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Mr David Boymal
The Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

27 August 2007
Our Ref: FB:DR

Dear David

Re: Invitation to Comment ITC 12 'Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of A Proposed IFRS for Small and Medium-Sized Entities'

We welcome the opportunity to comment on the Australian Accounting Standards Board (AASB) proposals in Invitation to Comment ITC 12 'Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB *Exposure Draft of A Proposed IFRS for Small and Medium-Sized Entities*' (the 'proposals').

Whilst the 'reporting entity' concept has served Australia well, we believe that it is timely that the differential reporting regime in Australia be reviewed. Although the IASB's Small and Medium-sized Entities (SME) proposals may have been the catalyst for the AASB's proposals, the issue of an appropriate differential reporting regime has become more urgent in light of Australia's transition to full convergence with International Financial Reporting Standards (IFRS).

We generally support the AASB's preliminary views on the proposed differential reporting regime for Australia, particularly the introduction of an Australian SME Standard. However, we believe the proposals can be improved, particularly in the following key areas:

- reducing the focus on 'general purpose financial reports' and instead realigning the differential reporting regime to apply only to financial reports where the reporting mandate requires compliance with Accounting Standards
- reassessing the 'dividing line' between those for-profit entities that would apply Australian equivalents to IFRSs and those entities that would apply an Australian SME Standard, preferably based purely on the IASB's concept of 'public accountability'

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- providing presentation and disclosure relief for entities where the costs of complying with the presentation and disclosure requirements of the full suite of IFRS or IFRS for SMEs exceeds the benefits of compliance – this particularly applies to subsidiaries and smaller entities that lack economic significance and/or do not have widespread interest in their financial reports
- simplifying the proposals as they apply to not-for-profit and public sector entities so that financial reporting for these classes of entities is based on only one, and not both, of the suites of Standards (i.e. A-IFRS or the Australian SME Standard, not both).

A diagrammatic summary of our proposals for how a revised differential reporting regime for Australia might be applied are outlined in Appendix A.

We have provided our detailed responses to the AASB's specific matters for comment in Appendix B.

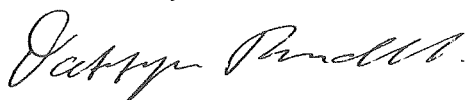
Finally, it should be noted that our comments in this letter are based on the IASB's proposals for an IFRS for SMEs as they currently stand, with perhaps some further simplification of the recognition, measurement, presentation and disclosure requirements as part of the IASB's finalisation of the IFRS for SME Standard. However, if the requirements for SMEs were significantly altered or simplified by the IASB in finalising the IFRS for SME Standard, our views may change.

Our own views on the IASB proposals for an IFRS for SMEs are outlined in Appendix C.

We also recommend that the AASB consider re-exposing its proposals for the revised differential reporting regime for Australia in light of the comments received and once the outcome of the IASB's SME project is known.

Due to the later IASB submission deadline in relation to the IASB proposals for an IFRS for SMEs, the global firm of Deloitte Touche Tohmatsu has not finalised its views in relation to the matters raised in the IASB's exposure draft. Furthermore, in this letter we have highlighted issues and concerns in the Australian context that may not have the same degree of relevance internationally or which may not be considered of sufficient significance to warrant separate comment by the global firm of Deloitte in its submission. Therefore, the views presented in this document in relation to the IASB's proposals for an IFRS for SMEs should be read in this context and may not necessarily represent the view of the global firm of Deloitte.

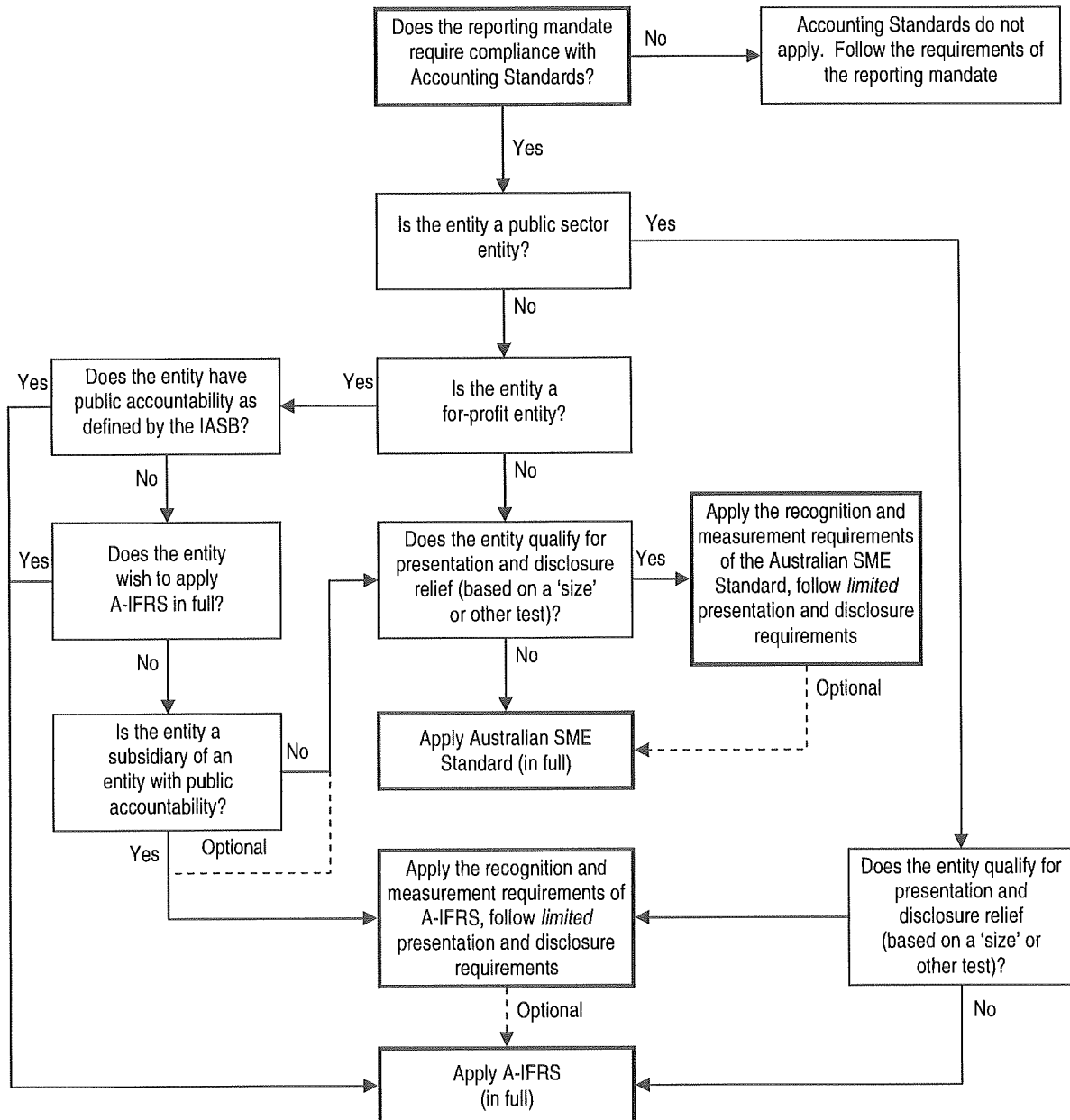
Yours sincerely



Darryn Rundell
Partner
Deloitte Touche Tohmatsu

Appendix A: Summary flowchart of our proposal

The flowchart that follows summarises our proposal for a revised differential reporting regime for Australia.



Appendix B: Deloitte responses to the specific matters for comment

(a) do you agree with changing the application focus of Australian Accounting Standards from ‘reporting entity’ to ‘general purpose financial reports’?

In our view, the AASB should develop its differential reporting framework by reference to those financial reports which are required to be prepared in accordance with Accounting Standards, rather than focussing on a nebulous concept of ‘general purpose financial reports’ or trying to classify the entity preparing the report.

By taking this approach, the AASB would then not need to address issues that arise for entities that are required to prepare and lodge ‘financial reports’ under particular legislation or other reporting mandate that may have requirements (e.g. cash based accounting) that are inconsistent with Accounting Standards. In other words, entities would only follow Accounting Standards where the reporting mandate for the *financial report itself* requires the entity to prepare financial reports in accordance with Accounting Standards.

This approach would eliminate many of the concerns that have arisen in relation to the existing proposals and substantially simplify the AASB’s process in dealing with this issue. In effect, this approach would leave it to regulators, owners, financiers and other interested parties to determine whether a particular financial report need be prepared in accordance with Accounting Standards.

The AASB’s role would then be limited to determine which and how Accounting Standards might apply to particular categories of entities, by reference to the user’s needs and cost benefit considerations. All entities reporting under the *Corporations Act 2001* would be captured, as too would those in the not-for-profit and public sectors where their governing legislation required the application of Accounting Standards.

We believe that this approach is more closely aligned with the approach taken by the IASB itself in setting its Standards and is also consistent with the AASB’s functions and powers under the *Australian Securities and Investments Commission Act*.

Our views as to how this regime might be applied are explained further in our detailed responses to the questions that follow.

(b) if it is considered desirable to retain the reporting entity concept as the basis for differential reporting, what improvements could be made to remove related concerns (see paragraph BC6) and make it more effective?

Whilst we acknowledge the subjective nature of applying the current ‘reporting entity’ concept in practice, our experience has been that it is only difficult to apply ‘at the margin’, e.g. substantial subsidiaries of foreign-owned entities that are integrated with, and largely funded by, their offshore parent or a company that dominates its industry but otherwise is not large.

However, while we do not support the retention of the reporting entity concept *per se*, we believe that the proposal outlined in our response to question (a) above, combined with disclosure relief in some cases, produces *outcomes* that are similar to the 'reporting entity' concept.

Financial reports prepared because of a reporting mandate under the *Corporations Act 2001* where the entity is currently classified as a 'non-reporting entity', generally follow the recognition and measurement requirements of Accounting Standards in preparing that financial report. Therefore, the significant benefit of being classified as a non-reporting entity under the current regime is the substantial disclosure relief available.

In the specific case of subsidiaries, the predominant user of the financial statements is the ultimate parent entity, for the purpose of preparing the consolidated financial statements. It is logical then that the recognition and measurement requirements of the ultimate parent entity be followed in each subsidiary's financial statements, but the presentation and disclosure requirements are largely irrelevant as they are of limited use.

As a result of the above observations, in our view, any revised differential reporting regime should focus on relief from the presentation and disclosure, but not recognition and measurement, requirements of the reporting framework applied¹.

In our view, the differential reporting regime must be structured to achieve an outcome that is largely consistent with that obtained under the 'reporting entity' concept and meets the following objectives:

- ensuring that entities with financial reports that are of widespread public interest produce comprehensive and consistent reporting
- providing disclosure relief for subsidiaries and other entities that produce financial reports for regulatory purposes only, i.e. where financial reports do *not* have widespread public interest
- providing simplified recognition and measurement approaches for smaller and medium-sized entities, which would be supplemented with disclosure relief in many cases
- developing a single framework for not-for-profit entities that also incorporates presentation and disclosure relief
- ensuring that public sector entities report under a consistent and relevant reporting framework, which may not necessarily comply with IFRS in all respects.

¹ We note that we would prefer further simplifications to, and relief from, the presentation and disclosure requirements proposed in the IASB's SME proposals.

Therefore, in our view, the optimal approach should be based along lines similar to the following:

For-profit entities

- all for-profit entities with public accountability (as defined by the IASB) should fully comply with all recognition, measurement, presentation and disclosure requirements of A-IFRS
- subsidiaries of for-profit entities with public accountability that are wholly-owned, closely held, or that are partially owned and which produce financial reports that are not widely distributed, should be allowed to follow the recognition and measurement requirements of A-IFRS, but be exempted from the majority of the presentation and disclosure requirements of those Standards (these entities should also be given the option of complying with the Australian SME Standard in the same manner as other entities if they so desire)
- all other for-profit entities should follow the recognition and measurement requirements of the Australian SME Standard, but relief from the presentation and disclosure requirements should be available for particular classes of entities. Relief should be available specifically for entities where the cost of full compliance with the Australian SME Standard exceeded the benefits – this may be based on some form of ‘size’ or other test.

Not-for-profit entities

- not-for-profit entities should follow the Australian SME Standard, but presentation and disclosure relief should be available for particular classes of entities, based on some form of size or other test
- modifications to the IFRS for SMEs for not-for-profits should be kept to an absolute minimum
- this proposal may need to be deferred in light of the existing commitment of the AASB to harmonisation with New Zealand in this area.

Public sector entities

- public sector entities should follow Accounting Standards that are based on IFRS, but modified where necessary, as currently occurs
- relief from the presentation and disclosure requirements should be given where the entities are small or where the financial statements are not widely distributed.

Our further views on how this approach might be applied can be found in our responses to the questions below.

- (c) **do you support the proposal to apply the IASB's definition of a publicly accountable entity to differentiate between for-profit entities that apply Australian equivalents to IFRSs and for-profit entities that apply an Australian equivalent to the IFRS for SMEs?**

Yes, within the context of our comments above, we fully agree with the use of the 'public accountability' concept to differentiate between those for-profit entities that must apply A-IFRS and those that would apply an Australian SME Standard.

We believe that this should be the only differentiator between those for-profit entities that must follow A-IFRS and those that can follow an Australian SME Standard.

- (d) **in respect of for-profit entities that do not satisfy the IASB's definition of a publicly accountable entity, but are viewed as being important from a public interest perspective because of their large size:**

- (i) **do you agree that such entities should in the public interest apply Australian equivalents to IFRSs and that it is appropriate to use size thresholds to identify these entities?**
- (ii) **do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds, and why?**

We do not agree with the proposal that for-profit entities that are viewed as being important from a public interest perspective should be *required* to follow A-IFRS. Instead, we believe that the IASB's notion of 'public accountability' is a sufficient and appropriate differentiator between entities that would apply A-IFRS and those that would apply an Australian SME Standard.

As noted in responses to questions (a) and (b) above, we believe that presentation and disclosure relief should be provided to entities in the following circumstances:

- subsidiaries of entities that prepare financial reports fully in accordance with all of the recognition, measurement, presentation and disclosure requirements of A-IFRS
- entities that do not have public accountability, where relief might be granted based on some form of 'size' or other test.

In addition, we believe that any entity that is eligible for the presentation and disclosure relief above should be entitled to *optionally* adopt 'full' A-IFRS or the Australian SME Standard (with or without presentation and disclosure relief) if they so choose.

- (e) **since the IASB's ED of A Proposed IFRS for SMEs has been developed with only for-profit entities in mind, do you agree it is appropriate to adopt the forthcoming IASB's IFRS for SMEs (after inclusion of Aus paragraphs similar to those included in Australian equivalents to IFRSs) in a differential reporting regime in respect of not-for-profit private sector entities and public sector entities?**

We agree that the Australian SME Standard should form a part of the differential reporting regime in respect of not-for-profit private sector and public sector entities. However we believe that the AASB should consider an alternative method of implementing that regime.

In particular, we believe not-for-profit and public sector entities should follow either A-IFRS or an Australian SME Standard, but not both.

Public sector entities

We do not believe that an Australian SME Standard should apply to public sector entities in any circumstances, regardless of their size or other status.

The IASB has developed the SME proposals in the context of a typical for-profit entity with about 50 employees. The needs of lenders, vendors, customers, rating agencies and employees were also broadly considered. The IASB's SME proposals, including the modifications made to 'full' IFRS, were determined within that broad framework².

The needs of users of financial reports of public sector entities do not necessarily coincide with the focus of the IASB in developing the SME proposals. At a minimum, there will be additional needs of these users, e.g. parliamentary scrutiny, enhanced probity, general public interest, non-financial objectives, and so on. It is therefore questionable whether the recognition, measurement, presentation and disclosure requirements of the IASB SME proposals will serve as an appropriate basis for modification, particularly for public sector entities.

Whilst it is true that A-IFRS is based on IFRS which itself is focussed on the participants in the world's capital markets, we believe that existing A-IFRS is a better basis from which to develop Accounting Standards for public sector entities (with appropriate recognition and measurement amendments and presentation and disclosure relief where applicable). This reflects the fact that many public sector entities are large, often enter into complex structuring, financing, contractual and other arrangements, are highly accountable to the public and subject to much public scrutiny – factors which in our view they share with entities listed on the major capital markets of the world on which IFRS is focussed.

In addition, superimposing of public sector modifications made to IFRS when developing A-IFRS onto an Australian SME Standard would create unnecessary complexity in the accounting framework and confuse users and preparers of financial statements. This approach would also force upon the AASB an arduous decision-making process in considering how to modify the SME Standard for these entities.

² IASB Basis for Conclusions on Draft IFRS for SMEs, paragraph BC45.

Not-for-profit private sector entities

In contrast to the public sector as a whole, the majority of not-for-profit entities do not share many of the characteristics of entities with public accountability and are also often simpler in their operations and the types and kinds of transactions that they undertake. Accordingly, from this perspective, not-for-profit entities share much in common with the for-profit entities which are the focus of the IASB's SME proposals, even though these entities might be considered 'publicly accountable' in some ordinary senses of that term. Therefore, in our view, not-for-profit entities should be required to follow an Australian SME Standard.

However, we believe that, except in exceptional circumstances, that the SME proposals should only be modified by the AASB for not-for-profit entities in rare circumstances. Any such modifications should only occur where the IASB's SME requirements cannot be applied in a meaningful manner by not-for-profit entities.

We would not support recognition and measurement modifications to an Australian SME Standard that effectively reflect 'differences of opinion' between the AASB and IASB on accounting issues. For instance, we would not support modification of the revenue recognition requirements for not-for-profit entities. In our view, this is consistent with the Financial Reporting Council (FRC) directive that Australia should adopt IFRS as the basis for financial reporting in Australia.

Furthermore, many of the modifications made to IFRS for 'not-for-profit' entities reflect the specific requirements of public sector entities and are not necessary for the purposes of not-for-profit entities.

Finally, we again believe that presentation and disclosure relief should be available for particular classes of not-for-profit entities, based on some form of a size or other test.

However, the above comments should be read in the context of our observations on harmonisation of requirements with New Zealand in response to question (n) below.

- (f) **in respect of not-for-profit private sector entities:**
- (i) **is there a need for differential reporting in the not-for-profit private sector? If yes, do you agree with using size thresholds to distinguish between not-for-profit private sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalent to IFRSs)?**
 - (ii) **do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate size thresholds and why?**

- (iii) **not-for-profit entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of \$500m revenue and \$250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of not-for-profit entities. Do you agree?**
- (iv) **both private sector not-for-profit entities and public sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would need to prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?**
- (v) **do you think a third tier of simpler reporting requirements should be added to cater for smaller not-for-profit private sector entities that prepare general purpose financial reports? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified? How would your answer to this question differ if the forthcoming IFRS for SMEs has fewer disclosures than the ED of A Proposed IFRS for SMEs?**

As noted elsewhere in this letter:

- we do not agree with the proposed differential reporting concept proposed by the AASB for not-for-profit entities
- we would strongly prefer that the requirements for not-for-profit entities be based on only the Australian SME Standard, rather than a differential reporting regime for not-for-profit entities that encompasses both A-IFRS and the Australian SME Standard based on an arbitrary threshold
- simpler reporting requirements should be introduced for less significant not-for-profit entities in the form of presentation and disclosure relief, and such relief may be based on some form of 'size' or other test.

Further details of our rationale for these observations can be found elsewhere in this letter.

- (g) **in respect of public sector entities:**
- (i) **is there a need for differential reporting in public sector? If yes, do you agree with differentiating based on size thresholds between public sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalents to IFRSs)?**
 - (ii) **do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds and why?**
 - (iii) **public sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of \$500m revenue and \$250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of public sector entities. Do you agree?**
 - (iv) **both public sector entities and not-for-profit private sector entities that meet the thresholds of \$25m revenue and \$12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?**
 - (v) **do you think another tier of simpler reporting requirements should be established to cater for smaller public sector entities? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified?**

We do not agree with the differential reporting concept being applied to public sector entities in the manner in which the AASB proposes.

As noted above, the IASB's SME proposals were developed by the IASB by focussing on the needs of users of financial statements of for-profit entities. We do not believe that this is an appropriate basis for the development of an Accounting Standard for the public sector.

As noted elsewhere in this letter:

- we would strongly prefer that the requirements for public sector entities be based on only A-IFRS, not both A-IFRS and the Australian SME Standard
- simpler reporting requirements should be introduced for less significant entities in the form of presentation and disclosure relief, and such relief may be based on some form of 'size' or other test.

Further details of our rationale for these observations can be found elsewhere in this letter.

- (h) **do you think there are approaches, other than the proposed approach based on public interest and employing size thresholds, that would reasonably distinguish between entities that should apply the Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs? If there are appropriate alternative approaches, please explain.**

As noted in our comments above, we believe that following the ‘public accountability’ criterion alone is sufficient for delineating between those entities that apply A-IFRS and those that apply an Australian SME Standard.

‘Full’ IFRS is targeted at the major global corporates listed on the world’s stock exchanges. The accounting requirements under IFRS reflect this emphasis and so are necessarily complex, thorough and robust. However, these requirements may not suit the users of the financial statements of entities that do not have public accountability, and we believe that the IASB’s proposals are an attempt to find a balance between complexity and usefulness of Accounting Standard to users in this group.

Once accounting by SMEs is segregated from IFRS by the IASB, it might be expected that IFRS and the IFRS for SMEs will diverge in a similar way to the experience in the United Kingdom with Financial Reporting Standard for Smaller Entities. In addition, IFRS may become more complex and targeted towards those entities that are ‘publicly accountable’, as the IASB’s decisions on its projects may be influenced by the ability to provide exemptions or modifications for SMEs in particular areas through the IFRS for SME Standard setting process.

Therefore, there is a risk that IFRS will become less and less meaningful for those entities that lack ‘public accountability’ and to artificially force ‘large’ entities to comply with A-IFRS when their international counterparts are not required to do so, is counterproductive.

We acknowledge that the IASB has largely left it to local jurisdictions to decide which entities should apply IFRS and which should apply the IFRS for SME Standard. However, we are persuaded by the IASB Working Group’s arguments that economic significance does not automatically result in public accountability and is more relevant to matters of political and societal accountability³. In our view, extending IFRS beyond those entities that have public accountability is not relevant in the Australian context.

³ IASB’s Basis for Conclusions on Draft IFRS for SMEs, paragraphs BC39-BC40.

- (i) do you agree that, consistent with the IASB's view of a general purpose financial report, under a revised Australian differential reporting regime:
- (i) all financial reports that are available on a public register, such as those prepared and lodged with the ASIC under the Corporations Act, should be regarded as general purpose financial reports; and
 - (ii) all financial reports that are made available to the public at large, such as those tabled in a Parliament, also should be regarded as general purpose financial reports?

If you do not agree, explain why.

Financial reports lodged on a public register

We do not agree that all financial reports that are available on a public register, such as those lodged with ASIC under the *Corporations Act 2001* should be regarded as 'general purpose financial reports'.

The International Accounting Standards Board (IASB) has itself acknowledged that this wide interpretation of what is a 'general purpose financial report' is not appropriate, we expect partially in response to concerns raised by Australian constituents.

At the IASB's December 2006 meeting, the IASB decided to "clarify the definition of 'general purpose financial statements'"⁴.

Deloitte observers at the meeting noted the following⁵:

Paragraph 7 of ED IAS 8 states:

'General purpose financial statements include those that are presented separately or within other public documents such as a regulatory filing or report to shareholders'

A large number of respondents alleged that the reference to 'regulatory filing' could be interpreted as defining all financial statements filed with any regulator to be general purpose financial statements. This may lead to controversy considering that a great number of registrants, public or not, report to various types of regulatory authorities (e.g. in Australia small private companies and subsidiaries of public companies with no external users of financial reports, will be required to prepare general purpose financial reports because they are required to place their financial statements as a public file).

The Board noted that this was not the intention and decided to clarify this by amending paragraph 7 of ED IAS 1.

The Basis of Conclusions in the near-final draft of the revised IAS 1 *Presentation of Financial Statements* reflects this intention, noting the following:

BC11 The exposure draft of 2006 proposed a change to the explanatory paragraph of what 'general purpose financial statements' include, in order to produce a more generic definition of a set of financial statements...

⁴ Source: *IASB Update*, December 2006, IAS 1 *Presentation of Financial Statements*.

⁵ The Deloitte observer notes from the meeting are available at <http://www.iasplus.com/agenda/0612.htm>

BC12 Respondents expressed concern about the proposed change. They argued that it could be understood as defining as general purpose financial statements any financial statement or set of financial statements filed with a regulator and could capture documents other than annual reports and prospectuses. They saw this change as expanding the scope of IAS 1 to documents that previously would not have contained all the disclosures required by IAS 1. Respondents pointed out that the change would particularly affect some entities (such as small private companies and subsidiaries of public companies with no external users of financial reports) that are required by law to place their financial statements on a public file.

BC13 The Board acknowledged that in some countries the law requires entities, whether public or private, to report to regulatory authorities and include information in those reports that could be beyond the scope of IAS 1. Because the Board did not intend to extend the definition of general purpose financial statements, it decided to eliminate the explanatory paragraph of what 'general purpose financial statements' include, while retaining the definition of 'general purpose financial statements'.

It is clear from the above analysis that the IASB itself does not necessarily intend that all entities publicly lodging financial information should do so in accordance with full IFRS. The IASB's SME exposure draft also notes that "[g]eneral purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meeting their particular information needs"⁶.

This matter is also wider than companies and other entities reporting under the *Corporations Act 2001*, as there are a large number of entities that have a reporting mandate to prepare some form of financial report under other Federal and state legislation. In many cases, these financial reports are lodged on a public register.

A common example are the various incorporated associations acts of the states and territories – many of these require lodgement (on a public register) by all associations and some permit or require lodged financial statements to be prepared using the cash basis⁷. It is unclear how the AASB's proposals can be readily and easily applied to these entities, particularly when Accounting Standards may be in conflict with a reporting mandate that does not explicitly require compliance with Accounting Standards.

In light of the above observations, we question whether it is wise for the AASB to take a view that all financial statements lodged with a regulator should be considered 'general purpose financial statements' and fully comply with A-IFRS or the Australian SME Standard.

Instead, we believe that the AASB should only develop Accounting Standards in relation to financial reports that are required by their reporting mandate to follow those Standards. This eliminates the issue of conflicts between the reporting mandate and Accounting Standards as noted above.

⁶ Paragraph P8 of the IASB Exposure Draft of a Proposed IFRS for Small and Medium-sized Entities.

⁷ For example, the Northern Territory act requires lodgement by all associations and the South Australian act permits the use of cash-based accounting in some circumstances.

It is then only incumbent upon the AASB to take a role in determining the reporting obligations for entities that are required to lodge 'financial statements' in accordance with Accounting Standards under the *Corporations Act 2001* or other statutes and reporting mandates.

Because of the wide diversity and application of reporting mandates that exist in the Australian context (which some may argue are derived from notions of political or social accountability), the AASB must acknowledge the pragmatic reality that many of the financial reports prepared are not 'general purpose financial statements' within the meaning of that term under IFRS.

Accordingly, as discussed in our answer to questions (a) and (b) above, the AASB should instead focus on providing presentation and disclosure relief for these entities, whilst maintaining consistency in recognition and measurement requirements under the reporting framework.

Financial reports available to the public at large

The AASB has acknowledged in AASB 1049 *Financial Reporting of General Government Sectors* that some public sector reports prepared do not need to consider the 'reporting entity' concept, nor be classified as 'general purpose' or 'special purpose' financial reports⁸.

Accordingly, we question the conclusion that all reports prepared by public sector entities or made available to the public at large, such as those tabled in Parliament, should be regarded as general purpose financial reports.

Instead, we believe that the reporting mandate should be considered in the context of the objectives that gave rise to it, which, in the context of how financial reports may be currently classified, may be based on factors other than those that would require a general purpose financial report to be prepared.

Whilst it is clear that many financial reports prepared by the public sector are general purpose and of wide interest to the public in general, other reports are prepared for other reasons and may not have a wide readership or interest, even though they may be available to 'the public at large'.

Legislation, international and other treaties, ministerial and other guidelines, government policy, international best practice and other factors will all impact how financial reports are prepared and presented in the public sector. It is questionable whether imposing a rigid 'one size fits all' financial reporting framework – 'general purpose financial statements' – will assist in meeting these objectives and requirements.

⁸ Paragraph BC3 of the Basis for Conclusions on AASB 1049 notes that "[t]he Board concluded that it is not necessary to specify whether the GGS is a reporting entity and whether the financial report prepared in accordance with the Standard is a general purpose financial report (GPFR) because the Standard itself prescribes the particular requirements for the scope of the GGS and the form and content of the GGS financial report".

Accordingly, we believe that Accounting Standards should only apply to those financial reports of public sector entities where the reporting mandate explicitly requires compliance with such Standards. Furthermore, consistent with our views above for financial reports lodged with a regulator, we believe that the AASB must provide presentation and disclosure relief to many entities, which may be based on some form of 'size' or other test.

- (j) **do you agree that, notwithstanding an entity having been exempted from filing a financial report with the ASIC, its financial report should be regarded as a general purpose financial report if it is required by the Corporations Act to be prepared in accordance with Australian Accounting Standards?**

Consistent with our comments elsewhere in this letter, we do not support this proposal and instead would propose that these entities be treated in the same manner as other entities of equivalent size in the economy. Accordingly, these entities would be required to follow an Australian SME Standard (unless they elect to apply A-IFRS) and entities that meet the relevant relief criteria, which may be based on some form of 'size' or other test', would not be required to comply with the full presentation and disclosure requirements of that Standard.

- (k) **the Corporations Act includes three size thresholds respectively for revenue, assets and the number of employees to distinguish between small and large proprietary companies.**

The AASB's proposed size thresholds only include the monetary thresholds of revenue and assets. Do you think that, except for the case of for-profit entities that are not publicly accountable but are important from a public interest perspective, a further size threshold for the number of employees would be appropriate under the proposed differential reporting for not-for-profit private sector entities and public sector entities?

As noted elsewhere in this submission, we do not agree that a size test is appropriate for the determination of which entities should adopt A-IFRS and which should adopt an Australian SME Standard – we instead believe that the IASB's definition of 'public accountability' should be used as the only differentiator. However, we support the use of some form of 'size' or other test as the basis for relief from presentation and disclosure requirements.

In the event that the AASB decides to proceed with its size-test proposal, we believe that a test based on employee numbers is not necessary, even though it is used by some other jurisdictions in their differential reporting regimes⁹. The number of employees is likely to have strong correlation with revenues and asset levels in many cases, rendering a further 'employee based' test largely irrelevant. Furthermore, the needs of employees as potential users of the financial statements should not, through the operation of these tests, be indirectly elevated above those of the other users of the financial statements, including equity holders to whom the primary reporting obligation is owed¹⁰.

In relation to the operation of the thresholds, we believe that it would also be more appropriate to implement the test based on equalling or exceeding *both* the revenue and asset tests, i.e. an 'and' rather than 'or' test.

The use of an 'and' test would produce a fairer outcome in a number of industries where profit margins can be very low with profitability dependent on high turnover, e.g. motor vehicle dealerships and many consumer retail operations.

Although reported revenues in these types of industries can be very high, causing the revenue threshold to be exceeded, the assets employed in these businesses can be comparatively low and well below the asset threshold. In these situations, it seems unfair to force compliance with A-IFRS upon entities that do not have otherwise have a large economic impact in the economy as a whole.

The revenue and asset tests may *together* be seen as a pragmatic surrogate for a measure of, 'total enterprise value', as determining that value would be subjective or costly to implement on an annual basis for entities that do not have public accountability. In our view, requiring both tests to be met would better reflect the 'importance from a public interest perspective' concept used by the AASB in devising the 'economic importance' thresholds and also be more aligned with the 'two out of three' criterion used in the *Corporations Act 2001* for delineating small and large proprietary companies.

In addition, to 'smooth' the impacts of changes in reported assets and revenues, we suggest that the AASB consider introducing some form of averaging concept around the thresholds, such that an entity would only switch between one framework and the other where a sustained change in those measures occurs. One form of this averaging concept might be a 'two out of three period' or similar rule. This approach would prevent entities unnecessarily changing between reporting frameworks due to non-recurring factors in one particular period.

⁹ For example, many countries in the European Union (such as Denmark) adopt a form of entity classification based on measures that include a count of the number of employees.

¹⁰ Equally, if the AASB adopts our suggestion to use the thresholds as the basis for providing presentation and disclosure relief, we believe that an employee numbers criterion is also unnecessary for this purpose for similar reasons.

- (1) **considering the AASB's tentative decision to base the second tier of reporting requirements on the IASB's pending IFRS for SMEs, do you consider that the IASB's ED of A Proposed IFRS for SMEs is appropriate for Australian circumstances. If not, explain how it could be improved, or what other options are more appropriate and why?**

We support the introduction of the IASB's SME proposals in the Australian context for the following reasons:

- it is consistent with the Financial Reporting Council's directive to adopt IFRS as the basis for financial reporting in Australia
- it would put Australian entities on an equal footing with their international counterparts
- as noted elsewhere in this letter, we believe that it is likely that IFRS and IFRS for SMEs may diverge over time to reflect the needs of the users of financial statements of each group, meaning that relying on IFRS alone in the Australia context may produce outcomes that are not suitable for entities without public accountability
- adopting the proposals in the Australian context would allow entities that are subsidiaries of foreign entities that report using the IFRS for SMEs to streamline their financial reporting, eliminating unnecessary compliance and reporting obligations.

Whilst we support the introduction of the IASB's proposals in the Australian context, we note that there is substantial opposition to the IASB's proposals from some constituents, often on the basis that the proposals do not provide sufficient simplification for the entities for they were designed. As a result, our comments in this submission regarding the suitability of the SME proposals for various purposes should be considered in this context.

It should be noted that we also support further simplification of the IASB's SME proposals, but nevertheless believe that the SME proposals so modified would remain suitable for the purposes we have outlined in this letter, including, for the avoidance of doubt, all not-for-profit entities and all entities that lack public accountability (recognising that for subsidiaries of an entity with public accountability A-IFRS is expected to be more desirable).

However, if the requirements for SMEs were so simplified by the IASB in finalising its proposals so that they were no longer suitable for large non-publicly accountable entities, this may call into question their suitability for some non-publicly accountable Australian entities. Therefore, we recommend that the AASB consider re-exposing its proposals for the revised differential reporting regime once the outcome of the IASB's SME project is known.

Our own detailed views on the IASB proposals are in the process of being provided to the IASB by the global firm of Deloitte Touche Tohmatsu and our local views are outlined in Appendix C.

- (m) **do you think adaptations, or additional guidance, are needed (in addition to Aus paragraphs that would be included consistent with Australian equivalents to IFRSs) for not-for-profit private sector entities and public sector entities if the IASB's IFRS for SMEs were adopted in Australia?**

Consistent with our views noted above, we do not support the widespread modification of IFRS for SME proposals in the Australian context. Instead, we believe that matters not specifically covered by IFRS or any SME Standard should, where possible, be subject to separate Accounting Standards, to the extent that those requirements are not inconsistent with IFRS and/or are absolutely necessary from the perspective of a public sector or not-for-profit perspective.

- (n) **do you think Australia and New Zealand should seek to achieve harmonisation in their reporting requirements regarding SMEs?**

In relation to for-profit entities, we agree that harmonisation between Australia and New Zealand would be a useful, but not crucial, goal when finalising the AASB's SME and differential reporting proposals and we encourage the AASB to liaise with the New Zealand board in this regard. However, we would prefer that an appropriate solution for Australian for-profit entities be the AASB's primary concern in this area and therefore believe that this solution should focus on ensuring 100% convergence between IFRS and IFRS for SMEs and their Australian equivalents. In other words, we would not support the divergence from full compliance with IFRS or the IFRS for SMEs in relation to for-profit entities to achieve harmonisation with New Zealand.

In relation to not-for-profit entities, we feel that it may be better to put a stronger emphasis on achieving harmonisation between Australia and New Zealand, consistent with the existing agreement between the boards of the two countries to do so. This may necessitate a deferral of the implementation of the Australian SME Standard to the not-for-profit sector while a harmonisation solution is developed between the two boards. In this instance, we believe that the 'status quo' be retained during this process, using IFRS and the 'reporting entity' concept, rather than potentially forcing two radical changes in accounting frameworks on these entities in a relatively short time frame.

- (o) **are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the preliminary views?**

We believe that there are regulatory and other issues arising in the Australian environment that may affect the implementation of the preliminary views. Our concerns in this area are detailed elsewhere in this letter and include:

- the impacts of the proposals on entities that are required to lodge financial reports under legislation other than the *Corporations Act 2001*
- the need to abandon the 'reporting entity' concept (or some derivation of it) when it has served the Australian economy well for a sustained period.

In addition, depending on how the proposals are ultimately implemented, it will be necessary for the AASB to carefully consider the transitional provisions on moving between the reporting frameworks and the ability of entities to state compliance with IFRS or the IFRS for SMEs, particularly where presentation and disclosure relief forms part of the differential reporting regime.

- (p) **do you think that the overall benefits that would arise from the proposals would exceed the overall costs? If you are an entity that prepares a general purpose financial report or would need to do so under the proposals, please advise us of any increased costs or any savings that would result from the proposals, and if possible, quantify them.**

We do not believe that the overall benefits of the proposals (as they are currently stated) will exceed the overall costs for the following reasons:

- the proposals would substantially increase the financial reporting obligations of many entities, producing information that would be of limited use to users of their financial reports
- due to a reliance on arbitrary thresholds and differential reporting in all sectors (for profit, not-for-profit and public sector), there is likely to be confusion amongst preparers and users of financial reports in differentiating between and applying the various 'GAAPs' that these proposals effectively create
- transitional costs are likely to be high and competition for appropriately qualified resources may mean that the proposals are not appropriately introduced by some entities. Additional costs in training and development could also be expected
- the movement of human resources between Australia to and from other countries may be limited due to the complexity overlaid by the AASB on top of 'pure' IFRS (including the IFRS for SMEs), again potentially unnecessarily increasing costs for Australian entities
- coming relatively quickly after Australian transition to IFRS may see entities suffering from 'reform fatigue', potentially undermining the efficacy of these further reforms to financial reporting in the Australian context.

However, we believe that with appropriate modification, the proposals could be beneficial and suggest that the AASB consider our recommendations in this regard as outlined elsewhere in this letter.

(q) would the preliminary views be in the best interests of the Australian economy?

Overall, we do not believe that the AASB's preliminary views are, without modification, in the best interests of the Australian economy, for many of the reasons highlighted elsewhere in this letter.

Our concerns are summarised as follows:

- the proposals around 'general purpose financial statements' are inconsistent with the IASB's views
- the proposals would impose unnecessary presentation and disclosure obligations on:
 - entities that are insignificant and which would clearly be considered 'non-reporting entities' under the existing regime
 - wholly-owned and otherwise closely held subsidiaries
 - public sector and not-for-profit entities lodging under enabling legislation
 - other entities where the use of the financial report by outside users is not widespread
- the threshold proposals as designed would not operate effectively in some industries and set the barrier between A-IFRS and an Australian SME Standard at an unreasonably low level
- the proposals could be seen as inconsistent with the Federal Government's objective of reducing or eliminating unnecessary 'red tape' and compliance burdens on Australian entities.

However, we believe that the adoption of IFRS (including the IFRS for SMEs) in the Australian context will improve the ability of Australian entities to compete for funds in global capital markets. Accordingly, we believe that with modification as suggested elsewhere in this letter, the proposals are in the best interests of the Australian economy.

Appendix C: Deloitte responses to the IASB *Exposure Draft of a Proposed IFRS for Small and Medium-sized Entities*

Overall comments

Overall we support the IASB's effort to develop an appropriate and comprehensive reporting regime for SMEs. The need for such a regime will increase as the full suite of IFRS becomes more complex to apply and full IFRS is primarily directed to serve the needs of sophisticated capital market participants. In this context we support the IASB endeavours, but at this point do not believe the process has gone far enough in providing a cost effective and efficient means of communication between SMEs and the users of their financial statements. Below we highlight our key concerns with respect to the IASB Exposure Draft (referred to in this Appendix as the 'IASB ED'); we have focussed on the key issues in an Australian context only and have not responded to all the questions in the exposure draft.

Our comments should be considered in light of our comments in Appendix B, particularly with respect to financial reporting by subsidiaries where we believe there should be some form of relief within IFRS for SME such that they can adopt the recognition and measurement requirements applied by their parent without having to also comply with all the disclosure requirements. This would prevent consolidation difficulties and the double cost of preparing two different sets of numbers under different accounting policies.

The final standard should be a stand-alone document

We support the objective of a self-contained, comprehensive, set of standards for SMEs and do not agree that the IFRS for SMEs should contain any cross referencing to full IFRS, except in rare circumstances. SMEs should be able to find all their financial reporting requirements in the one stand-alone document consistent with the IASB's conclusion that separate standards were appropriate¹¹. Whilst we appreciate the need to keep the IFRS for SMEs concise, we do not believe that directing SMEs to full IFRS in many situations is the way to achieve this objective.

We believe cross-referencing to full IFRS will be confusing when applying the proposals in the IASB ED, given that full IFRS itself contains extensive cross-referencing, including to IFRIC Interpretations. Accordingly, without clear and explicit guidance, it will be difficult for SMEs to determine when and if the requirement to use full IFRS ceases. In addition, both suites of Standards include topics that are not addressed in the other. For SMEs it is clearer that they do not need to fall back to full IFRS, however if entities are applying a similar framework it may be difficult to argue a different policy to full IFRS is appropriate. There is also no guidance in full IFRS as to the relevance of IFRS for SMEs in their accounting and, therefore, whether accounting requirements under IFRS for SMEs is required or allowed when full IFRS is silent.

¹¹ IASB Basis for Conclusions on Draft IFRS to SME, paragraph BC26,

As IFRS are revised we do not think it will be clear which version of a Standard the cross-reference refers. Under the maintenance approach suggested by the IASB, the application of a revised version of a full IFRS Standard to SMEs may not have been considered when it is issued. If the version of a full IFRS Standard to be referred by an SME is not clarified, it could potentially lead to a change in accounting policy by a SME that may need to be reversed in a future period. This issue could become more pronounced as full IFRS evolves, particularly if future full IFRS changes lead to further divergence between the requirements of full IFRS and IFRS for SMEs. Eliminating cross-referencing, where possible would alleviate these concerns.

Further simplification of the recognition and measurement principles is required

The users of SME financial statements are not as sophisticated as those of full IFRS financial statements and, therefore, the accounting requirements should be simplified. Although the IASB has proposed some simplifications in the IASB ED which represents a step in the right direction, we believe further simplification is required so that the IASB ED can be applied in an efficient and cost effective manner for SMEs.

The areas where we believe further or new simplifications are required include:

- leases
- consolidated and separate financial statements
- financial assets and financial liabilities – scope and measurement
- property, plant and equipment – componentisation of assets and annual reviews
- business combinations and goodwill – contingent liabilities, intangibles and goodwill
- foreign currency translation – disposal of a foreign operation
- share-based payments
- income taxes
- employee benefits – in relation to defined benefit plans
- specialised industries – particularly in relation to agriculture

The underlying reasons for why we believe further or new simplifications are required in the above areas are due to various combinations of the following factors:

- the significant costs that may be incurred in complying with the requirements, for potentially little benefit. In some cases this has arisen due to the IASB removing the simple or more appropriate option or imposing a requirement on a SME that does not exist under full IFRS. For example, the IASB ED currently imposes a fair value model more frequently on a SME than full IFRS reporters, primarily due to the elimination of options. It is unclear to us why the cost model is unacceptable. A fair value methodology imposes significant annual costs on preparers and the IASB ED fails to justify the appropriateness of this approach on cost/benefit grounds

- the IASB ED pre-empts proposals to amend full IFRS that would result from other IASB projects which have not yet been finalised. This is inconsistent with the proposal of maintaining the IFRS for SMEs through an omnibus exposure draft every two years and is potentially imposing more onerous requirements on IFRS for SME reporters before full IFRS reporters
- too much guidance being removed, which has the potential for different interpretations to arise where entities chose not refer back to full IFRS (which we agree should not be mandatory).

Further disclosure relief is required

We believe disclosure is one of the key areas where simplification for SMEs is beneficial without significantly decreasing understandability and relevance to users. We believe the IASB ED does not go far enough in removing those disclosures that do not necessarily provide benefits to the users of the financial statements in excess of their costs of preparation.

In our view, the disclosures for SMEs should be along the lines of the following:

- the SME Standard should incorporate core mandatory requirements that are equivalent to the principal full IFRS disclosure standards, that is, IAS 1 *Presentation of Financial Statements*, IAS 7 *Cash Flow Statements*, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and IAS 24 *Related Party Disclosures*
- additional disclosures should also be required to the extent that they are necessary to understand significant transactions and balance movements during each reporting period - the disclosures required by IAS 34 *Interim Financial Reporting* may provide a basis for determining these key disclosures.

In addition, we do not believe an entity which reverts to an option in full IFRS not outlined in the IASB ED should be penalised by having to follow the full IFRS disclosures for that Standard. Although the IASB selected the 'simpler' and/or most likely IFRS option that a SME may select when developing the IASB ED, historical practices, parent entity accounting policies and desire for comparability with larger organisations may cause an SME to instead choose the more 'difficult' option that is only available under full IFRS. This choice however may not necessarily affect the users of an SME's financial statements and their requirements for information, and therefore simplified disclosures should still be available in these circumstances.