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The Chair
Australian Accounting Standards Board
PO BOX 204
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9 November 2018

Dear Madam

INVITATION TO COMMENT ITC 39 APPLYING THE IASB'S REVISED CONCEPTUAL FRAMEWORK, SOLVING THE REPORTING ENTITY AND SPECIAL PURPOSE FINANCIAL STATEMENT PROBLEMS (PHASE 2)

Thank you for the opportunity to comment on the Board's proposals to remove special purpose financial reporting in Australia for entities preparing financial statements in accordance with Australian Accounting Standards.

While we acknowledge that the AASB's Phase 2 approach will create additional work, and some increased costs for some entities currently preparing special purpose financial statements, we agree with the approach on the basis that it will:

- remove the subjectivity currently present in the process for self-assessing whether an entity is a 'non-reporting entity',
- improve the consistency, comparability, usefulness, and credibility of financial statements prepared for regulatory purposes (i.e. for users other than shareholders),
- improve the comparability for entities of similar economic circumstances, and
- improve the trust and transparency within financial reporting to meet user needs.

Please refer to Appendix 1 for our detailed comments.

If you have any comments regarding this request, please do not hesitate to contact me.

Yours faithfully

Aletta Boshoff
Partner & National Leader, IFRS Advisory

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APPENDIX 1

Question 11: Do you agree with the AASB's Phase 2 approach (described in paragraph 166)

Why or why not?

BDO comment:

While we acknowledge that the AASB's Phase 2 approach will create additional work, and some increased costs for some entities currently preparing special purpose financial statements, we agree with the approach on the basis that it will:

- remove the subjectivity currently present in the process for self-assessing whether an entity is a 'non-reporting entity',
- improve the consistency, comparability, usefulness, and credibility of financial statements prepared for regulatory purposes (i.e. for users other than shareholders),
- improve the comparability for entities of similar economic circumstances, and
- improve the trust and transparency within financial reporting to meet user needs.

We note from the AASB's Research Report No. 1 that more than three quarters (76%) of non-disclosing entities publicly lodging financial statements are already complying with the recognition and measurement requirements of Australian Accounting Standards. Therefore additional costs to these entities from applying the proposals in Phase 2 will result from the need to:

- Provide some additional disclosures (GPRS – RDR or GPFS – SDR), and
- Prepare consolidated and/or equity accounted financial statements.

However, the 24% of such entities that do not currently comply with the recognition and measurement requirements of Australian Accounting Standards will incur significantly greater initial costs if these Phase 2 proposals are adopted.

Question 12: Which of the AASB's two GPFS Tier 2 alternatives (described in paragraphs 167-170) do you prefer?

Please provide reasons for your preference.

BDO comment:

Should the Board decide to proceed with the Phase 2 approach described in paragraph 166, we prefer the GPFS – RDR alternative because preparers and users are already familiar with these requirements, having been available as a general purpose alternative to Tier 2 since 2010. We also note that this alternative is being used successfully by 'significant global entities' having to provide general purpose financial statements to the ATO.

While at first glance the GPFS - SDR alternative appears to require overall fewer disclosures than GPFS – RDR (and therefore would appear to be a satisfactory compromise to entities having to step up their level of disclosure to general purpose financial statements), we do not believe that providing in-depth

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disclosures about a limited number of transactions and balances provide information that is useful to users of financial statements. The GPFS - SDR approach requires disclosure only for the following specific transactions and/or balances:

- Revenue from contracts with customers (AASB 15 *Revenue from Contracts with Customers*)
- Income taxes (AASB 112 *Income Taxes*)
- Impairment of non-financial assets (AASB 136 *Impairment of Assets*), and
- Related party transactions (AASB 124 *Related Party Disclosures*).

Many entities have significant transactions and balances that fall outside these above-mentioned standards, and in those cases, SDR would not require disclosure at all. For example, entities with significant financial instruments, business combinations, or subsidiaries and associates, under the SDR approach would not be required to provide any disclosure under AASB 7 *Financial Instruments: Disclosures*, AASB 3 *Business Combinations*, or AASB 12 *Disclosures of Interests in Other Entities*, whereas under RDR, minimum disclosures across all standards is required. We believe this spread of information is desirable to give users a complete picture of the financial affairs of the entity.

However, we do note that many entities are sensitive about certain competitive information being made available in the public domain, including, in particular, information related to gross margins. Applying the RDR approach would result in this information being disclosed, being easily be derived by deducting the amount of 'inventories recognised as an expense during the period', as required by AASB 102 Inventories, paragraph 36(c) from sales revenue. We note that ASB 102.36(c) is not removed under RDR.

Question 13: 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?

BDO comment:

Yes we agree that all Tier 2 entities required to prepare general purpose financial statements in accordance with Australian Accounting Standards should only have one disclosure alternative, i.e. GPFS – RDR, or GPFS – SDR.

As these entities are all considered non-publicly accountable (i.e. are unlisted entities whose debt and equity instruments are not traded in a public market, and which do not hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses), we believe it could cause confusion amongst users by having two different disclosure alternatives for GPFS for what is essentially a homogenous group of entities. We are also concerned that having a choice could result in entities moving between methods from year to year to avoid having to disclose material information.

Question 14: 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 and not-for-profit sectors.

BDO comment:

Given that IFRS for SMEs is only updated every three years, we agree with the AASB's decision not to make IFRS for SMEs available in Australia as a Tier 2 alternative because it could result in measurement bases and disclosures being significantly out of step with Tier 1 recognition and measurement principles, and it could also seriously lag behind in terms of disclosures for new standards.

We also believe that it would result in:

- Significant additional costs for practitioners (including staff training) in having to become educated with an additional set of recognition, measurement and disclosure standards, and
- Lack of comparability with entities applying GPFS – RDR or GPFS – SDR alternatives (both in recognition and measurement, and disclosure differences), particularly for for-profit entities.

Question 15: 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.

BDO comment:

Our comments below relate to the preparation of separate financial statements only - transitioning from SPFS to GPFS

Disclosures

Regardless of whether the Board chooses RDR or SDR as the Tier 2 alternative, entities moving from special purpose financial statements (SPFS) will need to include some additional disclosures. To ease the burden and reduce costs on first time adoption, we suggest that transitional relief be given so that such entities do not need to go back and include the additional disclosure as comparatives in the first year.

Recognition and measurement

AASB 1053 *Application of Tiers of Accounting Standards*, Appendix C - Chart 1 already includes guidance for transitioning from SPFS to Tier 2 as follows:

- If recognition and measurement requirements had been applied in the most recent SPFS – AASB 1 is not applied. The entity would simply continue applying recognition and measurement requirements, or
- If recognition and measurement requirements had not been applied in the most recent SPFS – AASB 1 would generally be applied.

Therefore, in principle, we do not consider any additional transitional relief necessary for recognition and measurement in first-time GPFS for separate financial statements. However, please refer to our further comments in Question 16 regarding transitional relief for consolidation and equity accounting.

Question 16: 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.

BDO comment:

Our comments below relate to the first-time preparation of consolidated financial statements only – transitioning from SPFS to GPFS.

Entities required to prepare consolidated or equity accounted financial statements for the first-time are likely to face a number of challenges, including:

- Where the interest in the subsidiary, associate or joint venture was acquired a number of years ago, much of the information required to prepare consolidation/equity accounting will no longer be available, e.g. fair values of assets, pre-acquisition share capital and retained earnings, etc., and
- Having the resources, skills and time to complete the process.

As such, to save on time and resources, we recommend the option of a modified retrospective approach on first-time consolidation or equity accounting, with opening adjustments made to retained earnings on 'date of initial application', and no prior year consolidation/equity accounted provided.

To deal with the problem of the unavailability of historical information, we recommend the following transitional relief on first-time adoption:

Method 1 – AASB 1, paragraph C4(j) – Pre-acquisition information available

Where the date of acquisition is known, and pre-acquisition amounts are also known – we recommend that the relief afforded by AASB 1, paragraph C4(j) from having to apply 'fair value' acquisition accounting to prior business combinations should be made available.

Goodwill is determined essentially as the difference between the cost of the parent entity's investment in the subsidiary, and the net carrying amount of the subsidiary's assets recognised and measured in accordance with Australian Accounting Standards on acquisition date. That is, no fair value adjustments are made to asset values on consolidation as part of business combination accounting, but instead all recognised in goodwill.

A simple example demonstrating how the relief would work is demonstrated below:

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	Parent entity	Subsidiary	Consolidation adjustments	Total	
Assets	1,000	500	0	1,500	Facts known:
Investment in subsidiary	200		(200)	0	1. Acquisition price was $200 (cost of investment)
Goodwill			50	50	2. Assets in Subsidiary at date of acquisition were $150 carrying amount.
	1,200	500	(150)	1,550	3. Share capital at acquisition date was $100
					4. Retained earnings at acquisition date was $50
Share capital	100	100	(100)	100	5. Applying C4(j), no FV adjustments to asset values of $150
Retained earnings	1,100	400	(50)	1,450	Acquisition journal entry is therefore:
Consolidation reserve	0			0	
	1,200	500	(150)	1,550	Dr Share capital 100
					Dr Retained earning: 50
					Dr Goodwill 50
					Cr Investment in subsidiary 200

Method 2 - Historical information not available

Where the information in Method 1 above is not available (e.g. because the acquisition occurred so long ago), a 'short-cut' transition option whereby no adjustments are made for pre-acquisition amounts on the date of initial application should be available to entities as a practical expedient.

A simple example demonstrating how this transitional relief might work is demonstrated below:

	Parent entity	Subsidiary	Consolidation adjustments	Total
Assets	1,000	500	0	1,500
Investment in subsidiary	200		(200)	0
	1,200	500	(200)	1,500
Share capital	100	100	(100)	100
Retained earnings	1,100	400		1,500
Consolidation reserve	0		(100)	(100)
	1,200	500	(200)	1,500

In this scenario, no goodwill is recognised, with all net consolidation adjustments recognised as a reserve within equity.

Implications for AASB 1053 Application of Tiers of Australian Accounting Standards

We note that AASB 1053, as currently drafted, does not cater for our two transitional reliefs proposed above and would create inconsistencies if made available to entities applying consolidation and equity accounting for the first time. We recommend that consequential amendments be made to AASB 1053 as appropriate.

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In particular, AASB 1, Appendix C (Chart 1) does not lend itself to applying AASB 1 as a transition option if consolidation and equity accounting are viewed (as per ASIC's Regulatory Guide 85) as a presentation requirement (i.e. recognition and measurement requirements had previously all been complied with). Chart 1 only permits the application of AASB 1 when moving from special purpose to general purpose financial statements if recognition and measurement requirements had previously not been complied with. Applying the logic in ASIC Regulatory Guide 85, recognition and measurement requirements had previously been complied with, therefore the relief in AASB 1 will not be available unless the AASB make an amendment to say that it is.

Question 17: 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.

BDO comment:

As noted to our response in Question 12 above, we do not believe that providing in-depth disclosures about a limited number of transactions provides information that is useful to users of financial statements. The SDR approach requires disclosure only for the following specific transactions and/or balances:

- Revenue from contracts with customers (AASB 15 Revenue from Contracts with Customers)
- Income taxes (AASB 112 *Income Taxes*)
- Impairment of non-financial assets (AASB 136 *Impairment of Assets*), and
- Related party transactions (AASB 124 *Related Party Disclosures*).

Many entities have significant transactions and balances that fall outside these above-mentioned standards, and in those cases, SDR would not require disclosure. We believe that GPFS – RDR would better suit user needs as it would ensure a base level of disclosure across all transactions and balances.

Question 18: 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).

BDO comment:

We do not have any other suggested alternatives for GPFS Tier 2 for-profit entities reporting in accordance Australian Accounting Standards.

However, we believe there is merit in considering a Tier 3 approach for use by not-for-profit entities at the request of not-for-profit regulators in order to reduce compliance costs in this sector.

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Question 19: 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).

BDO comment:

We believe that service performance reporting, fundraising and administrations cost disclosure provide useful information to the users of NFP private sector entities and should therefore be included as part of the chosen GPFS Tier 2 alternative.

Question 20: Are you aware of any legislation that refers to SPFS that might be impacted by these proposals?

If yes, please provide specific information.

BDO comment:

The *Australian Charities and Not-for-profits Commission Regulation 2013* refers to the preparation of special purpose financial statements (section 60.30) which would need to be removed.

Question 21: 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).

BDO comment:

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 in relation to for-profit entities.

Question 22: Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

BDO comment:

We are not aware of any.

Question 23: Whether, overall, the proposals would result in financial statements that would be useful to users.

BDO comment:

In our view the proposals would result in financial statements that would be useful to users. .

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Question 24: Whether the proposals are in the best interests of the Australian economy.

BDO comment:

Yes we believe the proposals are in the best interests of the Australian economy as it removes differential reporting for similar entities and brings Australian into line with overseas countries.

Question 25: 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.

BDO comment:

Please refer to our comments under specific matters for comment.