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By email: standard@aasb.gov.au

Dear Kris

Invitation to Comment – ITC 39 Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems (Phase 2)

Thank you for the opportunity to comment on Invitation to Comment – ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (Phase 2).

The provided comments have been prepared after considering the ITC, participating in sessions held by the Australian Accounting Standards Board (AASB) and discussions with AASB technical staff in relation to Phase 1 of the ITC. I have reviewed the publicly available submissions to Phase 1 along with the AASB technical staff analysis and recommendations.

Context

The two phases of ITC 39 are linked. Accordingly, before addressing Phase 2, I think it useful to briefly revisit Phase 1,

What action (if any), is required of the AASB following the release of a Revised Conceptual Framework (RCF) by the International Accounting Standards Board (IASB) to enable the directive of the Financial Reporting Council (FRC) to continue to be operationalised? Answering this question, along with the proposal to remove special purpose financial reporting are the focus of Phase 1 of the ITC.

My submission to Phase 1 contained two observations summarised here:

1. The AASB has not demonstrated why there is a conflict between the RCF and SAC 1 *Definition of the Reporting Entity* that would affect publicly accountable for-profit entities applying Tier 1 General Purpose Financial Statements (GPFS), so they could not continue to claim compliance with International Financial Reporting Standards (IFRS); absent immediate action from the AASB.
2. It is for the lawmaker to determine who of its regulated entities should prepare GPFS.

   In contrast, the role of the AASB is one of specifying what framework(s) and accounting standards should apply to the different entities in the preparation of those GPFS.

   This is the division of labour in many other jurisdictions.

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And the IASB acknowledges it does not have the authority to determine who must, should, or could prepare GPFS. This is the environment in which the International Financial Reporting Standards are developed.

The way that SAC 1 currently operates distorts this divide as SAC 1 and AASB 1057 *Application of Australian Accounting Standards* answer the who question.

I support the withdrawal of SAC 1, but not in isolation of an explicit statement from the lawmaker as to who of its regulated entities should prepare GPFS.

Phase 2

Regarding charities and other private and public not-for-profit sector entities, I support the AASB decision at the September 2018 meeting not to proceed with the Phase 2 plan now.

Instead, the AASB will undertake research and related activities to better understand the features of the different entities of those sectors and the needs of the users of the GPFS of those different entities.

Armed with that information, the AASB and its not-for-profit sector constituents will be much better placed to consider how categorising not-for-profit entities by their features, along with the comprehensive information about user needs might then be used to inform the development of one or more proposed financial reporting framework(s) for application by a not-for-profit entity in the preparation of its GPFS.

My recommendations are:

1. Regarding for-profit entities, the AASB not proceed with the Phase 2 plan agreed by the AASB at the September 2018 meeting (i.e., to proceed to develop a Tier 2 GPFS financial reporting framework for for-profit entities), hereafter, referred to as modified Phase 2.

   Work on the modified Phase 2 plan should be delayed until the AASB has performed significantly more research into the different features of for-profit entities, including those for-profit entities whose features involve serving a particular purpose such as wholly-owned subsidiaries or intermediate holding companies.

   That research will also need to obtain information about the needs of users with respect to the GPFS of the different entities.

   With that information in hand, the AASB and its for-profit constituents will be much better placed than they are now to consider how categorising for-profit entities by their features, along with the comprehensive information about user needs might then be used to inform the development of one or more proposed financial reporting framework(s) for application by a for-profit entity in the preparation of its GPFS.

2. On matters of developing financial reporting framework(s), the AASB take a synchronised approach when considering proposals for

frameworks and their application to for-profit and not-for-profit private and public sector entities.

There is a potential threat to the rigour applied by the AASB in its decision making if the start date of the modified Phase 2 plan is not delayed so as to coincide with the unknown-start date of the not-for-profit entity Phase 2 plan.

3. On matters of what financial reporting framework(s) to develop, the AASB not rule out of Tier 2 GPFS a financial reporting framework that uses a recognition and measurement model different from that used in IFRS, for example, *IFRS for Small and Medium-Sized Entities* (IFRS for SMEs) or FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland.*

4. On matters of future proofing financial reporting framework(s) so that they remain fit for future purpose, the AASB supplement its archival research with research that has a future orientation. ITC 39 heralds a major change to the current financial reporting framework. AASB Research Report No. 1 *Application of the Reporting Entity Concept and Lodgement of Special Purpose Financial Statements* issued in 2014 (Research Report No. 1) which provides descriptive statistics for the population of entities preparing special purpose financial reports that are lodged with the Australian Securities and Investment Commission (ASIC) is a useful document. However, Research Report No. 1 cannot be the basis for future proofing financial reporting frameworks. For example, the recent amendments to 2017's equity crowdfunding legislation to allow small proprietary limited companies to raise money from retail investors without needing to convert to an unlisted public structure illustrates how fluid the for-profit environment is.

If the AASB was to reconfirm its modified Phase 2 plan to develop a for-profit entity Tier 2 GPFS financial reporting framework, I ask the AASB to consider Recommendations 3 and 4 when operationalising that plan.

I have responded to the AASB request for comment Phase 2 (see Appendix A). The AASB decisions in September 2018 to modify Phase 2 of the ITC to focus on for-profit entities frame my response.

I have also prepared some other comments for your consideration (see Appendix B) whereby I recommend that the AASB:

1. Undertake further research as to the meaning of public accountability.
2. Delete paragraph B2 of AASB 1053, the AASB's supplement to the IASB definition of public accountability (that deems some for-profit entities to have public accountability). The presence of the supplement is not consistent with the way the IASB uses public accountability.

If you have any queries on the provided comments, please contact me at mshying@swin.edu.au.

Yours sincerely

Dr Mark Shying CA
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Appendix A

Specific matters for comment on Phase 2

ITC 39.106 describes the AASB's proposed medium-term approach to apply the IASB RCF to all entities (Phase 2).

At the September 2018 meeting of the AASB, the AASB agreed to modify Phase 2 of the ITC to focus on for-profit entities. That decision frames my response to the matters for comment.

11. Do you agree with the AASB's Phase 2 approach (described in paragraph 166) Why or why not?

No, I do not agree with the AASB's Phase 2 approach (or the modified Phase 2 approach).

Anstis and Steenkamp assert "Reform of the Australian financial reporting framework depends on the involvement of the government policymakers and regulators who have the power to identify entities that must report publicly and their reporting requirements.".[1]

The reference to 'reporting requirements' is significant. The AASB does not have the authority to determine who must, should or could prepare GPFS.

The Parliamentary Joint Statutory Committee on Corporations and Securities has issued reports that include its consideration of the reporting entity concept.[2] Notwithstanding statements made about the reporting entity concept, the Parliament of the Commonwealth of Australia has not been moved to make changes to the *Corporations Act* 2001 or its antecedent legislation.

In the absence of action by lawmakers to articulate who of their regulated entities should prepare GPFS, for the AASB to proceed with the original or modified Phase 2 plans would be premature.

Further, work on the modified Phase 2 plan should be delayed until the AASB has performed significantly more research into the different features of for-profit entities, including those for-profit entities whose features involve serving a particular purpose such as wholly-owned subsidiaries or intermediate holding companies. That research will also need to obtain information about the needs of users with respect to the GPFS of the different entities.

With that information in hand, the AASB and its for-profit constituents will be much better placed than they are now to consider how categorising for-profit entities by their features, along with comprehensive information about user needs might then be used to inform the development of one or

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[1] Anstis & Steenkamp, Reform of the Australian Financial Reporting Framework, Perspective, CAANZ, June 2016.

[2] See for example, Parliamentary Joint Committee on Corporations and Securities, Report on the First Corporate Law Simplification Bill 1994, March 1995, and Parliamentary Joint Committee on Corporations and Securities, Report on Aspects of the Regulation of Proprietary Companies, March 2001

more proposed financial reporting framework(s) for application by a for-profit entity in the preparation of its GPFS.

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.**
    I do not support either of the two GPFS Tier 2 alternatives.

    I think in the absence of comprehensive data and information about for-profit entities the AASB and its for-profit constituents are not well placed to make the necessary assessment.

    See my response to Question 11.

    Further, a Tier 2 GPFS financial reporting framework that uses a recognition and measurement model different from that used in IFRS, for example, IFRS for SMEs or FRS 102 should also be considered with feedback sought from stakeholders.

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?**
    No, I do not agree. I think in the absence of comprehensive data and information about for-profit entities to rule in or out Tier 2 GPFS frameworks – be they Alternative 1 or Alternative 2 or a different alternative - is premature.

    I note the IASB research pipeline includes a research project "SMEs that are subsidiaries", a project whose objective is to assess whether it would be feasible to permit SMEs to use a reduced disclosure requirements framework. If the research establishes this approach would be feasible, there may well be two alternative frameworks available to be used by reporting entities that do not have public accountability.

    See also my response to Questions 11 and 12.

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.**
    No, I do not agree with the AASB's decision that IFRS for SMEs not be made available as a Tier 2 alternative. I think to rule out IFRS for SMEs is premature. Instead feedback should be sought from stakeholders on their views about a Tier 2 GPFS financial reporting framework that uses a recognition and measurement model different from that used in IFRS.

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.**
    I have no comment on what transitional relief should be applied.

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.
I have no comment on what transitional relief should be applied.

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.**
I have no comment on the specified disclosures.

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).**
See my response to the earlier questions and the recommendations of my cover letter.

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).**
I have no comment to this question as it is not relevant to the modified Phase 2 plan.

20. **Are you aware of any legislation that refers to SPFS that might be impacted by these proposals? If yes, please provide specific information.**
No, I am not aware of any legislation that refers to SPFS that might be impacted by these proposals.

General matters for comment on Phase 2

21. **Whether The AASB's Standard-Setting Frameworks for For-Profit and Not-for-Profit Entities[3] . 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).**
Largely, ITC 39 refers to the data and findings of Research Report No. 1. More specifically, ITC 39 relies on those parts of Research Report No. 1 that deal with the analysis of a random sample of 394 large proprietary limited company lodgements to ASIC for the annual report years ending in 2009 and 2010. [4]

    I acknowledge the usefulness of Research Report No. 1. However as acknowledged by the AASB, the report has its limitations.

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[3] Refer to The AASB's For-Profit Entity Standard-Setting Framework and The AASB's Not-For-Profit Entity Standard-Setting Framework.
[4] ITC 39 asserts a more recent analysis of lodgements made to ASIC by a random sample of 394 large proprietary companies for annual report years 2008-2015 is largely consistent with the analysis in Research Report No. 1 (unpublished working paper Potter, Tanewski and Wright, Financial Reporting by Private Companies in Australia: Current Practice and Opportunities for Research).

I think in the absence of comprehensive data and information about for-profit entities and user needs the AASB is not well placed to develop further the proposals in modified Phase 2. Consequently, its' for-profit constituents are not well placed to make the necessary assessment.

22. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.**
    I believe the cost to preparers of Tier 2 Alternatives 1 and 2 would be greater than the costs those entities would incur when applying a financial reporting framework that uses a recognition and measurement model different from that used in IFRS.

23. **Whether, overall, the proposals would result in financial statements that would be useful to users.**
    I believe that in some circumstances the financial statements prepared using Alternatives 1 and 2 would be useful to users.

    However, other alternatives may have greater utility or a greater utility for some users.

    I encourage the AASB to consider the approach used in the UK which includes both a reduced disclosure framework standard and a standard that uses a recognition and measurement model different from that used in IFRS.

    Also, see my response to the earlier questions and the recommendations of my cover letter.

24. **Whether the proposals are in the best interests of the Australian economy.**
    I do not think the AASB has established the proposals are in the best interests of the Australian economy. See my response to the earlier questions and the recommendations of my cover letter.

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 nonfinancial) 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.**
    I have no comment.

Appendix B

Other comments

The AASB has used public accountability as the dividing line between those reporting entities that should adopt full IFRS and others that can adopt IFRS RDR.

I note it is the intention of the AASB to continue to use public accountability as the dividing line – full IFRS and Tier 2 GPFS.

Public accountability and equity crowdfunding

I believe the recent amendments to 2017's equity crowdfunding legislation to allow small proprietary limited companies to raise money from retail investors without needing to convert to an unlisted public structure raises some issues about what is meant by public accountability.

Currently, there is no secondary market for selling shares bought through an equity crowdfund raising. Investors can only really dispose of their investment if the company does an Initial Prospectus Offering, or the company is acquired.

In the absence of a secondary market, do these companies have public accountability? What does traded in a public market mean? Does the fact that they are initially sold with a disclosure document through a licenced platform constitute "traded in a public market"?

The SME Implementation Group publications Q&A 2011/02 *Entities that typically have public accountability* and Q&A 2011/03 *Interpretation of 'traded in a public market' in applying the IFRS for SMEs* appear to be relevant. However, they are no longer publicly available and no longer seem to be part of the IFRS for SMEs literature.

I recommend the AASB undertake further research as to the meaning of public accountability, notwithstanding its earlier concern about interpreting IASB terms and expressions (see paragraph BC 26 to AASB 1053).

Appendix B to AASB 1053

Appendix B to AASB 1053 *Application of Tiers of Australian Accounting Standards* deems certain entities to have public accountability, that is, the AASB has supplemented the IASB definition. ITC 39 does not propose amendments to paragraph B2.

B2 The following for-profit entities are deemed to have public accountability:

a. disclosing entities, even if their debt or equity instruments are not traded in a public market or are not in the process of being issued for trading in a public market;
b. co-operatives that issue debentures;
c. registered managed investment schemes;
d. superannuation plans regulated by the Australian Prudential Regulation Authority (APRA) other than Small APRA Funds as defined by APRA Superannuation Circular No. III.E.1 Regulation of Small APRA Funds, December 2000; and
e. authorised deposit-taking institutions.

I think it problematic that AASB 1053 deems certain entities to apply full IFRS; an approach that is not found in IFRS.

Paragraph BC26 to AASB 1053 states:

> The Board acknowledged constituents' comments about some aspects of the definition of public accountability that the application of the definition in some cases may involve interpretation or judgement. Some respondents to ED 192 noted it would be helpful for the Board to clarify certain terms used in the definition. These include the term 'public market' referred to in the first leg of the definition and the terms 'fiduciary', 'broad', 'outsiders' and 'primary business' referred to in the second leg of the definition. However, the Board noted it is not a policy of the Board to further interpret the IASB's terms and definitions. Accordingly, the Board decided that, instead of interpreting the terms in the definition, AASB 1053 should identify entities that the Board deems to be publicly accountable in the Australian context, to supplement the IASB's definition of public accountability (see Appendix B of AASB 1053).

I recommend the AASB delete paragraph B2 of AASB 1053, the AASB's supplement to the IASB definition of public accountability (that deems some for-profit entities to have public accountability).