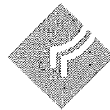
ITC 12 sub 67



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11 September 2007

Professor David Boymal
Chairman
Australian Accounting Standards Board
By email:
standard@aasb.com.au

Dear David

ITC 12: Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of a Proposed IFRS for SMEs

This submission presents our views and recommendations regarding issues raised in this Invitation to Comment issued by the AASB in May 2007.

In summary Pitcher Partners is concerned that there is an urgent need for a differential reporting regime in Australia, but we do ***not*** support adoption of the proposed IFRS for SMEs for the reasons outlined below. In particular we consider the adoption of the IASB's IFRS for SMEs will ***increase*** reporting obligations and is therefore contrary to Australian government policy for reducing the regulatory burden. We strongly refute the suggestion that public accountability, in the context of complying fully with accounting standards, includes lodgement on the ASIC database. Our reasons are provided below. We believe that the preparation of special purpose financial reports (SPFRs) by non-reporting entities is a preferable, timely, cost-effective solution where accountability to the public arises only through an entity's limited liability status. We consider that current perceived problems relating to application of the reporting entity concept should be addressed separately. For example, size thresholds (similar to those proposed for application of the IFRS for SMEs) could be incorporated into the reporting entity concept to improve clarity. Matters regarding enforcement should be addressed by the securities regulator and not by the accounting standard setter, who has no mandate for enforcement.

Further explanation of these views is provided below. Responses to specific matters requested for comment by the AASB in respect of ITC 12, are provided in the attachment to this letter.

Pitcher Partners supports the need for differential reporting

As previously examined in our paper "Differential Reporting – A Call for Legislative Reform" issued by Pitcher Partners in August 2006 to regulators and legislators (including the AASB), Pitcher Partner strongly supports the need for a differential reporting regime in Australia. Since 1 January 2005 the Australian Equivalents of International Financial Reporting Standards have been operative under the Corporations Act 2001. However, the nature of financial information produced in accordance with these accounting standards is often not relevant to the needs of entities that do not operate in capital markets (non-listed entities). Increasingly, non-listed entities are preparing statutory financial reports purely for compliance purposes, with the costs of compliance outweighing any benefits when the financial report contains information that is not useful or relevant to these entities. These matters were discussed in detail in the discussion paper and have not been repeated herewith.

Pitcher Partners does not support adoption of the IASB's IFRS for SMEs in Australia

Pitcher Partners does **not** support the differential reporting regime proposed in ITC 12. In our view, the proposals will ***increase*** the reporting burden for many SMEs and will not provide information with improved meaning. We consider that the proposals in ITC 12 are not consistent with government policy to reduce the regulatory burden for these entities and therefore we recommend that the AASB should not pursue the proposals put forward in ITC 12 for differential reporting.

Our reasons against adoption of the IFRS for SMEs are summarised as:

- IFRS for SMEs introduces mandatory disclosure requirements for all accounting standards. In many instances this will ***increase*** the reporting obligation for proprietary companies and increase their regulatory burden.
- In some areas the IFRS for SMEs introduces different criteria to the criteria required by full IFRS. This introduces a new range of problems for:
  - training and education (with a need to teach both methods);
  - internal quality control reviews;
  - systems development and selection of accounting programs, reporting templates and audit programs; and
  - (to a lesser extent) comparability of results of privately owned businesses with listed entities.
- An entity that transitions from proprietary company status to public company to publicly listed will need to adapt its accounting practices from IFRS for SMEs to full IFRS. This is likely to require changes to internal accounting systems and processes and an understanding of the differences that eventuate.
- Measurement and recognition criteria should be the same for all entities.
- For more complex accounting areas IFRS for SMEs often refers back to the full IFRS standard rather than presenting a simplified methodology. This means that knowledge of both sets of standards is required and raises questions as to the usability of "two books".
- IFRS for SMEs is derived from the "big book" but it is not possible to accurately determine whether this is a comprehensive self-contained document as currently users/reviewers of the document currently already have a working knowledge of the "big book".
- IFRS for SMEs will need to be separately updated each time an IFRS standard is reissued.

- IFRS for SMEs does not resolve any of the problems associated with the need for an appropriate reporting framework for not-for-profit entities, charities or government.
- Where IFRS for SMEs does not address an accounting issue, different results will eventuate depending on whether accounting principles in the small book or the big book are followed.
- It is unlikely that the IASB will issue the IFRS for SMEs within a suitable timeframe to enable problems in the Australian environment to be addressed promptly.

Pitcher Partners supports retention of the reporting entity concept and preparation of special purpose financial reports by non-reporting entities.

Although problems have been acknowledged regarding application of the reporting entity concept, we consider that the reporting entity concept is still valid and simply requires clarification. Our recommendation would be to restrict the definition of "reporting entities" to apply only to:

- Entities whose securities are traded on a public exchange; and
- Entities viewed as being important from a public interest because of their large size.

For example, the proposals for adoption of IFRS for SMEs include size thresholds for application of the full IFRS. The same criteria (consolidated revenue greater than $500m and consolidated assets greater than $250m) might be appropriate for application of the reporting entity concept. If these criteria were to be incorporated into the reporting entity concept the reporting burden would be significantly alleviated for the majority of non-listed entities.

There are significant benefits arising from preparation of special purpose financial reports prepared in accordance with the measurement and recognition criteria established in a single set of accounting standards (as applied to general purpose financial reports). These benefits include:

- Financial reports prepared by reference to only one set of accounting principles would enable consistent interpretation of key accounting measures such as revenue, expenses, profit, assets, liabilities and equity.
- Financial reports for subsidiary companies can be prepared in accordance with the same accounting measures as applied to the consolidated group, but can limit costs of compliance through reduced disclosures.
- Disclosure notes can be specifically tailored or limited to the needs of users when special purpose financial reports are prepared.
- As companies grow it is relatively simple to increase the level of disclosure and transition from SPFRs to GPFRs.
- It is preferable to have one set of standards for systems development, training and education, and pro-forma templates to promote comparability of financial information by external parties.

Pitcher Partners does not support the proposal that public accountability includes lodgement on the ASIC public database, thereby always requiring GPFRs to be lodged.

Pitcher Partners strongly opposes the suggestion that all financial reports lodged on the ASIC database should be general purpose financial reports. Paragraph 1.2(a) of the IASB

exposure draft states that an entity has public accountability if: "it files... its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market" (emphasis added).

Financial reports lodged with ASIC are ***not*** filed for the purpose of issuing securities in a public market. In fact the Corporations Act 2001 section 113(3) explicitly prohibits proprietary companies from issuing shares to the public.

There is an urgent need to understand what "public accountability" means in the context of the Australian regulatory system and to distinguish between different types of public accountability. For example, when an entity raises capital through public fundraising there is a need for public accountability to provide an explanation of how the resources provided by the public are used. This public accountability would be satisfied by reporting performance in accordance with accounting standards. In contrast, accountability to the public that arises through limited liability status is quite different as this accountability needs to satisfy the construct that debts will be paid as and when they fall due.

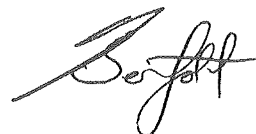
Public accountability in the context of limited liability, and the user needs for information that is required in that context, has not been researched or evaluated. Instead, by default alone, application of performance reporting in accordance with accounting standards is deemed to meet that requirement.

A further consideration is that lodgement on the ASIC database does not enable financial information to be made freely available to the public as this is a user-pays system where the context for lodgement is prescribed by the Corporations Act 2001.

Lodgement on the ASIC database by proprietary companies, which are economically significant entities, is a reporting requirement in response to limited liability status only. Proprietary companies are not able to offer securities to the public and therefore do not have a broader public accountability to explain performance, particularly at the level of detail captured by the disclosure requirements of accounting standards. Hence while it is appropriate to apply recognition and measurement criteria in accordance with accounting standards to ensure all debts are properly accounted for and consideration of going concern, extensive disclosure notes are not required to satisfy an objective of limited liability reporting.

Please do not hesitate to contact me if you wish to discuss further any matters arising from this submission.

Yours sincerely



S. DIANNE AZOOR HUGHES
Partner - Technical Standards

TERRY BENFOLD
Senior Audit Partner

ATTACHMENT

AASB specific requests for comment in ITC 12

(a) We do not support changing the application focus from "reporting entity" to "general purpose financial reports" as proposed.

(b) We support retention of the reporting entity concept. Although the *form* of this concept is not used internationally for the purpose of determining the application of accounting standards, *in substance* other jurisdictions have applied similar criteria to establish a differential reporting regime. For example, in the UK size criteria is used to assess economic significance and hence to determine the extent of public reporting of financial information required.

(c) We support the view that publicly accountable should relate to entities that issue securities to a public market (as per paragraph 1.2). However, we do not concur with the AASB's proposed interpretation that entities that lodge financial information on any public database are publicly accountable.

(d) We consider that application of the reporting entity concept provides a preferable methodology for identifying users' needs for financial information, by taking into account a range of factors rather than size criteria alone.

(e) We consider that the inclusion of "Aus" paragraphs simply provides a workable outcome when there is only one set of accounting standards. It is a "default" options that does not recognise the qualitative characteristics that drive user needs for financial information from not-for-profit entities, public sector entities or charities. The "Aus" paragraphs do not satisfy the objective of adapting accounting standards to present relevant information to users.

(f) We consider that the reporting needs of not-for-profit private sector entities have not yet been properly addressed by the AASB.

- The proposals for size thresholds are arbitrary solutions that do not go to the heart of the problem.
- Many requirements of the accounting standards do not provide relevant information for these entities and IFRS for SMEs does not resolve that issue.
- Incorporation of size thresholds as proposed may alleviate the cost burden but are unlikely to improve the quality of financial information.

(g) Refer to (f) above – these comments are also relevant to public sector entities.

(h) We do not support adoption of IFRS for SMEs for the reasons as explained in our submission.

(i) We do not concur with the AASB's interpretation of the IASB's view of general purpose financial reports as explained in our submission.

(j) We do not concur with the view that any entity preparing a financial report in accordance with the Corporations Act should prepare general purpose financial reports. Other sections of the Corporations Act are concerned with types of companies and the nature of their activities. However, the proposal does not refer to the nature of an entity. It does not distinguish between companies that raise funds from the public and have limited liability status, and companies that need to be accountable for their limited liability status only. The proposed approach does not adequately address the specific characteristics of the Australian reporting regime under the Corporations Act.

(k) We do not consider that the number of employees is a suitable characteristic for determining public interest in not-for-profit entities. Many not-for-profit organisations have voluntary workers who would not be included in the employee numbers, and therefore renders the measure inconclusive.

(l) We strongly oppose the AASB's proposals for introducing a second tier using IFRS for SMEs. This proposal introduces significant difficulties for education and training where a firm's client based includes a full range of entities from small privately owned businesses to large listed entities. Introduction of a second tier using IFRS for SMEs is likely to further disseminate the market for offering accounting and audit services and is likely to have an adverse impact on companies that wish to transition from privately funded to offering securities to the public.

(m) Refer to (f) above. These are simply "quick-fix' solutions.

(n) No. We see no reason for Australia to harmonise with the accounting requirements of a significantly smaller economy.

(o) We consider that if the proposals in ITC are implemented there will be increased costs of compliance and regulatory burden, which is contrary to government policy.

(p) No. We consider there will be additional costs incurred.

(q) No. We consider that the proposals will be detrimental to the Australian economy.

- As discussed above, they will create an increased regulatory burden.
- The transition from small to large business will be more difficult, requiring as a prerequisite, changes to an entity's internal accounting systems and processes.
- In the long term the proposals are likely to divide the market for accounting services even further if accounting firms decide to limit their training and potential practice risk to working only with full IFRS or IFRS for SMEs. A reduced level of competition in a market that is already dominated by four firms is not a desirable outcome for the business environment.