Queensland Audit Office
Better public services

Your ref:
Our ref: 12056

19 November 2018

Ms K Peach
Chair
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Dear Ms Peach

ITC 39 Consultation Paper — Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems – Phase 2

The Queensland Audit Office (QAO) thanks you for the opportunity to comment on Phase 2 of the Consultation Paper. QAO agrees that the financial reporting framework would benefit from simplification and clarification.

The role of an auditor is to provide assurance against the reporting framework adopted by our clients. Generally, we do not comment on the appropriateness of the adopted reporting framework, provided it complies with applicable regulations. What is reported is determined by legislators, regulators and policy makers.

We provide these comments only as it goes towards strengthening the efficiency and effectiveness of public sector reporting. The public sector is affected by these proposals as:

- agencies request financial information from entities that do not lodge financial statements with ASIC, for example entities that are not companies, or are small proprietary companies
- the varied and unique user needs surrounding public accountability
- some public sector entities are not consolidated into whole of government financial statements and therefore are not bound by those accounting principles.

We support the AASB researching a simplified measurement and disclosure framework in Australia, consistent with the approaches adopted globally. A simplified framework would increase the comparability of financial statement prepared by small to medium sized entities, without the cost of full IFRS. However we do not support the options proposed in the consultation paper.

We urge the AASB to involve not-for-profit and public sector entities in its deliberations on the for-profit Phase 2 of this project to ensure that there are no unintended consequences.

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The attachment to this letter addresses the AASB's matters for comment outlined in the Consultation Paper, as well as areas where QAO suggests the AASB could improve final drafting.

QAO appreciates the opportunity to respond and trust that you find our comments useful.

Yours sincerely

Brendan Worrall
Auditor-General

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AASB specific matters for comment

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

Under Phase 2, the special purpose financial reporting regime is proposed to be removed, and the Tier 2 Reduced Disclosure Requirements regime updated for ED277 proposals or changed to the Specified Disclosure Regime.

QAO does not agree with the proposals for two main reasons:

- the impact on existing reporting arrangements
- there is a need for a simplified measurement and disclosure framework.

The impact on existing reporting arrangements

As per our response to the Phase 1 proposals, included in the Australasian Council of Auditors-General submission, QAO expects issues with the Phase 2 proposals as there are numerous entities that are preparing financial statements for use in the public sector that are being prepared other than for public lodgement.

QAO is currently trying to assist other Queensland agencies to understand and identify the effect of the proposals and determine the consequences.

QAO expects that there are many situations where legislation, relevant contracts and agreements have been drafted with reference to financial statements being prepared in accordance with Australian Accounting Standards (AAS).

Currently, the requirement to prepare financial statements in accordance with AAS, and the requirement to prepare financial statements with no reference to a framework, are largely interchangeable. This is because both requirements permit special purpose financial statements, such that that not all primary financial statements, nor all accounting standards must be complied with. QAO expects additional costs to be incurred to identify the consequences of the AASB restricting the reference to AAS meaning a defined framework, and in particular, a framework based on all IFRS measurement and recognition requirements.

An example is the NHMRC (National Health and Medical Research Council) template agreement[1] with Administering Institutions. Under that agreement, an Administering Institution must, if requested by the NHMRC, prepare an audited financial statement in accordance with AAS. While the context of the requirement appears to be just income and expenditure, it is arguable that the reference to AAS (under the AASB proposals) would require at least a Tier 2 set of financial statements, including Balance Sheet, Cash Flow Statement and all notes.

Other situations arise when legislation is drafted to refer to "accounting standards". Such references are usually considered under the applicable Acts Interpretation Act to mean Australian accounting standards. Consequently, any entities required to report, whether lodging with ASIC or not, would be required under the AASB's proposals to apply IFRS recognition and measurement requirements.

[1] https://nhmrc.gov.au/about-us/publications/funding-agreement-between-nhmrc-and-administering-institutions

QAO expects considerable time and effort will be needed to identify where agencies may be affected. Our limited research to date has identified that references to the requirements for financial statement preparation are often not in the legislation (acts and regulations), but in other documents that cannot be identified by searches of legislation. For example, the NHMRC template agreement noted above. Another example is a guideline issued by the Queensland Industrial Relations Commission under subsection 765(1) of the Industrial Relations Act 2016[2].

QAO believes that the AASB should provide suitable transitional arrangements to cater for the implementation of the significant changes under the proposed Phase 2 approach. Without such transitional arrangements, many regulators and agencies will incur costs as they need to identify where they are affected and change the relevant legislation or legal agreements to cater for the new approach.

There is a need for a simplified measurement and disclosure framework

QAO notes that each of the seven jurisdictions that the AASB researched in relation to private sector reporting[3] had a simplified measurement and disclosure framework[4]. QAO notes that over 80 countries[5] have adopted a simplified reporting system based on IFRS for SMEs.

QAO also notes that there are over 2 million businesses in Australia, and that there are over 50,000 businesses with 20 or more employees[6]. Therefore, there are tens of thousands of businesses that use financial information that could benefit from a simplified measurement and disclosure framework.

As such, QAO believes that Australia should be consistent with the approaches adopted globally and introduce a simplified measurement and disclosure framework. We include some suggestions under question 14 below.

12. Which of the AASB's two GPFS Tier 2 alternatives (described in paragraphs 167-170) do you prefer? Please provide reasons for your preference.

QAO does not support either option and believes that the level of disclosures for Alternative 2 GPFS – SDR, particularly if used as a basis for not-for-profit reporting, are expected to be insufficient for the accountability purposes of the public sector. This is because the disclosures of over 20 standards will no longer be required. We note that under the RDR, and proposed SDR regime, there is no requirement to include material information, that would otherwise be required to be disclosed under the accounting standards, but has been removed from the mandatory disclosures.

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[2] http://qirc.qld.gov.au/qirc/resources/pdf/ind_org/reporting_guidelines_3_120918.pdf

[3] *Financial Reporting Requirements Applicable to For-Profit Private Sector Companies,* AASB Research Report No. 7 (May 2018*)*
http://www.aasb.gov.au/admin/file/content102/c3/AASB_RR_07_05-18.pdf
and *Comparison of Standards for Smaller Entities*, AASB Staff Paper (April 2018)
http://www.aasb.gov.au/admin/file/content102/c3/AASB_Staff_Paper_Comparison_of_Standards_for_Smaller_Entities.pdf

[4] United Kingdom – https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/united-kingdom/#application
Singapore - https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/singapore/#application
South Africa - https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/south-africa/#application
Hong Kong – https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/hong-kong-sar/#application
Canada – https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/canada/#application
United States – https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/united-states/#application
New Zealand – https://www.charteredaccountantsanz.com/member-services/technical/reporting/special-purpose-financial-reporting

[5] https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/#analysis, updated as at January 2018. 86 jurisdictions were noted as allowing IFRS for SMEs

[6] ABS 8165.0 Counts of Australian Businesses, including Entries and Exits, Jun 2013 to Jun 2017, Table 10
http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8165.0Jun+2013+to+Jun+2017

For public sector preparers, QAO expects that each jurisdiction will need to spend time and effort to determine which of the omitted disclosures needs to be included in its statutory reporting, resulting in a reduction in comparability across jurisdictions.

Given the reduction in disclosures, QAO expects that public sector organisations using financial statements (whether for-profit or not-for-profit) will not be able to rely on Tier 2 financial statements as general purpose and will have to undertake a similar evaluation of what disclosures are missing. While organisations need to determine whether additional disclosures are required under the current framework, a lot more effort will be required under the proposed approach.

The costs and effort for the review will also need to be undertaken for each new accounting standard, that does not become one of the minimum standards.

13. **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?**

QAO believes that only one Tier 2 GPFS is needed in Australia, together with the simplified measurement and disclosure framework recommended above.

14. **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**.

QAO would support a simplified measurement and disclosure framework such as the United Kingdom approach, that used IFRS for SMEs as a base.

The UK approach addresses many of the AASB's concerns about IFRS for SMEs as expressed in AASB 1053 *Application of Tiers of Australian Accounting Standards* paragraph BC73, such as including asset revaluations (subsequently included by the IASB) and including not-for-profit modifications.

The benefit of the UK approach is that the simplified measurement framework is the default framework, with IFRS as the exception.

Simplifications in measurement that QAO recommends include:

- Remaining with the current AASB 117 accounting for finance and operating leases.
- Not requiring peppercorn leases to be fair valued for not-for-profit entities. This requirement is causing a great deal of angst for not-for-profit entities in relation to valuation issues and the effect on their results. Many not-for-profit entities are unable to determine the fair value of the right-to-use assets given the diversity of views as to determining a fair value without a market, and without incurring additional costs of external advice and valuations.

15. **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.**

QAO expects that moving from special purpose financial statements to Tier 2 by public sector preparers for public lodgement will not involve a significant number of entities with measurement changes. Instead, changes will involve additional disclosures, and related comparatives.

QAO believes that having an appropriate transition period for entities changing to Tier 2 will mean that additional relief is not needed when comparatives are required in the first set of Tier 2 financial statements.

16. **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.**

    QAO does not expect public sector entity preparers to be significantly impacted by these proposals.

    The impact on entities supplying information to public sector agencies is unknown.

17. **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.**

    As noted in question 12, QAO does not support this as a reporting option. We consider the proposed disclosures are likely to be insufficient for the accountability purposes of the public sector, given that the disclosures of over 20 standards will be eliminated.

18. **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).**

    QAO is concerned that the proposed Tier 2 disclosures (RDR and SDR) may result in material information not being disclosed in the financial statements, based on the argument that the accounting standards do not require its disclosure. There is no requirement to include material information, that would otherwise be required to be disclosed under the accounting standards, but has been removed from the mandatory disclosures.

    QAO believes that further focus on applying materiality concepts to disclosures should be adopted, rather than having a minimum list of disclosures that may omit material items.

19. **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).**

    In relation to service performance reporting QAO continues to support[7] the mandatory application of a principles-based approach to NFP entities in the public sector to ensure a minimum level of reporting of this type of information is provided to users.

    While there are already several frameworks in place in the public sector across Australia, the frameworks differ, and some are more advanced than others. QAO also expects additional costs of implementing service performance reporting, from the impact on auditing procedures per ASA 720 (responsibilities relating to other information contained in an audited financial report) and the need to implement internal processes to capture this information.

    In relation to fundraising and administration cost disclosures, QAO notes that while many users request information on these disclosures, there are difficulties in having consistent and relevant information. For example, there is no IFRS or Australian accounting standard definition of fundraising or administration costs. All charities are expected to incur these costs. However, a lower level of costs does not mean better performing, as lower fundraising costs may mean that the charity should have put more effort into raising funds.

    QAO believes that the IASB's projects on alternative profit measures, defining EBIT, and wider corporate reporting may assist the AASB in these projects. The IASB projects have some similarities to defining non-IFRS terms and providing non-financial information on activities.

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[7] ACAG submission on ED270 Reporting Service Performance Information, 29 April 2016

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

QAO is still undertaking research to identify situations that specifically refer to SPFS.

QAO expects that a significant issue is identifying where the requirements have been drafted with reference to Australian Accounting Standards, with SPFS being acceptable. Refer to our response to question 11 above outlining a specific example.

As noted under question 11, our limited research to date has identified that references to the requirements for financial statement preparation are often not in the legislation (acts and regulations), but in other documents that cannot be identified by searches of legislation.

AASB General Matters for comment

21. Whether *The AASB's Standard-Setting Frameworks for For-Profit and Not-for-Profit Entities* has 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).

No, QAO does not believe that the *AASB's Standard-Setting Frameworks* have been appropriately applied. The AASB should consider the adoption of a simplified framework, based on IFRS for SMEs, to replace the SPFS regime.

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

QAO expects issues with the Phase 2 proposals. There are numerous entities preparing financial statements for public sector agencies, where financial statements are being prepared other than for public lodgement. QAO notes that there will likely be an impact on current reporting arrangements for such entities where their financial statements are required to be prepared in accordance with Australian Accounting Standards and are currently prepared as SPFS.

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

QAO does not believe that the financial statements would be useful to users. Neither the RDR nor the SDR frameworks have a requirement to include material information, that would otherwise be required to be disclosed under the accounting standards, but has been removed from the mandatory disclosures.

24. Whether the proposals are in the best interests of the Australian economy.

QAO does not believe that proposals evidence they are in the best interests of the Australian economy. There are tens of thousands of Australian businesses that will be left without an appropriate framework. Collaborative reform is required. Consistency with the approaches adopted globally is supported.

25. **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.**

    Benefits are inadequately demonstrated compared to the compliance burden that may occur.

    QAO has noted above situations where additional costs will be incurred. These include:

    - Imposing the IFRS measurement and recognition framework on entities that currently apply a simplified framework under SPFS, without providing a simplified framework. This has the potential to affect tens of thousands of businesses that do not currently lodge with ASIC.
    - Public sector agencies, and other users, identifying the consequences of the changes, and the costs of changing their existing reporting requirements.
    - If the SDR approach is adopted, requiring the above users to update their requirements when each new accounting standard is issued.

Other comments

Overall we believe that the proposals do not demonstrate sufficient research into an understanding of user needs.