ACT Government
Chief Minister, Treasury and Economic Development

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

Dear Ms ~~Peach~~ 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]

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the ITC 39 - *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems [Phase 2].*

HoTARAC broadly agrees with the AASB's Phase 2 approach, but strongly recommends the AASB be mindful of unintended potential impacts on public sector bodies being regarded as reporting entities.

The attachment to this letter sets out HoTARAC's response to the specific matters for comment. If you have any queries regarding HoTARAC's comments, please contact Vincent Padgham from the Australian Government Department of Finance on (02) 6215 1927 or by email to vincent.padgham@finance.gov.au.

Yours sincerely

David Nicol
Chair
Heads of Treasuries Accounting and Reporting Advisory Committee
15 November 2018

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?

HoTARAC members rarely use Special Purpose Finance Statements, but broadly agree with the AASB's Phase 2 approach.

More details on the transitional relief provided for entities moving from SPFS to GPFS and from one tier to another will be required for HoTARAC to express a view.

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.

HoTARAC strongly favours the current approach of jurisdictions being able to designate reporting entities Tier 2.

HoTARAC notes that Alternative 1 has the advantage that relevant disclosures can be selected from relevant standards and will be more flexible as new standards are published. This approach is currently favoured by HoTARAC members.

HoTARAC notes that Alternative 2 simplifies the overall approach and would suggest the AASB continue to canvass views on this topic as preparers and users work on assessing the impact of the alternatives.

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?

HoTARAC does not agree. In HoTARAC's view a third tier is needed for very small 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.

HoTARAC members are unlikely to voluntarily adopt IFRS for SMEs, noting that differing recognition and measurement requirements results in considerable additional effort for consolidating economic entities under AASB 1049 *Whole of Government and General Government Sector Financial Reporting*.

HoTARAC members would not favour IFRS for SMEs being available to public sector preparers.

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.

HoTARAC has no comment.

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.

HoTARAC has no comment.

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.

HoTARAC notes that limiting disclosures to specified standards may not always meet users' needs as these standards will not be equally relevant to all types of entities. Again, HoTARAC recommends the AASB continue to seek views on this topic as they progress with this project.

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).

HoTARAC recommends the AASB compile a separate standard for Tier 2 RDR disclosures to make them more user friendly.

As noted above, HoTARAC would favour the introduction of a third reporting tier for very small entities, similar to the approach taken by New Zealand. Introduction of a third tier would minimise the reporting burden on small entities and better balance the costs and benefits of financial reporting.

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

HoTARAC has no comment.

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

There is no such legislation that HoTARAC is aware of.

General Matters for Comment on Phase 2

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).

HoTARAC agrees that the standard setting framework has been appropriately applied. HoTARAC appreciates that there will be further consultation on NFP amendments.

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

HoTARAC notes that, for a number of jurisdictions, the application of Australian Accounting Standards (AAS) is mandated by legislation. Accordingly, any revision to the application of tiered reporting and the definition of the reporting entity should consider specific public sector circumstances.

Many public sector entities lack a separate legal identity. HoTARAC notes that in some of their jurisdictions a number of ministerial body corporates are established by legislation and deemed to be part of the service delivery of the relevant entity. As a practical matter, nuances in legislation passed at differing times can result in a subset of ministerial body corporates being viewed as reporting entities that are consequently exposed to compliance with Australian Accounting Standards. The consequence of this view is a significant increase in preparation and audit costs with negligible benefit to the public from individual reporting.

There are also other public sector circumstances that the AASB should consider. HoTARAC notes there are publicly accountable for profit entities in the public sector that will need to adopt the RCF in phase 1; it is unclear if this was intended by the AASB.

Some jurisdictions have discretion on designating the tier of reporting that entities apply and HoTARAC strongly recommends that AAS ensure that flexibility is not restricted.

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

More focused and simplified financial reports are expected to benefit users. HoTARAC acknowledges groups of users will be better placed to respond on this *Matter for Comment*.

HoTARAC observes that the information provided under the application of accounting standards may be of limited use to users, noting the research conducted in 2014 by Brown, Call, Clement, and Sharp (2014) *Inside the "Black Box" of Sell-Side Financial Analysts*, Journal of Accounting Research, https://doi.org/10.1111/1475-679X.12067), observed:

> *"users of financial accounting information (analysts) are likely to have more informative views on financial reporting issues than preparers (CFOs)."*
>
> *"Most analysts have contact with the CEO or CFO of the typical company they follow more than once per quarter, and they rate their private communication with management as a very useful input to both their earnings forecasts and stock recommendations"*

Whilst the quotes above relate to the private sector analyst activity, HoTARAC observes that the public sector is exposed to processes that mimic or imitate the information gathering undertaken by the surveyed analysts.

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

Simpler tiered reporting is anticipated to reduce the costs of preparing and auditing financial reports. These compliance overheads bring questionable benefits to the users of financial reports and consume scarce resources that could be better allocated to alternate purposes.

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.

Simpler tiered reporting will reduce the costs of financial reporting. Literature suggests that users suffer information overload from financial reports, yet solicit additional information from alternate sources. Therefore, it is reasonable to infer that users will benefit from more focused financial reports.