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Our ref ITC12-submission-2007-08-31.doc

3 September 2007

Dear David

**Submission - ITC 12 Request for comment on a proposed revised differential reporting regime for Australia**

We are pleased to have the opportunity to comment on ITC 12 issued by the Australian Accounting Standards Board.

**Executive summary**

The key issues discussed in this submission are as follows:

- We support the change in application focus of Australian Accounting Standards from 'reporting entity' to 'general purpose financial reports'.
- We support the concept of defining a group of for-profit entities that should apply full Australian equivalents to IFRSs (AIFRS). We have comments on the definition of publicly accountable proposed by the IASB.
- In general, we support the proposal that a differential reporting regime be established for the not-for-profit private sector entities and public sector entities. 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.
- We recommend the creation of an additional tier to the proposed differential reporting framework. This tier would apply all recognition and measurement requirements of full AIFRS, but receive relief from some of the presentation and disclosure requirements.

Given the comments contained in this submission we would recommend that the AASB consider re-exposing revised proposals for a differential reporting regime in Australia. We suggest that this occurs after the outcome of the IASB's SME project is known.

## **General issues**

It should be noted that our comments in this letter are based on the current IASB's proposals for an IFRS for SMEs. There may be some further simplification of the recognition, measurement and disclosure requirements as part of the exposure draft comment process. However, if the requirements for SMEs were significantly altered by the IASB in finalising the IFRS for SME Standard, our views may change.

## **Specific comments**

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

### **Reporting entity concept**

*Do you agree with changing the application focus of Australian Accounting Standards from 'reporting entity' to 'general purpose financial reports'?*

Yes, we agree.

The reporting entity concept is a subjective way to categorise entities between those that may prepare special purpose financial reports and those that are required to prepare general purpose financial reports.

Given interpretations of this subjective concept (for example, ASIC and the requirement that non-reporting entities should still apply all the recognition and measurement requirements in the AASB's, but need only apply some of the presentation and disclosure requirements), as a general rule, we would support a more objective test being put in place. The differential reporting framework proposed by ITC 12 provides an opportunity to achieve this – which is further discussed in this submission.

*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 and make it more effective?*

Not applicable

### **Publicly accountable**

*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?*

We support the concept of defining a group of for-profit entities that should apply AIFRS.

We have some specific issues with the IASB's definition of a publicly accountable entity:

- We agree that a listed entity or an entity in the process of obtaining a listing should not be an SME. However, we have a general concern that the definition of a “public market” is not clear enough, notwithstanding the additional clarification included in AASB 8 *Operating Segments* and AASB 133 *Earnings per Share*. By way of practical example, in the managed funds industry where units are issued by an unlisted fund to the public does this meet the definition of a “public market”. We would encourage the AASB to consider this definition outside the scope of ITC 12.
- We agree with the desire to include additional entities such as insurance entities, pension funds, mutual funds etc. in the definition of publicly accountable. However it is not clear to us what is meant by “fiduciary capacity” or “broad group of outsiders”. Fiduciary is not defined on the AASB web site. A dictionary defines it as held or given in trust, depending for its value on public confidence or securities. At a basic level what entity does not have some form of fiduciary capacity to its owners?

At a minimum further guidance should be provided if the AASB retains the IASB’s definition.

### **For-profit entities**

*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:*

- *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?*
- *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 see the need for an upper size threshold, that is the notion of publicly accountable should be a sufficient differentiator between for-profit entities who apply AIFRS and those who apply an alternate framework. If an entity is not publicly accountable, Australian equivalents to IFRS for SMEs (SME Standard) should be adequate regardless of its size in dollar terms (refer below for additional tier comments).

If the definition of publicly accountable does not capture a type of entity that the AASB would like to ensure applies full AIFRS then further consideration of the publicly accountable definition should be completed. We also need to ensure consistency with the requirement that all corporates who lodge financial statements with ASIC are required to prepare general purpose financial reports as they have economic significance. Economic significance does not equate to publicly accountable.

Given the government policy of retaining the grandfathering exemption at the last round of legislative changes it could be argued that including the proposed size thresholds would not be consistent with the policy direction of the corporate law economic reform program.

### **Additional 'Aus' guidance – Not-for-profit and public sector entities**

*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?*

In general, we support the proposal that a differential reporting regime be established for 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; and
- 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.

Refer to further discussion below in respect of not-for-profit private sector entities and public sector entities.

### **Not-for-profit entities**

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

- *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)?*
- *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?*
- *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?*
- *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?*
- *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?*

We agree that there is a need for differential reporting in the not-for-profit private sector.

We note that this area has been subject to recent discussion as a result of a Discussion Paper *Financial Reporting by Unlisted Public Companies* issued by the Department of the Treasury. We would recommend that the AASB defer further consideration on this topic until the outcome of this Treasury consultation process is determined. This process may result in certain not-for-profit private sector entities under the size thresholds proposed in ITC 12 having no reporting obligations at all.

Overall we would support the use of size thresholds combined with a 'nature of operations' concept as it is difficult to operationalise "public accountability" in the not-for-profit sector.

We agree with using size thresholds of revenue and assets and not using number of employees. Once defined, revenue and asset thresholds are readily understandable and can achieve consistency. We do not support using number of employees as given the use of voluntary labour in many entities in this sector it would not be viewed as a robust measure.

We support the 'nature of operations' discussion included in the AASB's letter to the Department of the Treasury dated 3 August 2007.

### **Public sector entities**

*In respect of public sector entities:*

- *Is there a need for differential reporting in 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)?*
- *Do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds and why?*
- *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?*
- *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?*
- *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?*

We agree that there is a need for differential reporting in the public sector.

However, we do not support the differential reporting framework proposed in ITC 12:

- We do not see merit in the higher degree of public interest justification provided by the AASB. We believe that public interest in the public sector is akin to shareholder interest and governance in a privately owned entity.
- The public sector also includes for-profit government owned entities. Why should the differential reporting framework produce a different outcome for a for-profit entity whether it be owned by a private shareholder or by a public shareholder? This cannot simply be explained by reference to a “higher degree of public interest”.
- Public sector entities will eventually need to be consolidated into a whole-of-government financial report (a similar issue to the wholly-owned for-profit subsidiaries issue discussed below).

We believe that it would be reasonable to create an additional tier in the proposed differential reporting framework. Refer below for further discussion.

If the AASB was to proceed with using size thresholds we agree that using size thresholds of revenue and assets and not using number of employees, as discussed above for the not-for-profit private sector entities, could be useful in defining a differential reporting framework for public sector entities. However, given the nature of some public sector entity business models the ratio of total assets as a percentage of revenues can be higher than say not-for-profit private sector entities. We would not recommend that the same dollar thresholds be used. Alternatively it might be appropriate to use a combination of both the revenue and asset thresholds.

### **Alternative approaches**

*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 recommend the creation of an additional tier to the proposed differential reporting framework. This tier would typically include companies which have public filing obligations either because of size or foreign ownership. We submit it is unreasonable to burden such companies with the full disclosure requirements of general purpose financial reports for both cost and competitive reasons. Companies in this category are already at a significant competitive disadvantage compared to grandfathered companies and trading trusts of equivalent size (or ownership) neither of which have public filing obligations.

In our view the additional tier of reporting would ensure that such companies disclose sufficient information to satisfy public interest in profitability, solvency and liquidity without imposing unnecessary costs and disclosure obligations.

The basis of this additional tier would be for entities to comply with the full AIFRS recognition and measurement requirements, but with relief provided for some of the presentation and disclosure requirements.

We recommend that there be clear legislative backing for the practice of applying all recognition and measurement requirements in the AASB's, but only some of the presentation and disclosure requirements.

The exact nature of the presentation and disclosure requirement exemptions should be subject to a separate exposure process by the AASB to get constituents to focus on those presentation and disclosure requirements that do not traditionally provide insight or value to typical users of financial reports for the types of entities included in this additional tier.

We believe the types of entities that should qualify under this tier include:

- Subsidiaries (wholly-owned or otherwise) who are consolidated into a group where the parent prepares general purpose financial reports which are made publicly available. Most likely the only users of these financial reports are the parent entity for consolidation purposes.

Refer to the discussion below on overall benefits.

- Foreign owned subsidiaries who are consolidated into a group where the parent prepares IFRS (or IFRS equivalent) general purpose financial reports which are made publicly available. It could also be argued that most likely the only users of these financial reports are the parent entity for consolidation purposes. However, it could also be argued that there may be some users who may wish to access a financial report that is prepared on a basis consistent with AIFRS.

The entities that would qualify for this additional tier should also be subject to a separate exposure process by the AASB to obtain consensus of constituents.

### **General purpose financial reports**

*Do you agree that, consistent with the IASB's view of a general purpose financial report, under a revised Australian differential reporting regime:*

- *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*
- *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 agree that all financial reports available on a public register should be regarded as general purpose financial reports – subject to the above discussion on our recommended additional tier.

We similarly agree that financial reports available to the public at large should be regarded as general purpose financial reports. However, the meaning of ‘otherwise made available to the public at large’ would benefit from some further clarification by the AASB. For example, an entity publishing its financial report (summarised or otherwise) on its web site, to save on copying and distribution costs, will probably be considered to have made the report available to the public at large, if access is not restricted to shareholders only. Does the AASB currently intend to capture these entities – even if they are for example small proprietary companies? Would this view change if the entity did not describe their financial reports as general purpose financial reports?

*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 believe that a grandfathered company should have to automatically prepare a general purpose financial report that complies with the all presentation and disclosure requirements in AIFRS.

By definition such a financial report is private with only a limited user group and only at the shareholders’ discretion. Therefore how does such a report meet the definition of a general purpose financial report as discussed in ITC 12?

“a financial report intended to meet the information needs common to all users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs.”

### **Proposed size threshold**

*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 – this issue has been subject to discussion above.

## IASB ED on SMEs

*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?*

Globally KPMG will provide a separate comment letter on the IASB's exposure draft, direct to the IASB.

## Other issues

*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 – this issue has been subject to discussion above.

As a general rule we do not support the widespread modification of IFRS standards in the Australian context, other than for direct application to the not-for-profit and public sector entities.

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

Yes – we believe that harmonisation would be desirable, but not crucial, given close economic relationship between the two countries.

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

Refer to the prior discussion on the Discussion Paper *Financial Reporting by Unlisted Public Companies* issued by the Department of the Treasury. Two bodies proposing different reforms through different pieces of legislation has the potential to make the reporting regime for not-for-profits even more complicated than it already is.

*Do you think that the overall benefits that would arise from the proposals would exceed the overall costs?*

We believe that overall this is hard to describe. The outcome will be different for different types of entities.

Under the proposals contained in ITC 12 it could be argued that there are potential benefits for some entities in applying a simplified Standard for recognition and measurement requirements, and hopefully reduced presentation and disclosure requirements.

However it has to be said that some entities will not see an overall benefit for reasons including:

- For some entities currently preparing special purpose financial reports (but under ITC 12 would be required to prepare general purpose financial reports) there may be additional disclosure requirements even if they elect to apply the SME Standard.
- Some argue that with the 2005 change from old Australian GAAP to AIFRS the accounting profession has been through a dramatic change. Entities have changed processes and reporting systems to comply with the new/changed recognition, measurement and disclosure requirements. Will entities have the desire or consider that the benefits of preparing simplified SME financial reports outweigh the costs of re-training staff and modifying reporting systems again – especially when they can elect to remain with the full AIFRS?
- Will groups of companies elect to apply the SME Standard when they are still required to prepare information for consolidation purposes which will most likely need to be prepared under full AIFRS?
- Grandfathered companies will be required to provide additional disclosures given the direction in ITC 12.

### **Transition issue**

Both ITC 12 and the IASB Exposure Draft do not provide guidance on how any entity practically accounts for a situation of having to apply the SME Standard then change to applying full AIFRS and then say go back to applying the SME Standard.

For example, under the current thresholds discussed in ITC 12 assume a large proprietary company at commencement of the SME Standard (say 30 June 2010) qualifies and decides to apply the SME Standard. How does it account for any necessary changes in accounting policies – for example property carried at a revalued amount?

Now assume the same company in say 30 June 2015 exceeds the thresholds and can no longer apply the SME Standard. How does it account for any necessary changes in accounting policies?

Now assume the same company in say 30 June 2025 no longer exceeds the thresholds and elects to apply the SME Standard. How does it account for any necessary changes in accounting policies? Will it have all accounting information to go back and say restate its properties back to cost?



*Australian Accounting Standards Board  
Submission - ITC 12 Request for comment on a  
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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 (02) 9335 7108, or Michael Voogt on (02) 9455 9744.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Chris Hall', written over a horizontal line.

Chris Hall  
Partner