ITC 12 sub 68

NATIONAL INSTITUTE OF ACCOUNTANTS

14 September 2007

Professor David Boymal FPNA
Chairman
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne VIC 3000

Dear Professor ~~Boymal~~ David

Re: International Financial Reporting Standards for Small-Medium Enterprises (IFRS for SMEs) and Invitation to Comment 12 (ITC 12)

I am pleased to present you with the National Institute of Accountant's (NIA) perspective on the important issue of differential reporting in Australia. The NIA supports the AASB's initiative to review the reporting framework. It is timely and one that has significant implications for the reporting regime in this country.

From the outset, it is worth noting the corporate regulatory environment has been the subject of a review by the Australian Government. The *Taskforce for Reducing the Regulatory Burden on Business* examined the various burdens facing business in Australia which culminated in the release of the *Best Practice Regulation Handbook* in August 2007. Accordingly, it is our view that these proposals ought to be read in conjunction with the Australian Government's priority to address, and where possible, reduce the regulatory burden on business.

This submission is presented in two parts. The covering letter firstly deals with the AASB's request for comments on a proposed financial reporting regime in Australia. Secondly, an appendix considers various issues raised for comment in the exposure draft released by the International Accounting Standards Board (IASB) and the Australian Accounting Standards Board's (AASB) on financial reporting for entities without public accountability as defined by the IASB. These are supplied to assist the AASB with its submission on the IASB proposal.

It is fundamentally the view of the NIA that there is no need for the AASB to introduce 'IFRS for SMEs' for general application to entities in Australia. However, following consultation with our members and other interested stakeholders, we have proposed an alternative regime for consideration and further discussion.

We consider the IASB proposal a suitable starting point for jurisdictions without a long history of standard setting or accounting

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regulation. Australia, however, has a different environment. The full suite of Australian equivalents to IFRS have been adopted by preparers, users and auditors. It is in our view, unnecessary to contemplate adoption of an accounting standard such as that proposed by the IASB for entities without public accountability.

In preparing this submission, the NIA has focused on the following principles that have been drawn from discussions with constituents:

- The Australian reporting regime should retain the core principles embedded in the reporting entity concept;
- A second set of accounting standards is unnecessary in a jurisdiction that has already transitioned entities to the reporting framework issued by the IASB;
- Any change in the reporting framework in Australia should be designed to clarify how the existing regime ought to be applied, rather than to impose a new or additional compliance burden; and
- Consideration must be given to developing a single standard that specifies the scope of financial reporting in Australia, rather than having the scope of application set in each individual standard.

Member feedback

The NIA has sought the feedback of members and other constituents via its web site and focus group discussions. Feedback has questioned whether the current model of reporting is in such disrepair that it warrants radical change. There was little support for two sets of accounting standards, however support exists for a regime that provides the flexibility in financial reporting that exists with the reporting entity concept. The appeal is that it focuses on the needs of dependant users who cannot normally demand information.

Discussions with NIA members and other constituents evidenced the following:

- Support for the decision making process under the existing reporting entity concept. Concern was expressed at the apparent lack of flexibility within the proposed AASB model. Members supported the retention of the reporting entity concept or at the very least the retention of the ability for there to be more flexibility around the application of disclosure requirements for the accounts of entities not deemed to be publicly accountable;
- Concern that thresholds set down in ITC 12 produce conflicting outcomes. A private company that exceeds two of three thresholds under the Corporations Act 2001 to lodge financial statements could lodge statements compliant with the shorter version of IFRS if they have less than either $500 million in consolidated revenue or $250 million in consolidated

assets. This would mean that an entity in the public sector with either $25 million in turnover or $12.5 million in assets would have to adopt full IFRS whereas a private company would be permitted to use the smaller version. This is viewed as both a complication and as inequitable;

- Fully owned subsidiaries of large companies – listed or unlisted - should be given relief from compliance with full IFRS in the form of disclosure relief. Constituents see the shorter IASB offering as complicating the compliance regime;
- Constituents believe the concept of public accountability is a reasonable tool for the purposes of structuring a differential reporting regime, but that it should be based on the quantum of disclosure an entity must provide to the marketplace rather than differences in recognition and measurement;
- A separate accounting standard for smaller entities is not necessary. One set of standards with exemptions from disclosure requirements is most preferred; and
- It has been further noted that recent law reform has continued to reduce the number of entities required to lodge financial statements. Some stakeholders have questioned the discussion on the introduction of another accounting standard for smaller entities in this context.

The NIA believes the proposals need to be reconsidered in the light of feedback. We propose an alternative below that meets the concerns expressed by constituents and also advances the development of the Australian reporting framework.

We will be developing this concept further into a working paper and issuing a detailed document via our web site for comment by members and others.

An alternative regime

The AASB should develop an accounting standard that deals with the scope of financial reporting. This accounting standard should be prepared in large part with reference to the existing reporting entity concept, which has qualitative criteria useful to determining when dependent users of an entity's financial statements exist (primarily, a user's capacity to request specific financial information). The standard should contain similarly qualitative criteria to assist those preparing and using accounts to determine whether an entity ought to prepare general purpose financial reports (GPFRs). The GPFRs would be prepared in accordance with the full requirements of IFRS unless the AASB states otherwise. Feedback from members suggests entities offering securities, holding funds in a fiduciary capacity, governments and statutory bodies, utilities and emergency services, and charities are entities for which there are dependent users of financial information. Thought could be given to incorporating a range of sectors as examples which would result in particular sectors being deemed to be reporting entities, irrespective of size.

We regard the existence of dependent users of financial statements as synonymous with public accountability. The term 'public accountability', however, is not preferred. It has a general meaning in English that if applied in the context of financial reporting would result in a broader range of entities preparing full sets of financial statements than the IASB or AASB may have intended.

Provision for what the NIA proposes to be called 'limited purpose financial reports' (LPFRs) should be made. These reports are of limited user interest when an entity is required to lodge information with a registrar or corporate regulator. These reports should comply with all existing recognition and measurement requirements. We expect that users accessing the LPFRs would direct questions or requests for further information to the entity concerned. LPFRs could capture large proprietary companies (LPCs) required to lodge but not currently regarded as reporting entities under the present conceptual framework, entities that are wholly owned subsidiaries of companies that prepare and lodge consolidated accounts with the corporate regulator, and public sector agencies that are small and deal only with services rather than revenue generating activity.

Entities not falling into either of the above categories would be free to prepare special purpose financial reports (SPFRs) on a basis agreed with the specific user, not necessarily accounting standards. Such situations include but are not limited to requests for information made by banking institutions or tax authorities. Information is made available to these organisations on a confidential basis for a specific purpose.

The AASB should reserve the right to develop individual disclosure standards that meet the specific needs of users of charity financial statements. We are aware that users of the accounts of not-for-profit entities and public sector authorities may find disclosures related to administration of donated or appropriated funds more useful, for example, than some of the detailed notes normally required on financial instruments.

Access to the IASB's proposed standard, should however be given to those entities as a subsidiary of a foreign parent required to lodge financial statements in Australia, perhaps by way of a class order issued by the corporate regulator.

I would like take this opportunity to thank the AASB for its efforts in engaging with constituents on this important matter. The holding of round tables in both Melbourne and Sydney has provided the opportunity for constituents to discuss their views. It is important that constituents are provided with the chance to engage with the standard setter directly.

Please feel free to contact the NIA technical division in relation to any of the topics discussed in the documents attached.

Yours sincerely

Andrew Conway PNA
Deputy Chief Executive Officer

Enclosures: *Attachment 1 (Response to key questions)*
Attachment 2 (Likely impact of tiered reporting regime)

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Attachment 1 – National Institute of Accountants

IFRS for SMEs: Response to key questions September 2007

The following are responses from the National Institute of Accountants (NIA) to the International Accounting Standards Board (IASB). In addition, there are several areas we believe need further revision in order to ensure the document is sufficiently robust for use in jurisdictions that adopt this standard as a part of their regulatory framework.

General Comments

The IASB must reconsider the basis for naming the standard 'IFRS for Small-to-Medium Enterprises (SME)', referred to throughout as the 'small book', particularly given the qualitative criteria the IASB has embedded as the rationale for restricting the use of the proposed standard. The use of 'public accountability' as a criteria for those that must use the full suite of international standards (or the 'big book') does not mean a restriction of the application of either the big book or small book of international standards to entities that are either big or small. Rather, it is based on whether entities have public accountability as defined by either the IASB or any individual jurisdiction. During extensive consultation with members we have found the title causes confusion and misunderstanding about the IASB's intentions. There were fears standard setters were trying to impose additional burdens on smaller entities currently not required to prepare and lodge accounts under law. These fears dissipate once the nature and purpose of the document is explained. The initial confusion indicates a need for the IASB to be clearer about the intent of its proposed standard.

The reference in the document to entities with 50 employees – a figure embedded in our *Corporations Act 2001* as one of three criteria used to determine whether a company is large or small – further confuses practitioners. It is arguable whether the benchmark of an entity with 50 employees used in the development of the standard is reasonably dealing with the bulk of cases in which this standard is likely to be applied.

We would encourage the IASB to reconsider both the title of the document and the manner in which it expresses the scope of application. This is necessary in order to ensure there is no confusion on what is meant. Possible alternative titles could be 'limited purpose financial statements' or 'financial reporting for lodging entities'. The latter would appear more suitable because it is being proposed as an alternative reporting framework for unlisted entities or those not involved in activities resembling those of deposit taking organisations such as banks, credit unions, pension funds and managed investment schemes.

Any redefinition of scope of the standards would in our view constitute grounds for the re-exposure of the document. We strongly urge the IASB to ensure any changes are re-exposed for further public consultation before a document is finalised.

A further issue needing consideration is that of first time application, particularly when an entity moves between the 'small book' and the 'big book'. Differences in recognition and measurement criteria between the two sets of standards create the need for transition. The notion of introducing measurement simplifications in the shorter document is questionable given that entities in jurisdictions that adopt this standard may be asked by the governing bodies in their jurisdiction to report in accordance with the full suite of accounting standards because either their size, nature of industry or the type of ownership structure is deemed significant enough to warrant full compliance. This is an ideal opportunity to streamline the passage between rules rather than create a need for entities to remeasure various elements within their financial statements because one set of standards permits a particular treatment. The application of this standard in various jurisdictions remains uncertain and as such it is important to make transition simple.

Specific questions

Stand alone document

A stand alone document is desirable if the objective is to provide guidance for the most common and simple transactions dealt with by reporting entities. This approach may need review if it emerges that small entities engage in transactions that force them to use parts of the full book.

Measurement and recognition simplifications

We welcome the underlying concept of simplification of recognition and measurement. It is however, difficult to see why the simplification of the principles in full IFRS should be restricted to those entities deemed to be without public accountability. The IASB should consider amending its comprehensive set of requirements. Larger entities may have greater resources to cope with the complexities in the full book of IFRS. This should not mean that the only entities deserving of relief are entities that are not publicly accountable. Amendments should be made to the full book of IFRS so that simplifications in measurement and recognition apply to all. This will assist in the objectives of consistent and comparable accounting being met long-term. We note that the IASB has also expressed a preference for the removal of options in its financial reporting standards over time. This process will also assist the simplification of the standards overall.

It is worthwhile noting that whilst smaller entities will typically have simple accounting, where entities enter into complicated transactions involving financial instruments such as derivatives, complex accounting ought naturally to apply. As a general principle, it is the nature of the transactions, not the size of the reporting entity, which ought determine the overriding measurement and recognition principles.

Fair or current value accounting

Some commentators argue that current values for various items are not relevant for those using accounts intended primarily for use by management. From the NIA's perspective it is difficult to see how a business owner could be exercising appropriate business judgment if the figures that appear on the balance sheet and income statement are not contemporary. The more critical question in this context is how quickly the IASB will be able to progress its measurement project to ensure clarity on what is meant by historical cost and fair value.

Should all accounting policy options be available to 'IFRS for SME users'?

Users of the 'small book' should be permitted to adopt options that exist in the 'big book'. The IASB has indicated that its intention is to remove options over time. This is an evolutionary process. It makes little sense to restrict the use of options in the larger book for smaller entities, when larger entities with the same transactions can account for them in different ways.

Borrowing costs

The treatment of borrowing costs should be consistent with the main body of IFRS. The NIA prefers the expensing approach as being more consistent with the notion of servicing costs rather than their inclusion as part of the asset being constructed, but accept that the current position in IFRS mandates capitalisation. The IASB should avoid wherever possible, accounting treatments that place entities at a disadvantage if they need to transition from one set of pronouncements to another.

Topics not addressed in IFRS for SMEs

The draft standard makes adequate reference to the most common transactions encountered by businesses.

Reference to the 'big book'

The IASB has little choice but to refer to the 'big book' if it wishes to keep the document within the current page limits. The demonstrated capability to simplify accounting requirements in plainer English is evidence that the full suite of standards could reduce in size if the same drafting approach were to be adopted across the suite of IFRS.

Adequacy of guidance

The NIA's concern in relation to guidance is whether the abbreviated and different approach will result in different technical answers when entities transition from one set of standards to another. We note that the use of a plainer English expression – a measure with which we agree – in the 'IFRS for SMEs' document could be interpreted differently by various users of the document.

Adequacy of disclosures

It is difficult to determine whether the disclosures are adequate as the purpose of these financial statements is unclear. The number of disclosures in the financial statements of entities without public accountability should ideally be driven by user needs rather than prescription.

The IASB needs to give further thought to the scope of the disclosures and whether even the version reflected in the implementation guidance could be simplified even further.

Maintenance of the shorter standard

The standard should be amended as accounting treatments in the main body of IFRS are changed. This will ensue that the small book is contemporary and lowers the risk of creating first time application issues for entities that move from the self-contained book to the full suite of IFRS. The use of accounting treatments that are by consensus no longer deemed to be appropriate in the full suite of IFRS may create a dilemma in those accounting practices with clients to which either document applies.

The IASB and AASB must also consider the training implications for the various entities and accounting practices that may eventually be required to consider two documents rather than one.

Appendix 2 – National Institute of Accountants

Likely impact of the proposed tiered reporting regime

Type of report	Entities affected
General Purpose Financial Report: Prepared in accordance with recognition, measurement, disclosure and presentation requirements of accounting standards.	• Entities currently regarded as reporting entities irrespective of the sector in which they operate, and, • Entities classified as disclosing entities under the Corporations Act 2001.
Limited Purpose Financial Report: Comprises key financial statements prepared in accordance with the recognition and measurement criteria of accounting standards. Disclosures to be included only where specific user needs are apparent.	• Entities regarded as non-reporting entities under the present framework but are obliged to lodge financial statements with an authority that may be publicly available, and, • Wholly-owned subsidiaries of companies that already lodge audited consolidated financial statements; and, • Other entities irrespective of sector for which the preparation and audit of full financial statements is deemed to be too onerous but lodgement of some financial information on the public record is justified.
Special Purpose Financial Report: The report is to be prepared in accordance with format requested by a specific user. These reports may comply with accounting standards but only where the user specifically demands that this be the case.	Entities that are meeting the needs of an information request from either an entity or individual

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