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Mr Kevin Stevenson
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Dear Mr Stevenson Kevin

AASB ED 192 REVISED DIFFERENTIAL REPORTING FRAMEWORK

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the Australian Accounting Standards Board on the AASB Exposure Draft 192 *Revised Differential Reporting Framework.*

Comments by HoTARAC on questions from the Exposure Draft are in Attachment 1.

HoTARAC acknowledges that the proposals in ED 192 are intended to reduce the burden of disclosure requirements on Australian reporting entities. HoTARAC welcomes the AASB intent in developing a Reduced Disclosure Regime. Subject to the comments below, HoTARAC supports the AASB's efforts to reduce the disclosure burden on smaller entities, and it is also generally supportive of the AASB approach of maintaining consistent recognition and measurement criteria, but with reduced disclosure requirements. This approach maintains consistency in the consolidation of an economic entity while also meeting the needs of smaller entities within a group.

The majority of HoTARAC members believe that the extent of the proposed reduction in disclosures does not go far enough for the public sector. In particular, to achieve more simplified financial reports, which genuinely reduce the disclosure burden for public sector entities falling within the Tier 2 category, the proposed RDR should be broadened to include more standards and disclosure paragraphs. However a minority of HoTARAC members feel that the proposed RDR should not be broadened as this may adversely impact consolidated whole-of-government financial reporting.

HoTARAC believes that the proposed differential framework does not adequately address the financial reporting outcomes, or specific needs of, public sector entities. The public sector includes a vast range of very large and very small entities. For some of these entities, the recognition and measurement criteria, let alone the disclosure requirements, are not that relevant to the needs of the users, especially where the principal user is the relevant Minister on behalf of Parliament. As such, HoTARAC recommends that the AASB considers the development of a smaller entities framework, such as a third tier of financial reporting. This

tier would encompass entities that would normally be exempt from any disclosure in the for-profit sector.

HoTARAC welcomes the choice that the AASB has provided to public sector regulators in determining which lower level public sector entities fall within the RDR. HoTARAC recommends that the AASB develops guidance, in the form of qualitative criteria, to support this outcome.

A further matter is that HoTARAC believes that the IASB's definition of public accountability has a very narrow focus on the for-profit sector which creates uncertainty for the public sector. HoTARAC seeks clarification and guidance from the AASB in relation to public sector entities. A minority of HoTARAC members disagree with the AASB's proposal to modify/limit the reporting entity concept.

Finally, HoTARAC is concerned with the due process approach taken by the AASB, which seems to be driven by for-profit sector needs. HoTARAC also notes that the approach whereby the Consultation Paper and the Exposure Draft were issued for comment at the same time is inconsistent with past practice.

Due to the stage and urgency of the Project, HoTARAC supports the introduction of the RDR, which appears to mainly be focused on for-profit sector needs. However, HoTARAC strongly believes that, looking forward, the AASB should continue to pursue reforms to the development of the differential framework, particularly in reference to addressing those specific public sector entity issues identified in this submission. Some jurisdictions are investigating the impact of the proposed RDR. HoTARAC is keen to liaise further with the AASB regarding the specific public sector entity issues, to identify additional disclosure reduction that provides real benefit, related to user's needs and cost benefit, for the public sector.

If you have any queries regarding HoTARAC's comments, please contact Peter Batten from the Victorian Department of Treasury and Finance on (03) 9651 2395.

Yours sincerely

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

27 April 2010

Encl

Contact Amy McShane
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Our Ref AM/DT 10/42415

Attachment 1

HOTARAC Response to ED 192 Revised Differential Reporting Framework

HoTARAC acknowledges that the proposals in ED 192 are intended to reduce the burden of disclosure requirements on Australian reporting entities. HoTARAC welcomes the AASB intent in developing a Reduced Disclosure Regime while retaining full IFRS recognition and measurement requirements.

HoTARAC supports the move towards a differential framework. However, HoTARAC believes that the AASB should carry out further work in the development of this Framework, with particular reference to addressing specific public sector needs.

In particular, HoTARAC is concerned with certain proposals in ED 192, and considers that further work needs to be undertaken in the following areas:

- establishing qualitative attributes, or guidance, to assist public sector regulators distinguish between Tier 1 and Tier 2 entities. The majority of HoTARAC members support the relevant and appropriate public sector regulator being able to distinguish between Tier 1 and Tier 2 entities. HoTARAC also believes that the AASB should develop qualitative guidance to assist public sector regulators (see response to Question (a));
- the use of public accountability in ED 192 as a criterion for applying the exemptions under the RDR (see response to Question (c));
- modification/limitation of the reporting entity concept (see response to Question (e));
- the extent of the reduction in disclosures – there should be further reduction in disclosure requirements, as the current proposals do not go far enough for the public sector (see response to Question (f)); and
- the need for a third tier for very small public sector entities.

Public sector needs of a reduced disclosure regime

HoTARAC believes that the proposed differential framework does not adequately address the financial reporting outcomes for public sector entities.

The majority of HoTARAC members believe that the proposed RDR has not gone far enough in addressing the specific needs of public sector entities and does not demonstrate an understanding of the issues which would best meet public sector needs.

In particular, the proposed RDR seems irrelevant to the public sector. Under the proposed RDR, most of the topics or disclosure paragraphs selected for exclusion (ie disclosures now exempt to Tier 2 entities) are rarely used by public sector entities and currently do not impact at the whole-of-government level. The disclosures selected for exemption to Tier 2 entities are mainly

for-profit sector disclosures. In effect, disclosures for a public sector entity, regardless of whether they are under Tier 1 or Tier 2, will be the same. As such, it would appear that the proposed reduced disclosure regime will not, in practice, produce benefits for public sector entities.

Further, given that there are a large number of very small entities within the public sector, especially in some jurisdictions, the proposed RDR would not have a major impact on many smaller entities in the public sector and so does not meet the user's needs for such entities. These small entities would be exempt from reporting if they were for-profit sector companies, but the need for transparency and accountability in the public sector demands some level of non-onerous, value for money, reporting.

HoTARAC recommends that the AASB considers the following before finalising the proposed RDR for the public sector:

- Within the public sector, there are a very large number of entities which vary in size, nature, structure and responsibility. For example, these entities range from very large government departments to very small statutory authorities and committees of management. As a consequence, the user/stakeholder needs of these entities vary. However, the common factor is the need to achieve an appropriate level of financial reporting accountability to the specific users – in some instances, complying with the full set of Australian Accounting Standards achieves this, however, there are also many instances, where this may not be appropriate level of reporting.
- As acknowledged by AASB, the need for public accountability is very different to that implied by the IASB's definition. In the public sector, the term public accountability generally refers to the relationship between those who govern (ie the State) and those who are governed (ie the public). Those in government are expected to be accountable to the public for their decisions and actions. Likewise, there are many entities, entrusted with public resources, which are required to be held accountable for their fiscal and social responsibilities by those that have entrusted those resources to them.
- Financial reporting as a tool to achieve accountability has sometimes a different application in the public sector as opposed to the for-profit sector. Unlike the for-profit sector, financial statements are merely one way in which a public sector entity discharges its accountability obligation to users. Often the key accountability mechanism, that satisfies user's needs, for small entities, is a statement which indicates to public sector stakeholders what the resources were that have been committed and to what purpose these have been committed – the issue of the accounting basis is often not as relevant to a stakeholder decision as to the best purpose application of committed resources. The critical issue is for reporting to be done on a consistent basis that is meaningful to users. This may be on a cash basis, or otherwise not comply with existing onerous Accounting Standards.

- The majority of HoTARAC members consider that the current RDR does not go far enough – to achieve simplified financial reports, even for Tier 2, the RDR net needs to be cast much more widely to include more standards and disclosure paragraphs.
- Consistent with the principles of Trans-Tasman convergence, New Zealand recognises that, for very small entities in the public sector, public accountability can be achieved through simple format reporting, with very reduced disclosures. The implications of the proposed RDR for very small entities in the public sector will be a highly onerous disclosure burden to bring them within the Tier 2 realm (which in effect will be the same level of disclosure as required under Tier 1); and
- the AASB should acknowledge that the development of a reporting framework for Tier 2 and smaller entities can achieve accountability in a cost effective way. Further, recent developments in accounting standard-setting demonstrate this, for example IPSASB's development of cash-based reporting standards for small entities, as well as developments in the European Union exempting micro-entities from the requirement to prepare annual accounts.

Specific user needs of public sector financial statements

- Paragraph IN6 Appendix C of ED 192 and Paragraph 8.3 of the Consultation Paper, refer to the user needs of for-profit entities that do not have public accountability. Amongst the considerations listed, the AASB proceeds to note that, in determining the disclosures under the RDR, the information needs of the users of financial statements of not-for-profit entities should be considered. However, the user needs listed are not exhaustive of the specific needs of public sector entities. Both the ED and Consultation Paper fail to recognise what the specific information needs are for users of public sector financial statements prepared in accordance with Accounting Standards. HoTARAC believes that there should be a public sector equivalent to Paragraphs IN6 and 8.3.
- Paragraphs 9.6 and 9.7 of the Consultation Paper do not necessarily apply to the public sector. In the public sector, the results, assets and risks of all entities, unless immaterial or insignificant, are consolidated into the whole-of-government and General Government Sector financial statements. Therefore the economic risk, which the AASB discusses in these paragraphs, does not apply in the same way in the public sector as for individual entities in the for-profit sector. Creditors or employees are not going to be left out of pocket by the failure of a government entity. This further reinforces the need for an even more reduced disclosure framework, and possibly a third tier as indicated above.

A minority of HoTARAC members believe that since, in some jurisdictions, all public sector entities have adopted the full recognition, measurement, presentation and disclosure requirements of IFRS, the benefits of allowing some entities to now fall within the Tier 2 category are outweighed by the disadvantages associated with the problems that may arise when preparing consolidated whole-of-government financial reports. This view advocates that,

for the purposes of preparing consolidated whole-of-government financial statements, any presumed savings identified under the RDR may not be realised. Therefore, this view does not consider there to be any benefits in broadening the proposed RDR.

Detailed HoTARAC comments in response to questions (a) to (k), are attached.

Question (a) whether you agree with the introduction of a second tier of reporting requirements for preparing general purpose financial statements (GPFSs) for:

(i) for-profit private sector entities that do not have public accountability;
(ii) not-for-profit private sector entities; and
(iii) public sector entities other than those required by the AASB to apply Tier 1?

If not, and you support differential reporting, what other classifications of entities do you think would be more appropriate for differential reporting and why?

ED 192 specifies those public sector entities required to be Tier 1 as Australian, State, Territory, Local Governments and Universities. The AASB provides a choice to other public sector entities between applying the full IFRS and the reduced disclosure regime. However, this choice may be subject to a relevant public sector regulator.

The majority of HoTARAC members welcome the choice, citing the benefits of applying local criteria. However, a minority of HoTARAC members believe that it is problematic to push this decision to a public sector regulator, citing that this decision cannot be deferred by the AASB, as it is a fundamental concept, the outcome of which may result in incomparability between like entities across jurisdictions.

There is some confusion amongst the majority of HoTARAC members as to what reference point regulators should use in deciding which entities need to prepare GPFSs under Tier 1, Tier 2 or not at all. The AASB, in both the ED and the Consultation Paper, identifies the application of the reporting entity concept as the underpinning benchmark to determine which entities should prepare GPFSs, but this does not assist in determining the entities that should be included in Tier 1 or Tier 2, given that both will have the status of GPFSs.

One suggestion would be to provide qualitative guidance to regulators, which would address both the user need and cost benefit issues. A framework for decision making that considered the risk profile, level of complexity of the entity and size would be an appropriate benchmark. In terms of size, consideration could be given to a threshold criteria, such as total assets, net assets or total expenses, based on materiality for each jurisdiction. However, HoTARAC would not support the AASB setting quantitative measures. Other

factors that should be considered in developing this guidance could include cost benefits, whether the entity is a material entity to be consolidated into the whole-of-government financial statements and the level of political sensitivity associated with the entity.

Extent of simplification and reduced disclosure requirements

Further, the majority of HoTARAC members welcome a regime that leads to simplified financial reporting, subject to the comments above on the distinction between Tier 1 and Tier 2. However, they have concerns in relation to the extent of the simplification and the reduced disclosure requirements for the public sector.

The AASB's decision to provide a choice to the public sector recognises that this issue exists. However, in itself this is problematic. The AASB has identified two tiers – in the Consultation Paper, the AASB recognises that "there are potentially thousands of entities that would be able to apply a second tier of GPFS requirements". Potentially, the development of a third tier would best address this issue for very small entities, – a further tier of simplified, but adequate, financial reporting would recognise the activities and responsibilities, but limited credit risk, of many public sector entities.

The current AASB proposal that public sector entities should have a choice of applying Tier 1 or Tier 2, except for governments (Australian, State, Territory and Local Governments) and Universities is understood in the context that the governmental structure under the whole-of-government or General Government Sector varies from jurisdiction to jurisdiction. The classification and structure of governmental entities varies across jurisdictions, for example in Victoria there are currently 10 large departments, and over 200 small government entities, and a similar number of public corporations. In addition, there are a large number of very small entities such as community boards of management. Whereas, in other jurisdictions such as New South Wales and Western Australia, there are a higher number of entities classified as departments, and a lower number of other government entities and public corporations.

Given this variability in the structure of government administration across jurisdictions, the majority of HoTARAC members believe that it is appropriate that the AASB has remained intentionally silent on the issue of whether departments and other government agencies should be Tier 1. HoTARAC welcomes the AASB's decision to leave this important distinction to the public sector regulators.

However, in so doing, this raises a number of practical issues. Namely, this may result in inconsistencies and comparability of entities' note disclosures across the jurisdictions. There may be some entities which perform similar activities in different jurisdictions which may have different disclosures dependent on the decision made by the relevant public sector regulators. Of course, the issue of comparability will be related only to the relevant RDR exemptions. HoTARAC accepts that from a recognition and measurement perspective, Tier 1 and Tier 2 financial statements remain the same.

Therefore, HoTARAC recommends that the AASB considers providing terms of reference to regulators, which would require them to consider the differential framework in terms of an entity's risk profile, the level of complexity and size.

HoTARAC does not support the inconsistency in principle which may arise from ED 192 Paragraph 35. The outcome is a parallel basis for determining which entities prepare GPFSs. Some for-profit sector entities will use the public accountability criteria, whilst other not-for-profit entities use the reporting entity concept. Likewise, ED 192 creates parallel criteria for the public sector - mandating those entities which are Tier 1, whilst requiring the remainder to apply the reporting entity concept (see also response to Question (e)).

It may help to have some acknowledgement by the AASB that regulators may utilise some appropriate qualitative threshold criteria to support their decisions. A typical threshold or criteria may be total assets, total net assets or total expenses, based on the materiality concept. This criteria would at least provide some certainty to entities and regulators alike, although any final decision should be left to the jurisdictions and regulators concerned. HoTARAC does not support the AASB setting quantitative measures because of the variations between jurisdictions.

Consideration of a reporting framework – a third tier - for very small entities in the public sector

As described above, there is high variability in the nature, purpose, size and structure of entities within a single jurisdiction, let alone across the broad spectrum of jurisdictions represented by HoTARAC.

Victoria, consistent in part with recent developments in New Zealand under the *Proposed Application of Accounting and Assurance Standards under the proposed new statutory framework for financial reporting* put forward by the Accounting Standards Review Board of New Zealand, argues that for very small public sector entities, the principle of public accountability, as it is widely understood in the public sector, can be fulfilled through the appropriate simplified level of transparent disclosure and reporting.

Simple format reporting, or the development of a simple set of reporting requirements, should apply to this large subset of entities in the public sector. The current New Zealand proposal includes the development of a third tier, with the following features:

- mandates the use of accrual accounting;
- requires that recognition and measurement principles be consistent with the full set of applicable Accounting Standards;
- fundamental disclosures required to be applied, appropriate to the sector;

- minimum requirements include a Statement of Financial Position, a Statement of Financial Performance and simple service performance reporting; and
- the use of a template type approach.

New Zealand envisages that the Tier 3 reporting requirements would be a simpler form of the differential framework.

Victoria would go further and not mandate the use of accrual based accounting for very small entities. These entities are typically not consolidated into whole-of-government financial reports because of their immateriality. Victoria notes that the IPSASB has a Accounting Standard that addresses financial reporting under the cash basis of accounting. Globally, relatively few governments have adopted full accrual accounting. Consequently, Australia may be setting higher standards for school councils or small cemetery trusts than achieved by many governments.

A minority of HoTARAC members believe that the AASB should not have any role in specifying these requirements (provision of guidance to public sector regulators). This view supports the AASB's current proposal that each individual regulator/responsible authority should have the capacity to set down financial reporting requirements.

Question (b) whether you agree that entities within the second tier should be able to apply the proposed reduced disclosure regime, which retains the recognition and measurement requirements of full IFRSs or would you prefer another approach (e.g. IFRS for SMEs)?
If you prefer the IFRS for SMEs, what do you consider to be the specific advantages of the individual differences of recognition and measurement requirements in the IFRS for SMEs compared with full IFRSs?

Under a reduced disclosure regime, the RDR as proposed by the AASB is preferred by all jurisdictions over the IFRS for SMEs. This is because the proposed RDR retains the full recognition and measurement requirements of IFRSs, enabling ease in the consolidation of material entities at the General Government Sector and whole-of-government levels and minimises GAAP-GFS differences.

The overriding principle in considering what the appropriate recognition, measurement, presentation and disclosure requirements should be for entities that are not Tier 1 entities (that are not required to comply with the full disclosure requirements of IFRS), is the qualitative characteristics of the financial statements themselves.

The benefit of preparing financial statements which comply with Accounting Standards is derived from the minimum requirements set by standard-setters for information for users/stakeholders that is useful and relevant to their

decision making. As such, as identified by the IASB, there is evidence that user's needs differ for smaller entities. HoTARAC agrees that there is a need to distinguish entities within a second tier and develop a reduced disclosure regime to meet this need.

To retain the recognition and measurement requirements of full Accounting Standards will ensure user's understandability of financial statements and comparability. HoTARAC is of the view that the reduced disclosure regime aim is to provide sufficient information by removing unnecessary disclosure for this type of entity.

Question (c) the definition of public accountability (which is used to identify those for-profit entities that must apply Tier 1) and whether there are categories of entities in the Australian environment that should be cited as examples of publicly accountable entities other than those already identified in paragraph 26.

As indicated in the general comments section of HoTARAC's response, the majority of HoTARAC members have an issue with the use of the IASB's definition of public accountability, on the basis that it creates confusion and uncertainty in the public sector. This definition is not consistent with universal understandings of public accountability.

In particular, while the differentiation of the meaning of public accountability for the for-profit sector and public sector is clearer within the detail of the Consultation Paper, the description on the cover sheet and on Page 5 could lead some readers to assume that certain activities in the public sector are non-publicly accountable. HoTARAC suggests in the additional comments section, that this could be better expressed.

The majority of HoTARAC members consider that the AASB should provide clarification on the use of the term publicly accountable due to confusion on its applicability to the public sector. Most HoTARAC members would prefer a broader definition of public accountability which would capture the public sector. However, HoTARAC does concede that, in developing this definition, IASB was predominately pre-occupied with its application to the for-profit sector.

In addition, as advised above, because the wider needs of public accountability in the public sector capture, in some jurisdictions, the reporting of some very small entities, this generates the need for a further very simplified third level of reporting, such as that applied in New Zealand.

Use of 'public accountability' terminology in the public sector

HoTARAC is concerned that the use of the IASB's public accountability definition in ED 192 causes confusion and uncertainty for the public sector because the term public accountability is already a well used term in the public sector.

The IASB's definition for public accountability has a very narrow focus (on the for-profit sector only). An entity is considered to have public accountability if its debt or equity instruments are publicly traded or will be publicly traded; or it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

However, in the public sector context, the term public accountability generally refers to the relationship between those who govern (ie the State) and those who are governed (ie the public). Those in government are expected to be accountable to the public for their decisions and actions. Likewise, there are many entities, entrusted with public resources, which are required to be held accountable for their fiscal and social responsibilities by those that have entrusted those resources to them.

All HoTARAC members agree that, for transparency and public accountability, all entities need to prepare financial statements/reports that are transparent and fit for purpose. This is consistent with the principle of presenting fairly, with relevant and appropriate disclosure, the funds and activities of the governmental unit, in compliance with Generally Accepted Accounting Principles.

A minority of HoTARAC members believe that to be consistent with this generally understood concept of public accountability, that all entities in the public sector should prepare full general purpose financial statements.

However, the majority of HoTARAC members believe that a differential framework of reporting is preferable based on the user needs (fit for purpose) and risk profile of the entity. Consequently, the introduction of a differential disclosure regime is consistent with this preference.

HoTARAC has not identified any other examples or categories of entities in the Australian environment that should be cited as examples of publicly accountable entities other than those already identified in ED 192 Paragraph 26.

Question (d) whether you would require any other classes of public sector entities, such as Government Departments, Government Business Enterprises or Statutory Authorities, to be always categorised as 'Tier 1' reporting entities and, if so, the basis for your view.

HoTARAC supports the AASB determination of which entities in the public sector automatically default to Tier 1 classification. HoTARAC agrees that Australian, State and Territory governments will "always" be categorised as Tier 1, - by virtue of their size, complexity, risk profile and accountability obligations to stakeholders.

However, HoTARAC members remain divided about which entities below the government entity should fall into Tier 1. There is general consensus that government departments and many government business enterprises

(government corporations) may more appropriately fit within Tier 1 than Tier 2. However, the majority of HoTARAC members prefer to leave this decision to the regulator, subject to the AASB providing additional qualitative guidance.

Further investigation is required to make a full assessment.

For the public sector – Tier 2 and Tier 1 disclosure requirements are in effect largely the same.

For many entities in the public sector, there will be negligible impact in terms of reduced disclosure, regardless of whether they are Tier 1 or Tier 2. Therefore there are no perceived benefits to any public sector entity, particularly in terms of cost savings, of electing to be Tier 2. Under the current RDR proposal – Tier 1 and Tier 2 public sector entities will effectively have the same level of disclosures.

More work is required to be done to meaningfully reduce public sector Tier 2 disclosures.

Question (e) the clarification of the meaning of GPFSs and modifying the way the reporting entity concept is used.

Within the Exposure Draft, Paragraph 24 defines GPFS and Paragraph 27 explains the conditions that must exist to prepare financial statements as GPFSs:

- financial statements are required to be publicly available; or
- prepared under AASs under legal mandate; or
- required to be GPFSs under legal mandate.

The majority of HoTARAC members acknowledge that there are examples/instances where the reporting entity concept has been inappropriately applied, sometimes deliberately so. As such, HoTARAC accepts that to maintain consistency with the IASB's approach of establishing a brand "financial statements prepared in accordance with IFRS", it is appropriate to modify the meaning of GPFSs in Australia.

However, in this context, HoTARAC is disturbed by the residual use of the reporting entity concept in Paragraph 35 of the Exposure Draft. What is the underlying intention of this Paragraph, stating that the reporting entity concept will be the underlying basis for GPFS preparation? How does it assist differentiation between Tier 1 and Tier 2, given that both will result in GPFSs?

The AASB has made it clear in both the Exposure Draft and in the Consultation Paper (Paragraphs 9.9-9.11) that regulators are expected to use the reporting entity concept as a benchmark in identifying entities that should prepare GPFSs. Is the AASB proposing parallel criteria for the preparation of GPFSs? It appears that the AASB is proposing that the for-profit sector applies the public accountability definition, and regulators in the public sector

must apply the reporting entity concept. How then does this apply to not-for-profit private sector entities, which are also given the public sector choice – two sets of criteria for the private sector? HoTARAC believe that this issue needs to be addressed before the Exposure Draft can be formally adopted.

A minority of HoTARAC members propose that there be no modification to the way the reporting entity concept is used. This view suggests that since it has been used in Australia since the early 1990s, and is now widely understood, the focus should not now change to GPFS. This view believes that the reporting entity concept should not be abandoned as it answers the fundamental question of who should be preparing GPFS. In contrast, the proposed approach will largely leave the answer to this question to the regulators.

Traditionally, the use of the reporting entity concept in the application paragraphs to the Standards has meant that the principle of who should report has been the realm of the Accounting Standard-setters. The danger in leaving this to the regulators is that the regulators are not compelled to follow any reporting entity principle. This means that entities that would have otherwise been reporting entities may not be required by regulators to report.

Modification/limitation of the reporting entity concept

Currently, the AASB provides guidance to regulators in ED 192 Paragraph 35: "the reporting entity concept is expected to be used as a benchmark by other regulators in identifying entities that should prepare GPFSs (whether Tier 1 or Tier 2) and those that need not".

Further, in the Consultation Paper, reference is made to "retaining the reporting entity concept as an underpinning concept" (Paragraphs 9.9-9.11).

It seems that the AASB, in placing the responsibility of making the cost benefit analysis onto the regulators, should, as suggested above, acknowledge the appropriate framework within which to do this. Reference to the reporting entity concept as a benchmark seems almost contradictory to the proposed RDR reforms.

Further, it would seem inappropriate to consider amending the reporting entity concept in SAC 1 and SAC 2 (Paragraph 44) prior to the completion of the IASB's Conceptual Framework review.

Question (f) the extent and nature of the proposed disclosures under the RDR (Tier 2), including whether the RDR would be effective in reducing sufficiently the disclosure burden on entities in preparing their GPFSs.

The real impact, in terms of burden of disclosure, will be on for-profit sector entities not already applying full IFRS recognition and measurement, as a result of AASB broadening the scope of which entities prepare GPFSs – as

such entities which are now required to prepare GPFSs transition into Tier 2, they will be required to apply the increased recognition and measurement requirements ED 192 Paragraph 40.

Conversely, there will be little impact on the public sector.

In terms of the disclosure exemptions proposed under the RDR, there are two key issues which need to be addressed:

- the extent of the exemptions for Tier 2 entities – the exemptions are not sufficient in a reduced disclosure regime for the public sector – they are too limited; and
- the basis for, and the process by which, the AASB intends to maintain the RDR.

On the first issue, HoTARAC is mainly concerned that the disclosures do not go far enough for Tier 2 entities. Further, as mentioned in the general comments section, a preferred approach for the public sector is that very small entities would be a third tier, similar in nature to what is currently being proposed by New Zealand. This would offer, to some part of the public sector, a genuine reduction in the reporting burden, enabling a simpler reporting format that would still meet user needs and cost benefits whilst fulfilling public accountability expectations.

A majority of HoTARAC members support the introduction of a third tier into this disclosure regime, similar to what is currently being proposed by the New Zealand Accounting Standards Review Board. Under such a differential framework, a simple format reporting structure would be applicable which would still enable small government entities to fulfil the public accountability needs of those public sector entities, which, if they operated in the for-profit sector, would be completely exempt, from any external reporting requirement.

Notwithstanding the development of such a third tier for Australian public sector entities, the current disclosure reductions proposed under the RDR, would not result in sufficiently reduced disclosure requirements for public sector entities which fall within Tier 2. The disclosures identified for exemption mainly apply to for-profit sector entities falling within Tier 2.

In addition, HoTARAC is concerned with instances where inconsistent disclosure exemptions have been identified relating specifically to public sector entities that may be Tier 2. For example, a comparison of AASB 1004 *Contributions* and AASB 1050 *Administered Items* highlights this inconsistency. Current proposals require all entities (Tier 1 and Tier 2) to apply the full disclosure requirements of AASB 1004 (as it seems the AASB is assuming departments will be Tier 2). Yet in AASB 1050, the RDR exempts Tier 2 entities from disclosing in their administered items note to the financial statements, the relevant income and expense items attributable to a government department's activities and those amounts not attributable (Paragraphs 7(a)(ii), 7 (b)(ii), 8 and 9). On what basis has the AASB determined that the disclosure of contribution income (Paragraph 60(a)

AASB 1004) is a more critical disclosure than the administered activities disclosures required by AASB 1050 Paragraph 7?

HoTARAC seeks clarification from the AASB on the basis of what appear to be contradictory positions prior to the current Exposure Draft being adopted.

Question (g) any particular disclosure requirements that:
(i) have been retained in the RDR that you consider should be excluded from the RDR, and your reasons for exclusion;
(ii) have been excluded from the RDR that you consider should be retained, and your reasons for retention.

The majority of HoTARAC members believe that the differential framework proposals do not go far enough. Most HoTARAC members are investigating the impact of the proposed RDR. HoTARAC is keen to liaise further with the AASB regarding this issue to identify additional disclosure reduction that provides real benefit, related to users' needs and cost benefit, for the public sector.

Inconsistent application of the RDR

The majority of HoTARAC members have concerns in relation to the basis of determining the relevant disclosure exemptions. Whilst the AASB have clearly explained the way in which it has adhered to the criteria applied under IFRS for SMEs, there seems to be inconsistencies in a number of paragraphs shaded under the RDR, specifically in relation to exemptions on the disclosure of comparative information from one Standard to another, the introduction of new RDR paragraphs and RDR Aus paragraphs.

The AASB should have been clearer in its intentions when, in certain cases, it shaded out multiple paragraphs and replaced them with new RDR paragraphs. This unexplained approach has caused confusion to readers.

HoTARAC also seeks further clarity from the AASB about the basis on which exclusions/exemptions under the RDR were determined. Appendix C of ED 192 sets out the basis for determining the type and extent of disclosures under the proposed RDR. Effectively, the AASB has adopted the IFRS for SMEs approach. However, as indicated in HoTARAC comments under Question (b) above and in the general comments section, in relation to concerns with the application of Paragraphs IN6 and 8.3, HoTARAC does not feel that these apply adequately or appropriately to the public sector.

In addition, clarity is sought from the AASB on the basis of which AASB 101, Paragraph Aus 138.6 has been excluded from the RDR. That Aus paragraph relates to the disclosure of commitments. This seems more relevant to IFRS for SMEs disclosure criteria (as per IN6 ED192) – "short term cash flows about obligations, commitments or contingencies".

The second issue of concern for HoTARAC relates to the basis for and the process by which, the AASB intends to maintain the RDR. Clarity is sought from the AASB on what is meant by "maintaining the RDR on a continuous basis" (Paragraph 42 of ED 192).

Question (h) transitional provisions for entities applying Tier 1 or Tier 2 for the first time and moving between Tiers.

The transitional arrangements appear quite complex and onerous, with the main transition burden being for entities moving from Tier 2 to Tier 1, or for previous Special Purpose Financial Statements preparers moving into either the Tier 1 or Tier 2 categories.

In relation to the implications for public sector entities, the AASB should provide some clarity around these transitional arrangements, particularly in relation to the adoption of AASB 1.

For example, an SPFS preparer moving into Tier 2, say a small public sector entity which is considered to now be publicly accountable on the basis of a government decision, would have to adopt AASB 1, thereby adopting the full recognition and measurement requirements of IFRS. This would appear to result in onerous requirements for an entity that would otherwise not be considered to be a reporting entity.

This raises the issue of the application of AASB 1 by public sector entities. If an entity moves from Tier 1 to Tier 2, then back to Tier 1 again then they are required, under the current proposals, to re-apply AASB 1 (if they did not already apply the full recognition and measurement requirements). However, how would an entity re-apply AASB 1 in the public sector given the requirements of AASB 1049? AASB 1049 applies to whole-of-government, and the General Government Sector consolidated entity. How would these entities then be consolidated in the economic entity under the current proposals?

This may also be problematic if, as a result of a government decision which results in some sort of administrative restructure/Act of Parliament, perhaps the merger of three public entities, say three service providers, public non-financial corporations, which as individual entities may be reasonably small in their own right, and had been preparing SPFS for a long time. These entities, by virtue of merger, may have to enter the Tier 2 category. What would be the practical implications of this? The entity concerned would have to adopt AASB 1? Yet how would the new merged entity actually adopt the full recognition and measurement principles of IFRS? Would the individual entities have to adopt them first, prior to merger?

Consideration should also be given as to whether the RDR framework requires an equivalent of AASB 1.

Question (i) whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals

There are probably a few relevant developments which the AASB may need to be mindful of in the interaction with this differential framework. These are listed below.

The Australian Government's Corporations Amendment Bill proposals and the NSW Fair Trading Exposure Draft provide examples of what happens when the reporting entity concept is abandoned. The regulator proposes to exempt some companies limited by guarantee from reporting (based on thresholds). The regulator proposes to exempt parent entities from separate reporting and proposes to exempt small cooperatives from reporting (again based on thresholds). The danger here is that the regulator could effectively exempt entities from reporting that would ordinarily be classified as reporting entities required to report.

Proposed differential reporting framework under the Corporations Act (Corporations Amendment Corporate Reporting Regime) Bill 2010.

- This Bill proposes the introduction of a differential reporting framework for companies limited by guarantee, resulting in a three tiered reporting framework based on thresholds, with some entities being totally exempt from reporting.
- Another proposal in the Bill is to relieve parent entities from preparing and lodging financial statements when they prepare consolidated financial statements. The reason for this proposal is the long-standing debate over whether parent entity financials are really useful when consolidated financials are also prepared.

The Australian Government's *Commonwealth Authorities and Companies Legislation* (CAC Act) requires all Australian Government's companies to report as if they were public companies.

Trans-Tasman convergence issues (developments in New Zealand)

New Zealand is currently proposing something quite different to the Australian proposals:

- New Zealand proposes three tiers instead of two – the third tier consists of not-for-profit private and not-for-profit public sector "small" entities who would report in a "simple format". The tiers are based on thresholds.
- New Zealand proposes different sectors; i.e. for-profit public sector would be included with other for-profit entities while the public sector is considered to be all not-for-profit. Australian proposal has public sector in one category – both for-profit and not-for profit entities.
- New Zealand relies on the *IFRS for SMEs* for its Tier 2 and a reliance on IPSAS for some of the categories: Australia is likely to reject the *IFRS for SMEs* and does not seem ready to embrace IPSAS.

So, overall, public sector convergence between Australia and New Zealand may be difficult.

NSW Fair Trading ED on revised Cooperatives Law that could be adopted nationally

- Large cooperatives will apply Accounting Standards.
- Small cooperatives will be exempt from financial reporting.

Victorian proposed Public Finance and Accountability legislation

- Proposes four categories of entities, with Category 4 (the lowest level) of entity, not necessarily applying the recognition and measurement requirements of accounting standards. Reporting for these very small entities may well be on a cash basis.

Question (j) whether, overall, the proposals would result in reducing the costs of preparing GPFSs that would remain useful to users.

The impact of the reduced disclosure regime has not been fully assessed by HoTARAC members due to timing constraints. HoTARAC's preliminary view is provided below, subject to comments made above regarding the extent of the disclosures.

In its Consultation Paper, the AASB makes a number of assessments on the extent that the RDR will reduce costs of financial statement preparation for both preparers and users. HoTARAC queries some of the assumptions made and the conclusions reached.

Specifically, HoTARAC questions the claim in Paragraph 6.2 of the Consultation Paper, which sets out Table Option 1: the reduced disclosure regime. In the table for preparers, the AASB makes the assessment that there will be:

> Significantly reduced audit and assurance costs, on the basis that there are significantly fewer disclosures and the extent of audit and assurance work in connection with the GPFSs is expected to be reduced with a commensurate reduction of costs.

On what basis does the AASB make this claim? It is widely understood that assurance is provided in the audit process based on compliance with all of the relevant and applicable AASs, assurance is not based on compliance with the disclosure paragraphs alone. Therefore, for many entities, especially those moving into the Tier 2 category for the first time from full IFRS, the audit cost and time reduction may actually be negligible. If anything, there may be additional time and cost involved to ensure that Tier 2 entities correctly apply the RDR.

Also, under the table for Option 1 setting out the impacts to users, the AASB states that, in relation to the overall effect on comparability to users, the impact is neutral because both Tier 1 and Tier 2 entities will be applying the

full recognition and measurement principles under full IFRS adoption. However, there may be instances where an entity will require some comparative information in relation to disclosures, for example comparatives on the fair valuation of financial instruments, in order for the financial statements to be comparable.

For many entities currently preparing SPFSs, there will definitely be a negative impact, as the cost of disclosure/the reporting burden may rise. The impact of this will also be in terms of applying AASB 1 and the full recognition and measurement requirements of IFRS. Under the IFRS for SMEs approach, these entities would only have to refer to the one collection of standards which will be updated at defined intervals. Under the RDR approach, they will have to refer to a vastly larger and often less clearly written, body of literature which is prone to being updated frequently on a somewhat ad hoc basis.

Question (k) whether the proposals are in the best interest of the Australian economy.

From the perspective of reducing the disclosure burden, there may be some reduction in the cost of financial statement preparation, however it is not expected to make such a significant difference in the quantum of costs for there to be an obvious significant flow on effect on the Australian economy.

The extent of reduced disclosure requirements mainly benefit the for-profit sector as the main focus is on the financial instruments (AASB 7), related party transactions (AASB 124), income taxes (AASB 112), leases (AASB 117), impairment of assets (AASB 136), employee benefits (AASB 119) and share-based payments (AASB 2).

Additional Comments

HoTARAC also considers the following issues to be of importance in the development of a differential reporting framework:

Consultation process and early adoption issues

The AASB is ambitious in setting a requirement for a final standard to be adopted by 30 June 2010 in anticipation that entities will early adopt. HoTARAC is concerned with the due process outlined in ED 192. HoTARAC is of the view that it is both impractical and unrealistic for the AASB to expect that public sector entities will be in a position to early adopt by 1 July 2010. Across the Australian public sector, most jurisdictions are in an election year, or as in the case of Victoria, both an election year and the potential implementation of change in its financial management/public accountability legislation.

The consequences are that very few public sector entities will be in a position to early adopt the proposals as this will require greater consultation processes

and the development of supporting guidance materials. It would be extremely unlikely for any public sector entity to adopt for the financial year beginning on 1 July 2009 or even 1 July 2010.

The timing outlined in the Exposure Draft and Consultation Paper appears to be driven by for-profit sector needs. The timing does not reflect the public sector reality of consultation and Budget preparation requirements. HoTARAC understands and appreciates the needs of the for-profit sector and the value of adopting the current proposals. As such, HoTARAC does not intend to impede the AASB's process in meeting the needs of these constituents. However, HoTARAC would like to strongly reinforce the view that the present proposals do not reflect the best interests of the public sector in Australia.

In addition, HoTARAC is of the view that the due process, whereby the Consultation Paper was issued for comment at the same time as an Exposure Draft with the same date for comments to the AASB, is inconsistent with past practice.

Intent and implication of shading

Clarity is required in relation to the intent and implication of shading in a number of AASs/AAS paragraphs which refer specifically to Tier 1 entities (as specified by the AASB).

For example, in AASB 1052, Paragraphs 11-14, which apply only to local government, are shaded, denoting that they are exempt to Tier 2. However, local government is a mandated Tier 1 entity. Could the AASB please clarify to which Tier 2 local government entities these paragraphs will apply?

Further, in relation to AASB 1052, Paragraphs 20-21, which apply only to government departments, are shaded. In these instances, such exemptions under the RDR may be problematic, should a regulator deem that government departments are Tier 1 entities.

Interaction with audit requirements/audit standards

It is important for public sector entities, such as statutory authorities, to be clear as to what type of financial statement has been made (to Parliament) and what type of audit opinion has been issued.

Universities

A minority of HoTARAC members question the proposed AASB requirement that Universities be mandated Tier 1 entities. It is suggested that since Universities are statutory bodies (in some specific jurisdictions) then they should be subject to the same reporting requirements that apply to other statutory bodies in that jurisdiction – that is; the decision should be left to the local regulator.

While it is acknowledged they are large entities, there would appear to be no conceptual reason mandating the classification of Universities under Tier 1 of the differential reporting framework – they have no coercive power to tax, rate

or levy. They do obtain Australian Government funding and voluntary donations, but so do many government departments. As Universities may be more akin to other potential public sector Tier 2 entities, the basis for their inclusion in Tier 1 is questioned.

Branding of the RDR proposals

Both the Consultation Paper and the Exposure Draft headline the proposals as: "A proposed reduced disclosure regime for non-publicly accountable for-profit private sector entities and certain entities in the not-for-profit private sector and public sector".

This headline could potentially create confusion about applicability to the different sectors and should be clarified. As it currently reads, the headline implies that public sector entities are not publicly accountable. A possible suggestion would be to amend the wording to: "A proposed reduced disclosure regime for certain entities in the not-for-profit private sector and public sector and for non-publicly accountable for-profit private sector entities".

General shading/referencing errors

AASB 138 Paragraph RDR 118.1 refers to Paragraph 73(e). This is incorrect and the reference should be to Paragraph 118(e) instead.