WESTWORTH KEMP
CONSULTANTS

710/2 York Street
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9 November 2018

The Chairman
AASB

By email

Dear Sir

Re: Discussion Paper DP/2013/1 A Review of the Conceptual Framework for Financial Reporting

Westworth Kemp Consultants value the opportunity to provide feedback into the consultative process surrounding the development of a conceptual framework for financial reporting. We are a boutique consultancy specialising in financial reporting, assurance and compliance issues, particularly in the context of litigation and dispute resolution (www.westworthkemp.com.au). The nature of our work is such that we often see instances where financial reporting has failed as a communication tool for stakeholders and we are therefore keen to contribute to the establishment of sound conceptual underpinnings for the development of accounting standards.

We support the AASB in its decision to adopt the international conceptual framework, and make some observations as to what the effect of that should be on the Australian reporting entity concept.

In our view, all entities that lodge financial statements prepared under a fair presentation framework with a regulator should comply with all the recognition and measurement tenets of accounting standards. While this may at first sight appear draconian, several factors must be borne in mind:

1. Lodgement with a regulator places the financial statements on the public record and makes them accessible to anyone willing to pay the fee. The preparer therefore does not know who the user might be.
2. Smaller entities by and large have simpler transactions. However, if a small entity has a complex transaction, the preparer of the financial statements should apply professional competence and due care under APES 110 in order to understand the complex transaction within the context of the accounting standards and ensure that the resulting balances are fairly stated.
3. Entities that appear to be privately held may have some stakeholders who are less involved in the business and whose rights can be jeopardised by others who are closer to the management of the entity. This can become apparent in the case of family disputes involving substantial family companies.
4. The availability of software packages like Xero makes compliance with standards much easier than it used to be.
5. There is scope for lobbying for a change to the Corporations Act raising the financial thresholds at which a proprietary company is considered large.
6. There is scope for reducing the disclosure burden of full recognition and measurement as set out in paragraph 166 onwards of the ITC.

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Our views are informed by the fact that we have seen a number of instances where the preparation of special purpose financial reports has prejudiced the rights of stakeholders.

1. SMSF accounts for a number of funds where the financial planner took the beneficiaries' savings and used them for options trading. The accountant for the fund accounted for the options on a cash basis and ignored the fact that a liability to the bank for losses was building up. The beneficiaries lost significant amounts of money and the case is currently before the courts. The funds also held impaired financial assets at their full cost without provision.
2. A group of unconsolidated non-reporting entities that had borrowed heavily, the stakeholders of which were not closely involved in the management of the entity and were not in a position to understand their financial exposure. The entity also had intangible assets that had not been subject to impairment testing.
3. A privately owned non-bank lender where there was geographic separation between owners, who thought they were closely involved, and management who prepared special purpose financial reports and did not make provision for impaired loans under AASB 139.
4. A substantial private company with a related party owned by other family members. The auditor was unable to ascertain the fair value of the intercompany balances and creditors were recognised in companies other than those in which the liabilities actually arose.

While the idea of tailoring reporting to the needs of users as described in SAC 1 is appealing, it has not worked in practice because the concept is not sufficiently robust for regulators to be able to support it by means of regulatory action. In our view, the way in which the reporting entity concept has been applied hitherto has led to poor practices both in the compilation and the audit of financial reports.

We are also concerned that the existence of non-reporting entity accounting with its relaxed attitude to recognition and measurement has led in some firms to a lack of rigour in compilation and audit engagements for smaller clients purporting to prepare general purpose reports.

We attach hereto our responses to the questions for specific comment.

Yours faithfully

C N Westworth, LLB, FCA, FAICD

Appendix – Responses to specific questions

Q11 – Do you agree with the AASB's Phase 2 approach (described in paragraph 166)? Why or why not?

We agree with the AASB's Phase 2 approach.

Q12 – Which of the AASB's two GPFS Tier 2 alternatives (described in paragraphs 167 - 170) do you prefer? Please provide reasons for your preference.

Our preference is for Alternative 1 – GPFS RDR. It already exists and is familiar to users and has the flexibility to respond to the specific features of each business.

Q13 – Do you agree that we only need one Tier 2 GPFS alternative in Australia (either Alternative 1 GPFS – RDR or the new Alternative 2 GPFS – SDR described in paragraphs 167 - 170)? Why or why not?

We agree that we only need one set of Tier 2 requirements, but recommend that the AASB lobby for a raising of the small proprietary company threshold.

We also suggest that Australia needs an optional Tier 3 best practice small company accounts that practitioners could use for smaller entities requiring more than just a tax return or a cash based statement of income and expenditure.

Q14 – Do you agree with the AASB's decision that GPFS – IFRS for SMEs (outlined in Appendix C paragraphs 18 to 36) should not be made available in Australia as a Tier 2 alternative for entities to apply? Please give reasons to support your response, including applicability for the for-profit and not-for-profit sectors.

We would not object to IFRS for SMEs being made available as an option. It is a cohesive set of requirements which while falling short of full recognition and measurement is nevertheless a recognised GAAP. If an entity chose to adopt IFRS for SMEs instead of RDR, that fact would have to be prominently disclosed under the Basis of Preparation in Note 1.

Q15 – If the AASB implements one of the two proposed alternatives (described in paragraphs 167 - 170) as a GPFS Tier 2, what transitional relief do you think the AASB should apply (in addition to what is available in AASB 1)? Please provide specific examples and information.

In our view AASB 1 is adequate.

Q16 – What concerns do you have on consolidating subsidiaries and equity accounting associates and joint ventures as proposed in the AASB's medium-term approach? What transitional relief do you think the AASB should apply? Please provide specific examples and information.

While establishing fair value will be difficult, that in itself is not a reason for not requiring consolidation and equity accounting.

Q17 – If the new Alternative 2 GPFS – SDR described in paragraphs 167 - 170) is applied, do you agree that the specified disclosures would best meet users' needs? If not, please explain why and provide examples of other disclosures that you consider useful.

Our preference is for Alternative 1.

Q18 – Do you have any other suggested alternative for the AASB to consider as a GPFS Tier 2 and whether this would be applicable for for-profit and not-for-profit sectors? Please explain rationale (including advantages and disadvantages and the costs and benefits expected).

See our answer to Question 13 above.

Q19 – Do you think service performance reporting, fundraising and administration cost disclosures for NFP private sector entities should be included as part of the chosen GPFS Tier 2 alternative? Please explain rationale (including advantages and disadvantages).

No comment

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

No

General matters for comment on Phase 2

In our view the proposals are in the interests of the Australian economy as they will result in an improvement in the quality of financial information that is held on the public record and make that financial information more useful to users.

However we also suggest that the AASB should lobby for

- a review of the disclosure thresholds in the Corporations Act and
- the removal of the absurd grandfathering concession for the old exempt proprietary companies that do not qualify as small.