Group Accounting/Controller

ITC 12 sub 76

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The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
MELBOURNE VIC 8007

Dear David,

Re: Invitation 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

We refer to ITC 12 "Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of A proposed IFRS for Small and Medium-sized Entities" ("ITC 12") issued by the AASB in May 2007.

Given our year end reporting commitments, our response in this letter only addresses the AASB's preliminary views on differential reporting and the specific questions on these views, as set out in ITC 12. We will respond separately to the IASB on their Exposure Draft of "A Proposed IFRS for Small and Medium Sized Entities" by 1 October, with a copy provided to the AASB. We acknowledge, however, that the proposed requirements of the IASB's exposure draft are a strong influence in considering Australia's solution to differential reporting. In particular, we believe the views of respondents to the questions about differential reporting might be different if the means of delivering differential reporting (the IFRS for SME's) was different to that proposed by the IASB.

In the context of the IASBs exposure draft, we do not concur with the AASB's proposed differential reporting regime.

Special purpose financial reports

The BHP Billiton group has over 100 Australian subsidiaries, many of which currently prepare special purpose financial reports. These entities prepare special purpose financial reports on the basis of judgements made by the directors that they are not reporting entities, as it is not considered reasonable to conclude that there are users who depend on general purpose financial reports for information which will be useful to them in making and evaluating decisions about the allocation of scarce resources to those entities. Experience of the Group, in terms of the absence of enquiries from potential users of the financial reports of these subsidiaries, continues to confirm the validity of these judgements.

These special purpose financial reports involve compliance with the recognition, measurement and presentation standards of IFRS and AIFRS, but generally do not comply in all respects with the disclosure requirements of the following standards:

- AASB2 Share based payments
- AASB 107 Cash Flow Statements
- AASB 110 Events after the Balance Sheet Date
- AASB 114 Segment Reporting
- AASB 119 Employee benefits (disclosure of benefit plans)
- AASB 124 Related Parties
- AASB 128 Investments in Associates (disclosure only)
- AASB 132 Financial Instruments

The proposed changes to the differential reporting regime will force these entities to report as follows:

Not publicly accountable entities

For companies which do not have public accountability as defined by the ED of a Proposed IFRS for SMEs and are not classified as important by the AASB (i.e. consolidated revenue is less than $500m and consolidated assets are less than $250m) they will be forced to choose between two sub-optimal reporting regimes;

a) prepare financial statements in accordance with the proposed IFRS for SMEs which will require maintenance of a separate ledger in order to account for various transactions on an entirely different basis to that required for inclusion in the consolidated BHP Billiton Group, or
b) use existing Group accounting policies for the recognition, presentation and measurement of items (thereby invoking full IFRS/AIFRS) and therefore comply with all the additional disclosures required by those standards.

Both of these options will require substantially greater work effort from the group with no added value to the financial reporting community or to the shareholders. Given that each entity has previously concluded that they do not have users which rely upon the financial reports, we fail to see any positive benefits in either outcome. Essentially, any cost / benefit analysis clearly appears to us to be lost on this proposal.

In our view, option (a) is untenable and would struggle to be given serious consideration. The work practices, policy compliance, training and systems administration requirements of maintaining separate ledgers for entity versus Group reporting make this option unviable. Accordingly, the IFRS for SMEs would be of no relevance or use to the BHP Billiton Group. We suspect that most groups with a publicly accountable parent entity and wholly owned subsidiaries would be of the same view.

Important to consider in option (b) is not merely the additional work effort to produce the required disclosures at the entity level, but significant doubts about the relevance of the additional information disclosed. For example, as wholly owned entities, most BHP Billiton subsidiaries operate under central cash management and risk management regimes, often with marketing arrangements, management structures and employee remuneration and benefit structures that reflect the Group organisation, with little or no relevance to the legal entity perspective. Accordingly, disclosures about the cash flows, financial risks, operating risks and results, management remuneration and employee entitlement arrangements would fail to convey information that would be relevant to the entities on a stand alone basis.

Publicly accountable entities

For companies which do not have public accountability as defined by the ED of a Proposed IFRS for SMEs and are classified as important by the AASB (i.e. consolidated revenue is greater than $500m and consolidated assets greater than $250m) they will have to apply the Australian equivalent to IFRS to their financial reports. Given that the directors of each company have concluded that there are no users who rely on this financial information to make decisions about the allocation of scarce resource, we believe this outcome warrants significant additional work effort with no additional benefit to the financial reporting community.

While we understand the AASB's objective of simplify the reporting regime and trying to meet many competing objectives, the proposed differential reporting regime does not suit the needs of corporate groups of entities in which the parent is publicly accountable. We have two main difficulties with the approach of the AASB:

Modification of the notion of "public accountability"

It appears to us that the AASB's proposal involves a modification of the IASB's concept of public accountability. The IASBs intention is that general purpose financial reports comply with IFRS, and where the entity is publicly accountable, the relevant IFRS is full IFRS. Otherwise, IFRS for SMEs would be available. While the AASB presents its differential reporting proposal as multi-tiered, with a further "Important entities" layer inserted, this is in effect a rejection and modification of the publicly accountable definition, which therefore modifies the intentions of the IASB and extends the application of full IFRS beyond that intended by the IASB's SME project. The AASB has obviously concluded that the IASB's proposed definition does not provide sufficient delineation between publicly accountable entities and all other entities. However, this modification is capturing entities that are not publicly accountable, but in the view of the AASB, are of public interest by virtue of their size. We believe that this concept is presently well catered for by the reporting entity concept.

Implications of current conclusions about the reporting entity concept and general purpose financial reports

Part of the thinking behind the AASB's proposals challenges wide-spread conclusions about whether entities are required to prepare general purpose financial reports. Specifically, it has been suggested that the filing of a financial report on public record causes it to become a general purpose financial report, notwithstanding the conclusion that the entity is not a reporting entity. This suggestion is contrary to the current interpretation of the Law by the accounting and auditing profession and the enforcement of the Law by ASIC. We believe this suggestion needs to be robustly debated by reference to the applicable definitions of general purpose financial report and reporting entity and in our minds is more critical to the design of a differential reporting regime than is suggested in the AASB's proposals.

Reporting entity versus entity thresholds

We appreciate that the proposed introduction of $ thresholds to define layers in a differential reporting regime is an attempt to remove subjectivity in the application of such a regime. However, we have found the reporting entity concept to be both practical and effective in implementing differential reporting. This has been particularly the case when applied with the guidance of ASIC, such that special purpose reports nonetheless comply with all of the recognition, measurement and presentation requirements of IFRS, but differ only in the nature and extent of disclosures presented. We also believe that the reporting entity concept is more conceptually sound than fixed $ thresholds, as it gives appropriate recognition to the objective of financial reporting meeting the needs of users.

If the AASB believes that a monetary threshold approach must be adopted to establish differential reporting via use of IFRS for SME's, a modification to absolute bright line $ thresholds may be to consider the application of a % test based on the revenue and assets of subsidiary entities relative to the size of their consolidated group. We would consider this to be a more pertinent test of which entities are deemed to be important from a reporting perspective. However, this approach would only work for entities within a larger group and therefore added further complexity to the regime.

A simpler differential reporting regime

BHP Billiton believes that the existing reporting entity approach to differential reporting has worked well and would prefer that it be retained, without use of IFRS for SME's, which as explained above, is of no value in a corporate group environment.

A simpler alternative, in the event the reporting entity approach is not supported, is as follows

- Apply the concept of publicly accountable entities in the manner defined and intended by the IASB. That is, do not impose another concept of "important" entities.
- Require that publicly accountable entities apply full IFRS
- Permit entities that are not publicly accountable to apply either:
  - Full IFRS
  - IFRS for SME's (if the AASB considers such a framework important for international harmonisation)
  - Full IFRS for recognition, measurement and presentation, but a reduced disclosure set when the information excluded from that disclosure is already presented in a consolidated financial report which includes the reporting entity.

The above approach would resolve most of the issues raised in this response. Two reservations we have with this solution are;

- Conceptually and practically, we see no merit in the long term maintenance of an IFRS for SME's with different recognition and measurement requirements as we believe there should be one consistent basis of measurement and recognition within IFRS, regardless of the status of an entity.

- We acknowledge that the above framework would not resolve the additional burden on single, non-publicly accountable entities which would be forced to "upscale" from their existing special purpose financial reports to IFRS for SME's reports. On this issue, we believe the AASB needs to carefully consider the cost benefit analysis for such impacts. On balance, we believe the analysis would fail to justify the change.

Specific matters on which comment is sought

In relation to the specific matters for comment, we respond to the questions related to for-profit entities as follows:

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

No, in our view the general purpose financial report focus does not currently provide sufficient reporting alternatives to address all preparers and users needs. As explained above, we believe the reporting entity concept is more conceptually sound as a framework for differential reporting as it responds to the needs of users of financial reports.

(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 and make it more effective?*

We consider the current reporting entity concept is appropriate for the BHP Billiton group and for the wider financial reporting community. We believe the concept can be made more robust by codifying the ASIC guidance, whereby special purpose financial reports prepared under the company law should comply with the recognition, measurement and presentation requirements of IFRS.

(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?*

No, as noted above this distinction would require significantly more work effort with little additional benefit.

(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?*
- (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?*

No, refer to specific comments above. Imposing a further layer in the differential reporting framework defined by reference to monetary thresholds is a significant departure from the IASB's proposed framework and is conceptually unsound.

(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 believe that the AASB should conform to the definition of publicly accountable as proposed by the IASB, if it intends to depart from the reporting entity concept. Accordingly, the size thresholds for important entities are not warranted. If size thresholds are to be used, we believe a differentiation based on an appropriate % of the group position may be a better indication of "important" entities within a consolidated group.

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

- (iii) *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*
- (iv) *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.

No. This is not the view that underpins predominant practice among the accounting profession and the business sector. Such a view has not been properly examined, and appears to assume that the provision of financial information in a public forum automatically causes users to exist who are dependant on that information. As defined, a general purpose financial report is one directed towards a wide range of users. A compulsory filing of an annual report by a privately owned entity does not, in our view, constitute an action seeking to provide information to such a user group. If this were the case, how does the view distinguish the financial report filed with ASIC from a preliminary profit release lodged by a public company with a stock exchange? In that situation, there is clearly a wide range of users dependent on that information, however such releases are clearly not prepared as a general purposes financial report and do not comply with all of the requirements of IFRS.

(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?*

No, for the same reasons given immediately above.

(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 employee would be appropriate under the proposed differential reporting for not-for- profit private sector entities and public sector entities?*

No, the number of employees of an entity is often difficult to define and then measure and has little relevance on whether the entity is significant.

(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?*

No, whilst the proposed SME standard is intended to provide smaller and medium sized entities with a reduced reporting obligation, entities which are part of a larger group will find no relief from existing reporting obligations. The fact that the proposed standard introduces measurement differences will result in significant difficulties for entities which are part of larger groups or whose circumstances may change as a result of an acquisition, disposal or future public listing. Mandating relief from disclosure requirements which are commonly excluded from Special Purpose Financial Reports provides more effective and relevant reporting relief and does not provide reporting difficulties for entities whose circumstances and needs may change in the future.

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

We do not believe this is an imperative, but we believe Australia and Ne Zealand should work collectively in analysing the merits or alternative differential reporting regimes.

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

Not 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.*

No, the costs of implementing the proposals would far outweigh the benefits. The additional time required to prepare general purpose accounts and/or maintain a separate ledger in compliance with the ED for SMEs would be significant but is difficult to quantify. Given the absence of users for many entities that would be affected by the proposals, little or no benefit can be seen for such entities.

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

No

We would like to thank the AASB for providing the opportunity to comment on this important issue.

Yours sincerely,

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Nigel Chadwick
Group Financial Controller