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Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Via Email: standard@aasb.gov.au

Dear Kris

Submission on Consultation Paper – Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems, Phase 2 (Medium-term Approach)

Thank you for the opportunity to provide a submission on the Consultation Paper – Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems ("**CP**") in relation to Phase 2 (Medium-term Approach).

The Australian Institute of Company Directors (**AICD**) has a membership of more than 43,000 including directors and senior leaders from business, government and the not-for-profit (**NFP**) sectors. The mission of AICD is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society.

The AICD supports the need for review of the Australian financial reporting framework, given its complexities and its impact on a wide range of entities. We also acknowledge that special purpose financial statements (**SPFS**) are not comparable because of its self-assessment approach to compliance obligations.

Our responses to the specific and general matters on which the Australian Accounting Standards Board (**AASB**) requested feedback for Phase 2 are set out in the Appendix.

1. Overview – for-profit entities

The AICD does not support the AASB's preferred Phase 2: Medium-term Approach which involves removing the ability for non-publicly accountable entities to prepare and lodge SPFS and to instead require general purpose financial statements (**GPFS**).

We do not consider that the rationale presented in the CP on the problems with SPFS is clear and based on unequivocal evidence. More empirical evidence is needed, based on up-to-date information on the current state of reporting, the identification of the relevant users and the deficiencies with SPFS from those users before this project should proceed.

Further, we are concerned that such an expansion of GPFS will be in excess of user needs without adequate analysis of the costs and benefits of the change. The alternatives proposed by the AASB will increase the compliance burden on business by requiring:

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- Consolidations and equity accounting;
- Increased complexity in adopting the recognition and measurement of International Financial Reporting Standards (**IFRS**); and
- Additional disclosures.

The AICD considers that a broader review of the Australian financial reporting regime should be undertaken by exploring both elements – review of 'who' needs to lodge financial reports and a review of 'what' these entities should be reporting. The AASB proposals attempt to explore the 'what' without policy makers addressing the 'who'. Only a review of these parts together will enable the development of an effective financial reporting regime that will support the economy without imposing unnecessary compliance burden on small business.

In the meantime, we encourage the AASB to work with regulators in providing additional support to business and professional advisers to better understand who can prepare SPFS and regulators to 'enforce' its application in the most effective manner.

2. Overview – not-for-profit entities

We note the AASB announcement, after the release of the proposals in the CP, indicating their intention to apply the proposals in the CP only to for-profit entities. We agree that the impact of removing SPFS is more significant on the NFP sector and a longer timeframe is needed to consider the best outcome for this sector. We support the AASB working with NFP regulators and the sector itself to develop consistent national reform proposals for the sector.

In particular we note the recommended increase in charity financial reporting thresholds in the recent review of the Australian Charities and Not-for-profits Commission. We support an increase in charity financial reporting thresholds, and consider that thresholds should also be reviewed more broadly across the whole NFP sector.

Even with increased NFP thresholds, NFP thresholds will remain much lower than those in the for-profit sector. Therefore, we do not consider that a 'one size fits all' reporting framework will necessarily suit both the for-profit and NFP sectors, particularly as the users likely want different information from financial reporting in these sectors. Therefore, we recommend the AASB consider a simpler accounting standard, with recognition, measurement and disclosure simplifications, to apply to certain NFP entities. Such a standard should consider user needs, the size and capacity of the entities and requirements in other jurisdictions around the world.

3. Next steps

We hope our comments will be of assistance to you. If you would like to discuss any aspect of this submission, please contact Kerry Hicks, Senior Policy Adviser, on 028248 6635 or at khicks@aicd.com.au.

Yours sincerely

LOUISE PETSCHLER
General Manager, Advocacy

Specific matters for comment on Phase 2

Q11 – Do you agree with the AASB's Phase 2 approach (described in paragraph 166?) Why or why not?

The AICD does not support the AASB's preferred Phase 2: Medium-term approach which involves removing the ability for non-publicly accountable entities to prepare and lodge SPFS and to instead require GPFS.

We do not consider that the rationale presented in the CP on the problems with SPFS is clear and based on unequivocal evidence. More empirical evidence is needed, based on up-to-date information on the current state of reporting, the identification of the relevant users and the deficiencies with SPFS from those users before this project should proceed.

Further, we are concerned that such an expansion of GPFS will be in excess of user needs without adequate analysis of the costs and benefits of the change. The alternatives proposed by the AASB will increase the compliance burden on business by requiring:

- Consolidations and equity accounting;
- Increased complexity in adopting the recognition and measurement of IFRS; and
- Additional disclosures.

The alternatives proposed by the AASB do not offer a suitable 'one size fits all' reporting framework for non-publicly accountable entities. We note that internationally both the UK Financial Reporting Council and the IASB have recognised that IFRS does not suit SME entities, and have therefore produce a standard particularly suited to SME users with recognition, measurement and disclosure differences. Therefore, we consider that the AASB should explore these options further and consult specifically on the appropriateness of adoption of such an option in Australia if unequivocal evidence can be produced that special purpose financial reports do not meet user needs. We do not consider that the evidence presented to date is sufficiently robust or up-to-date on the current reporting framework.

The AICD considers that a broader approach to the review of the Australian financial reporting regime should be undertaken by exploring both elements – review of 'who' needs to lodge financial reports and a review of 'what' these entities should be reporting. The AASB proposals attempts to explore the 'what' without policy makers addressing the 'who'. Only a review of these parts together will enable the development of an effective financial reporting regime that will support the economy without imposing unnecessary compliance burden.

Q12 – Which of the AASB's two GPFS Tier 2 alternatives (described in paragraphs 167–170) do you prefer? Please provide reasons for your preference.

We do not consider that either of these Tier 2 alternatives are appropriate to meet the wide range of user needs that exist for non-publicly accountable entities.

We consider the reduced disclosure regime (**RDR**) has been an acceptable alternative to full IFRS for the last five years, although note that the extent of disclosure reductions from full IFRS could be increased.

However, in our view neither RDR nor Specified Disclosure Requirements (**SDR**) are an acceptable alternative to SPFS.

Q13 – 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?

Until the broader framework is reviewed – reviewing both 'who' needs to lodge financial reports along with a review of 'what' the entities should be reporting, we do not support requiring all entities to prepare GPFS.

Without any review of the financial reporting thresholds, we do not consider that only one alternative to full IFRS is sufficient.

Q14 – Do you agree with the AASB's decision that GPFS – *IFRS for SMEs* (outlined in Appendix C paragraphs 18–36) 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.

While entities have been able to prepare special purpose financial reports when complying with Australian Accounting Standards there has not been a demand for a simplified recognition and measurement framework, such as IFRS for SMEs.

SMEs are currently required to report based on the existing proprietary company financial reporting thresholds in Australia. Many SMEs currently report using SPFS. We consider these thresholds should be increased so SMEs will no longer have to publicly report their financial information. If this is undertaken, exploring a financial reporting alternative for SMEs may not be necessary.

In our view, IFRS for SMEs as developed by the IASB, has the following advantages:

- The requirements are contained in one separate standard/book making it easier for preparers to identify the reporting requirements that exist
- It leads to comparable financial statements for those applying the framework
- It provides simplified recognition and measurement requirements, mostly designed to meet the needs of users within an SME market
- The standard is subject to some stability, as it is only updated periodically
- It is based on IFRS fundamentals that are already taught in education institutions, therefore further education needs will be limited
- The standard has not been designed to be used for entities operating in capital markets
- The standard is maintained and consulted on internationally, with education modules to assist with application, so Australian costs to maintain would be minimal
- The standard is already being used (either as is or in a modified form) in some other international jurisdictions for SME reporting.

We do not consider that IFRS for SMEs can be used for the NFP sector, as it was not designed with NFP users in mind. However, we note the UK has used this standard as a base for the NFP sector and then made further modifications to the standard to meet the needs of NFP users. This could be explored further in Australia.

Q15 – 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.

The AICD does not support one of the two proposed alternatives, as noted above.

If the AASB proceeds with its project, transitional relief would be appropriate to the maximum extent possible.

Q16 – 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.

Our concerns with consolidation arise because preparing consolidated accounts is costly and for no obvious user need. If users required consolidated accounts, they would have been specifically requested and prepared under the current framework.

Transitional relief could include not applying the requirements retrospectively, not requiring comparatives and allowing the deeming of cost as fair value for opening balances. However, even with this transitional relief, preparing consolidated accounts comes with a compliance cost to business with no obvious user need.

Q17 – 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.

We do not agree that GPFS – SDR would best meet user needs. Developing a set of disclosures that meet user needs would require analysing each standard individually using similar principles to those set out in IFRS for SMEs. We question why the government should embark on such a costly exercise when suitable frameworks already exist in jurisdictions around the world.

Q18 – 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).

No other suggestions than already discussed above.

Q19 – 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).

The NFP private sector is incredibly diverse in terms of the purposes, structure, size and maturity of the entities within it. It follows that the users of these entities' financial reports are also diverse, comprising people such as funders, donors, beneficiaries, members, regulators and the general public.

In order to make evidence-based policy decisions about the format of financial reporting, a theoretical understanding must be developed about who the users of NFP financial reports are and what information they need. AICD is not aware that such an understanding has been developed by the AASB.

The AICD recommends that the AASB, together with relevant regulators and policy-makers, undertake comprehensive research to establish this before advancing any significant reform to the NFP financial reporting framework.
Notwithstanding this, the AICD does not support the inclusion of mandatory service performance reporting information or fundraising and administration cost disclosures as part of any GPFS Tier 2 alternative.

The AICD holds the view that such standardised performance measures do not contribute to building a picture for users about a NFPs performance.

Many NFPs will already use some form of performance measures, but others will communicate their purpose by means of case study, personal testimony or through more sophisticated social impact measurement initiatives.

Further, such metrics are not comparable between entities and could lead to erroneous conclusions about the performance and impact of NFP entities. It could also lead to adverse policy outcomes whereby entities are incentivised to compete on metrics such as administration cost ratios at the expense of their overall impact and effectiveness in delivering their mission.

The introduction of standardised performance measures would undermine the flexibility of NFP entities to communicate with their stakeholders in a way that is tailored to their unique circumstances. This would be an adverse outcome for the NFP sector and for donors.

Q20 – Are you aware of any legislation that refers to SPFS that might be impacted by these proposals? If yes, please provide specific information.

We are not aware of any legislation that refers to SPFS. However, guidance exists in the form of ASIC's RG 85 *Reporting requirements for non-reporting entities* and the ACNC web page (https://www.acnc.gov.au/annual-financial-report-general-and-special-purpose-statements) on SPFS. Such guidance may also exist on state/territory regulator information websites.

General matters for comment on Phase 2

Q21 – What are your views on whether *The AASB's Standard-Setting Frameworks for For-Profit and Not-for-Profit Entities* (the Framework) 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).

Paragraph 29 of the Framework indicates that the AASB must take into consideration user need, public interest issues and undue cost or effort considerations. We do not consider the AASB has provided sufficient evidence that it has applied these criteria in developing its CP.

Q22 – What are your views on whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?

To date 'comply with accounting standards', the term contained in legislation as well as many non-legislative agreements (such as trust deeds and the like), has been interpreted as applying the reporting entity concept. This concept has allowed for SPFS in circumstances where users can demand information from the entity and do not have to rely on GPFS to make decisions about scarce resources.

We consider that if 'comply with accounting standards' were to have a different meaning, and only mean that GPFS would be acceptable, this would require a substantial amount of clear evidence indicating that SPFS were not meeting the public benefit need for public reporting. We do not consider the CP has provided a substantial amount of clear evidence in this regard. Such a change would be substantial and have a huge increase in reporting burden on many companies, many of which are SMEs.

We understand the AASB may consider that many entities already adopt the recognition and measurement of IFRS and therefore the proposals in the CP may not impose a huge increase in reporting burden in this regard. The AICD challenges this finding, as this statement has never been tested through regulator findings and there is a lack of understanding of full IFRS accounting standards in the non-publicly accountable sector.

Q23 – What are your views on whether, overall, the proposals would result in financial statements that would be useful to users?

We believe the proposals in the CP provide insufficient evidence of the identity of users and their needs for the financial statements of non-publicly accountable entities. Therefore, we do not consider the proposals would result in financial statements that would be useful to users.

Q24 – What are your views on whether the proposals are in the best interests of the Australian economy?

AICD does not consider the proposals are in the best interests of the Australian economy, because:

- Sufficient evidence has not been provided to demonstrate the nature of the problem with SPFS; and
- The proposals will create an extensive compliance burden on business, particularly for SMEs. This would be contrary to the government's current efforts to provide initiatives to help small business grow through tax cuts, less red-tape, simpler GST reporting and providing tools for easier compliance.