitable objectives.

However membership, sporting and recreation not-for-profit entities are not established for the purpose of fundraising, with the members generally more interested in the area of service or performance accountability. Therefore they may not be regarded as ‘publicly accountable’ and therefore should be able to adopt reduced and simplified disclosure requirements as outlined in (c) above.

We do recognise that there exists in Australia some very large membership or sporting not-for-profit entities that have widely dispersed stakeholders and a significant impact on the community. However, we believe that if it is considered beneficial that such entities comply with the full requirements of AIFRS, any differentiation of reporting requirements should also be based upon the nature of the operations and the membership structure of these entities, rather than on the basis of an arbitrary size test.

**(ii) Do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate size thresholds and why?**

As mentioned in (f) (i) above, we do not support the introduction of size thresholds and would prefer a differentiation based on nature of operations rather than size.

However, if size thresholds were to be adopted for differentiation purposes, we believe that the AASB should complete an Impact Statement similar to that undertaken by Treasury in adopting the proposals under the Simpler Regulatory System to effectively gain an insight into the costs and benefits of requiring not-for-profit entities to prepare full AIFRS accounts.

- (iii) **Not-for-profit entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of \$500m revenue and \$250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of not-for-profit entities. Do you agree?**

No – see comments above.

- (iv) **Both private sector not-for-profit entities and public sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would need to prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?**

No – see comments above.

- (v) **Do you think a third tier of simpler reporting requirements should be added to cater for smaller not-for-profit private sector entities that prepare general purpose financial reports? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified? How would your answer to this question differ if the forthcoming IFRS for SMEs has fewer disclosures than the ED of A Proposed IFRS for SMEs?**

No – see comments above.

- (g) **In respect of public sector entities:**

- (i) **Is there a need for differential reporting in the public sector? If yes, do you agree with differentiating based on size thresholds between public sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalents to IFRSs)?**

We do not consider there is a need for differential reporting in the public sector since we consider that these entities should meet the definition of ‘publicly accountable’ and thereby be required to adopt AIFRS.

- (ii) Do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds and why?**

We do not agree with the proposed size thresholds. As noted above, we do not support differential reporting in the public sector, nor do we support the use of size thresholds as the basis for differentiation.

Nevertheless, if size thresholds were to be adopted for differentiation purposes, we believe that the AASB should complete an Impact Statement similar to that undertaken by Treasury in adopting the proposals under the Simpler Regulatory System to effectively gain an insight into the costs and benefits of requiring public sector entities to prepare full AIFRS accounts.

- (iii) Public sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of \$500m revenue and \$250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of public sector entities. Do you agree?**

No – see comments above.

- (iv) Both public sector entities and not-for-profit private sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?**

No – see comments above.

- (v) Do you think another tier of simpler reporting requirements should be established to cater for smaller public sector entities? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified?**

No – see comments above.

- (h) **Do you think there are approaches, other than the proposed approach based on public interest and employing size thresholds, that would reasonably distinguish between entities that should apply the Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs? If there are appropriate alternative approaches, please explain.**

We have proposed an alternative approach in our comments above.

- (i) **Do you agree that, consistent with the IASB's view of a general purpose financial report, under a revised Australian differential reporting regime:**
- (i) **all financial reports that are available on a public register, such as those prepared and lodged with the ASIC under the Corporations Act, should be regarded as general purpose financial reports; and**
  - (ii) **all financial reports that are made available to the public at large, such as those tabled in a Parliament, also should be regarded as general purpose financial reports?**

**If you do not agree, explain why.**

We note that the AASB has, since issuing ITC 12, decided to remove from AASB 101 the notions that financial reports available on a public register or available to the public at large should be regarded as general purpose financial reports (GPFRs). This is consistent with the IASB's own amendments to IAS 1. We are concerned that without additional guidance specifying the characteristics of a GPFR, applying the definition of a GPFR will result in entities having to make precisely the same judgments currently needed to be made in applying the reporting entity concept.

We therefore urge the AASB to undertake additional work to clarify the characteristics of a GPFR.

Note that we do consider that financial reports required to be lodged with ASIC and those tabled in Parliament are public documents and as such it should be clarified in any future reporting framework whether that makes them general purpose financial reports.

- (j) **Do you agree that, notwithstanding an entity having been exempted from filing a financial report with the ASIC, its financial report should be regarded as a general purpose financial report if it is required by the Corporations Act to be prepared in accordance with Australian Accounting Standards?**

We do not agree that the financial report of an entity that is exempted from lodging that report on a public register should be automatically regarded as a GPFR. We fail to see how such a financial report can be regarded as being prepared to meet the information needs of users who



are unable to command the preparation of reports tailored to their information needs, when there is no requirement to make that financial report available to such users. However, where these entities are required, under the terms of the exemption, to prepare financial reports in accordance with Australian Accounting Standards, they will be applying the Standards issued for the preparation of GPFRs.

- (k) **The Corporations Act includes three size thresholds respectively for revenue, assets and the number of employees to distinguish between small and large proprietary companies. The AASB’s proposed size thresholds only include the monetary thresholds of revenue and assets. Do you think that, except for the case of for-profit entities that are not publicly accountable but are important from a public interest perspective, a further size threshold for the number of employees would be appropriate under the proposed differential reporting for not-for-profit private sector entities and public sector entities?**

No. As noted above, we do not support the use of size thresholds as the basis for differentiation.

- (l) **Considering the AASB’s tentative decision to base the second tier of reporting requirements on the IASB’s pending IFRS for SMEs, do you consider that the IASB’s ED of A Proposed IFRS for SMEs is appropriate for Australian circumstances. If not, explain how it could be improved, or what other options are more appropriate and why?**

We believe that the benefits to the Australian economy of a single set of accounting recognition and measurement rules applicable across all sectors and all entities outweigh any benefits that might flow from adopting differential recognition and measurement rules. This is especially the case given the significant costs already incurred by Australian entities converting to the recognition and measurement principles in full IFRS.

The benefits to the Australian economy of a single set of recognition and measurement rules extend to:

- the comparability of financial information across entities and across industry sectors by users and preparers of financial reports;
- the mobility of accountants across entities and across industry sectors;
- the ongoing costs of training and maintaining a highly skilled accounting profession; and
- the regulatory and other costs of maintaining two sets of generally accepted accounting principles.

It is fair to say that the proposed IASB’s ED of A Proposed IFRS for SMEs is well written and more easily understood than full IFRS. It proposes some significant differences, improvements and simplifications to the measurement and recognition principles and the disclose requirements compared to full IFRS. However, we believe that some of these improvements and simplifications should be incorporated into full IFRS for the benefit of all entities, rather than being used as the basis for a differential recognition and measurement system.

However, for jurisdictions moving from local GAAP to IFRS, the IFRS for SME proposals may be considered a high quality comprehensive GAAP in this regard.

- (m) Do you think adaptations, or additional guidance, are needed (in addition to Aus paragraphs that would be included consistent with Australian equivalents to IFRSs) for not-for-profit private sector entities and public sector entities if the IASB’s IFRS for SMEs were adopted in Australia?**

No. Refer to commentary above.

- (n) Do you think Australia and New Zealand should seek to achieve harmonisation in their reporting requirements regarding SMEs?**

While harmonisation is a desirable goal, both Australia and New Zealand are at different stages in the adoption of IFRS. New Zealand SMEs have not yet gone through a full conversion to IFRS, whereas this is not the case in Australia. Therefore we believe Australia needs to reach an independent decision which is in the best interests of the Australian economy and the users of Australian financial reports.

- (o) Are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the preliminary views?**

None that we are aware of.

- (p) Do you think that the overall benefits that would arise from the proposals would exceed the overall costs? If you are an entity that prepares a general purpose financial report or would need to do so under the proposals, please advise us of any increased costs or any savings that would result from the proposals, and if possible, quantify them.**

For the reasons outlined in (c) and (l) above, we do not believe that the overall benefits of adopting the AASB’s proposals as currently drafted would exceed the overall costs.

- (q) Would the preliminary views be in the best interests of the Australian economy?**

As indicated in our comments above, we do not believe the AASB’s preliminary views to be in the best interests of the Australian economy.

