Nexia Australia

2 November 2018

Ms Kris Peach
Chair
Australian Accounting Standards Board
Podium Level,
Level 14, 530 Collins Street,
Melbourne VIC 3000

By email: standard@aasb.gov.au

Dear Kris,

AASB ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* – Phase 2: Medium-term approach

We welcome the opportunity to provide the Australian Accounting Standards Board ("AASB", "the Board") with our views on Phase 2 of the AASB's Consultation Paper ITC 39.

On 4 September 2018, the Board decided to exclude not-for-profit entities from the proposals in ITC 39 and, instead, intends to develop a separate consultation paper for not-for-profit entities at some time in the future.

The AASB has stated in ITC 39 that it is not proposing a Tier 3 reporting framework. It has also previously stated its desire to develop and apply Australian Accounting Standards ("AAS") in a sector neutral manner. As stated in our response to Phase 1 of ITC 39, we remain concerned that the adoption of the Revised Conceptual Framework ("RCF") and decisions taken by the Board regarding the form and structure of Tier 2 GPFR in a piecemeal fashion (that is, initially only to for-profit entities), will lock the AASB and other stakeholders into adopting that single framework for not-for-profit entities.

Consequently, we strongly recommend that:

i) The Board not proceed with its current proposals until any amendments have been made to the financial reporting requirements and thresholds in the ACNC Act following the ACNC legislative review; and

ii) Subsequent to those changes, the AASB issue a comprehensive exposure draft incorporating its final proposals relating to both for-profit and not-for-profit entities to enable stakeholders to consider the Board's proposals in their entirety.

This submission should be read in conjunction with our comments on Phase 1 dated 9 August 2018.

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Comments on Phase 2: Medium-term approach

Issues the Board is attempting to address and justification for change

In our view, the AASB has not justified the urgent need for the changes contained in ITC 39. For example, through its own presentations and publications the Board acknowledges that:

- only 0.6% of all companies registered with ASIC (approximately 14,000 entities) prepare SPFR; and
- only 0.1% of all companies registered with ASIC (approximately 3,000 entities) prepare SPFR that do not fully comply with the recognition and measurement requirements of AAS.

A key element of the Board's reasoning for change is that data aggregators, credit analysts, banks and the Australian Taxation Office are users of financial reports and that they are disadvantaged, their benchmarking data invalidated or are not having their information needs met, by potentially 0.1% of entities not preparing GPFRs that comply with the measurement and recognition requirements of AAS. (ITC 39 para 53; AASB Staff Briefing presentation – September 2018)

Financial reports cannot be all things to all users. By virtue of the proposals contained in ITC 39, the AASB implicitly agrees that the information needs of users of non-publicly accountable entities' financial reports do not extend to all disclosures required by AAS. The AASB has asserted there are users without clearly articulating what information those users apparently want from financial reports that is not being currently provided.

Part of the AASB's justification for change is that some companies and entities registered with the ACNC and ASIC are not properly self-assessing their status as a non-reporting entity. We agree with the comments of the AASB Chair, who was quoted as saying, "from our perspective, the vast majority of companies are already complying with RG85 and doing the right thing and it seems very unfair to us that a small minority of people are not complying with the same requirement and really having a competitive advantage because they've chosen not to comply with ASIC's regulatory guidance." (Accountants Daily, 31 May 2018 https://www.accountantsdaily.com.au/tax-compliance/11726-aasb-speaks-up-on-proposed-financial-reporting-changes)

We suggest that if a small percentage of entities are not 'following the rules', then it is the responsibility of the regulators (ASIC and the ACNC) to address those instances rather than changing the existing framework.

We are aware that some vested interests support the Board's proposals as an opportunity to generate additional fees from the preparation and audit of GPFRs that mandatorily apply AASB 10 and AASB 128. In this scenario of winners and losers, we are concerned that the Board has not fully considered the additional costs to business and the increase in the regulatory burden on some entities of imposing this change.

Our responses to the specific matters on Phase 2 are contained in the attached appendix.

Should you wish to discuss any aspects of our submission, please contact the undersigned.

Sincerely

Nexia Australia Pty Ltd

Martin Olde
Technical Director

Appendix – Specific matters for comment on Phase 2

Specific matter for comment

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

We disagree with the AASB's Phase 2 approach as described in paragraph 166 for the reasons described at Q12 below.

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 prefer neither GPFR Tier 2 alternatives.

In our opinion:

i) the existing Tier 2 RDR contains excessive disclosures for non-publicly accountable entities; and

ii) the proposed Tier 2 SDR is excessive insofar that it requires all the disclosures contained in the four specified accounting standards, but not require disclosures contained in other Accounting Standards that may be relevant to users.

   Some preparers view the financial statement preparation process as a compliance exercise. We do not agree with the proposition that preparers will voluntarily present more information than mandatorily specified in Tier 2 in order for the financial report to present a true and fair view without the Board providing additional guidance.

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?

Our preliminary view is that there should be only one Tier 2 GPFS alternative and that SPFR should be available for those entities below reporting thresholds. Our preliminary view may change depending upon the outcome of the Board's proposals in respect of NFP entities.

Q14 – 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.

For the reasons set out by the Board in ITC 39, we agree that GPFS – IFRS for SMEs should not be available in Australia as a Tier 2 alternative.

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) Should AASB 1 be applied, or simpler relief provided? Please provide specific examples and information.

Appendix C Exemptions for business combinations of AASB 1 states "An entity shall apply the following requirements to business combinations that the entity recognised before the date of transition to Australian Accounting Standards". (emphasis added)

It is unclear, but unlikely, that entities currently preparing SPFS that do not apply AASB 10 would therefore be able to apply the exemptions for previous business combinations contained in Appendix C of AASB 1 unless the Board clarified the application of those requirements.

We maintain that full retrospective application of AASB 3 and AASB 10 would be impracticable. Furthermore, applying AASB 3 and AASB 10 prospectively to new business combinations would fail the AASB's own objective of IFRS compliance, comparability and arguably would not present a true and fair view of the entity's financial position or performance.

It is possible that other unintended consequences and practical difficulties may exist in applying AASB 1 on transition that we have not identified to date. We recommend that the Board undertake detailed field testing before deciding on transition requirements.

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.

We have significant concerns regarding the mandatory application of AASB 10 and AASB 128 as proposed in the AASB's medium-term approach.

Specifically, we have concerns from both preparation and audit perspectives. These relate to the ability of preparers to determine the business combination accounting to past transactions in accordance with AASB 3 (including which version would apply) and the ability of auditors to opine on such information.

We are unable to support the proposal without first undertaking significant additional outreach and analysis to explore and identify actual and unintended consequences as well as practical implementation issues arising from the Board's proposal. We recommend that the Board examine specific case studies to determine the practicality of its proposals.

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 with the proposed GPFS – SDR. We are unable to determine whether "the specified disclosures would best meet users' needs" because neither we nor the AASB have ascertained what the disclosure needs of hypothetical users are.

Nevertheless, in our opinion inclusion of the full disclosure requirements of AASB 15 and AASB 136 for entities that do not have 'public accountability' is excessive.

Q18 – Do you have any other suggested alternatives 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.

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).

As the AASB has deferred consideration of applying the proposals in ITC 39 to not-for-profit entities, this question is not addressed in this submission.

Q20 – Are you aware of any legislation that refers to SPFS that might be impacted by these proposals?

No.

General matters for comment

Q21 – 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).

We do not believe that the proposals satisfy the Board's objective of 'improving comparability, trust and transparency within financial reporting to meet user needs, whilst mitigating, where appropriate, the increased reporting burden for some entities who are required to prepare financial statements in accordance with AAS'.

Q22 – Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

ITC 39 states that" These proposals would not impact the 'public lodgment relief' granted to 'grandfathered proprietary companies' (provided they meet certain conditions) under s1408 of the Corporations Act. However, we note that these grandfathered large proprietary companies are still required to prepare financial statements and comply with the audit provisions of Chapter 2M.3 of the Corporations Act.

Because those entities are privately held and not required to publicly file their audited financial statements, those reports are predominantly prepared as SPFS.

Consequently, the effect of the AASB's proposals is that those entities will be required to prepare GPFS, notwithstanding those financial statements are not publicly available.

Those entities will face additional financial statement preparation time and cost as well as increased audit cost for no discernable benefit.

We are not satisfied that the AASB has undertaken a full cost/benefit analysis of, or identified all classes of entities that may be effected by, the proposals and remain concerned that the proposal will add to the regulatory burden of those affected entities for little or no public benefit.

Q23 – Whether, overall, the proposals would result in financial statements that would be useful to users.

In our opinion, the proposals in their current form, would increase the regulatory cost burden on many entities that outweighs the perceived benefits to an unidentified cohort of potential users.

Q24 – Whether the proposals are in the best interests of the Australian economy.

While the proposals may be viewed by some as in the best interest of the accounting profession, we believe that the cost to those affected entities outweighs the perceived benefits of the changes. We would prefer that if deficiencies exist in the existing reporting framework that the regulators use their existing enforcement powers to address those issues.

Many banking covenants, business purchase agreements, contracts and other non-legislative provisions require entities to prepare financial statements in accordance with AAS. At present, those users accept SPFS. By virtue of their relationship, those users can command additional information if required. We are concerned that the Board's scoping requirement to include entities that are required, or choose, to prepare financial statements to prepare GPFR will default those entities into GPFS, thereby increasing the cost of business for those entities. The Board's suggestion that those entities could renegotiate contracts and covenants or change constitutions is simplistic and ignores the cost to business of doing do.

Q25 – 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.

No additional comments.