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Financial Reporting Council

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Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
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Dear Hans

Thank you for providing us with the opportunity of commenting on key matters relating to the IASB's agenda over the next three years. We note that the Australian Financial Reporting Council (FRC), in line with its focus as the peak body responsible for overseeing the effectiveness of the financial reporting framework in Australia, will only comment on matters relating to the broad strategic priorities for the IASB. Other entities from Australia and the region will be providing comments on the more operational issues put forward for discussion in the consultation paper.

Q1 What do you think should be the IASB's strategic priorities, and how should it balance them over the next three years?

Not for profit sector

The FRC is concerned that the agenda paper makes no mention of how the IASB proposes to deal with the not-for-profit (NFP) sector, both in the private and public sectors. The FRC believes strongly that the IASB should commit to a long term goal of a single suite of global standards for both the private and the NFP (including public) sectors. Since NFP differences still need to be addressed, this single suite may take a variety of forms such as multi-tiered standards, some separate standards for specific NFP issues and standards with additional paragraphs addressing NFP issues.

We are not arguing for complete development of such a suite in the three year agenda period. However, to facilitate the objective, IASB should take the following immediate steps:

- Adopt it as a commitment and build it into concrete planning;

- Include consideration of the not for profit perspective in its current deliberations regarding the development of its framework and new standards.

A modest investment in considering NFP sector issues in the development of accounting standards and projects at this stage may prevent a major exercise in convergence in the future. Deferring these issues, and in particular the practice of developing standards that are solely applicable to the private sector, may result in divergence between NFP and private sector accounting practices.

At the very least, the future development of standards should encompass the perspectives of the not-for-profit (NFP) sector to achieve a single set of global financial reporting standards for the for-profit and the NFP sectors. This is achievable through the continuation of IASB's practice of issuing principle-based accounting standards, the completion of its conceptual framework and the use of generic/sector neutral terminology.

Deferral of NFP considerations, and in particular the practice of developing standards that are solely applicable to the private sector, is leading to national standard setters that cater for both sectors, such as Australia, developing NFP and public sector paragraphs to IFRSs for local application. This creates a risk that implementation and adoption practices will diverge. Alternatively, standard setters may decide to move away from applying IASB's accounting framework and adopt other more suitable frameworks for the NFP sector (for example, New Zealand has recently announced it will use IPSAS standards as a basis for its public sector financial reporting).

Completion of the conceptual framework project (including Phase G which relates to the NFP sector), is of utmost importance in this regard. The existence of a robust conceptual framework can generally assist NFP entities to comply with agreed underpinning principles when specific standards do not cover the particular issue, which generally is the case when public sector issues are not considered in the development of accounting standards

In this endeavour, it would be desirable for the IASB to liaise closely with the International Public Sector Board (IPSASB) and formulate a strategic plan as to how its relationship with the IPSASB should develop. Setting out such a strategic plan, with at least indicative timelines and target dates, would provide stakeholders with some reassurance that the ultimate objective of a single set of global financial reporting standards issued by a single global standard-setting organisation was being kept in mind. The FRC is pleased to note the recent MOU with the IPSASB including the commitment to discussions on the various possibilities of structuring the future relationship between the two entities, including a single governing body for the two standard setters or even a single standard setter for the private and public sectors. At the appropriate time the FRC would welcome the provision of some milestones and timelines, even if they are only of an indicative nature, outlining the process for bringing these discussions to a conclusion.

Integrated reporting

The FRC supports the IASB spending some time in monitoring developing key strategic issues. In particular, we note that much time and effort is being devoted to developing a detailed integrated reporting framework by entities such as the International Integrated Reporting Committee (IIRC), with a detailed draft framework expected to be available at the end of 2012. Admittedly there is currently a lack of substance and detail attached to the concept of integrated reporting, and there is even less clarity about how any framework, once it is developed, could be implemented across jurisdictions. Nevertheless, given the widespread interest in the idea, it is important for the IASB to remain aware of developments in this area and to have a position on the role it sees for itself in the further development and implementation of an integrated reporting framework.

IFRS for SMEs

The FRC is disappointed that the review of IFRS for SMEs will be conducted as a separate exercise. During a recent round of visits I made to key stakeholders in Asia, Europe and the USA a consistent theme brought up in meetings was the need to find a solution to the financial reporting needs and problems of smaller entities. In many cases IFRS for SMEs had been considered as a possible solution but had been rejected, because it does not respond to these needs and problems. On the other hand an alternative solution, the reduced disclosure approach that has been implemented in Australia, has attracted significant interest, and similar regimes are being developed for example in Europe.

There also seems to be some confusion about the role of IFRS for SMEs, as there are reports of emerging economies using IFRS for SMEs as a first step in developing a financial reporting regime before moving to a full IFRS-based system. We consider that there must be some question whether this is an appropriate way to go about developing a financial reporting system, and whether it is in agreement with the IASB's thinking about the appropriate use of IFRS for SMEs.

It therefore seems to us that there is substantial disagreement about the best approach to financial reporting for smaller entities, and whether IFRS for SMEs is the appropriate answer to this (or some other) problem. We consequently urge the IASB to take a more strategic approach to addressing the financial reporting needs and problems of smaller entities.

Consistent application of IFRS

The FRC considers that consistent application of IFRS is becoming one of the most serious problems in international financial reporting. An example of this was recently provided by the case of the diverging accounting treatment applied to Greek government bonds by European financial institutions, at least partly based on disagreements about the use of fair value and the definition of active markets in the accounting standards. It appears to us that there is no easy solution to this problem, but that part of the answer must lie in striking a balance between the principles-based and rules-based approaches in the development of accounting standards. The role of IFRIC may also need to be considered in this context, and whether it is providing sufficient guidance on the right issues in dealing with this problem.

A further method for dealing with inconsistent application of IFRS may be to develop some type of brand protection for IFRS. This would help to deal with jurisdictions that claim to be fully IFRS compliant, but may in reality only be converging towards IFRS or have retained significant carve-outs from the IFRS regime.

Consistent terminology

A further instance of inconsistency can be found in the widely divergent terminology used to describe profits restated by reporting entities to better reflect their underlying performance. Terms that we have encountered to describe such restatements include 'underlying profit', alternative profit, 'realised profit' and 'non-GAAP profit'.

The FRC would support using the term '**non-IFRS**' profit, which will be applied, after much consultation, in relevant guidance being prepared by the Australian Securities and Investments Commission. Some guidance from the IASB would be of assistance in ensuring consistent terminology in this area and reduce the risk of misunderstandings and confusion.

Relationship with regional bodies

A topic that is becoming of increasing interest to stakeholders concerns the relationships of the IASB with regional bodies around the world, especially once the convergence process with the US has run its course. Questions that arise in this context include the relative position of the Financial Accounting Standards Board (FASB) and whether it should have some privileged status in dealing with the IASB. Another issue of concern is whether national standard setters should still be able to work with the IASB, or whether they should be confined to contributing to the positions and submissions developed by the regional bodies such as EFRAG in Europe and the Asian-Oceanian Standard-Setters Group (AOSSG) in Asia-Pacific.

One model that we have seen and which we find attractive places the IASB at the centre of a web of regional bodies including FASB, with communication flows going to and from the centre, but also occurring directly between the regional bodies and FASB. This model would also allow direct communications between national standard-setters and the IASB, so that the IASB could continue to benefit from the work done at the national level.

Providing stakeholders with some indication of the IASB's thinking on these issues would help in making decisions on allocation and positioning of available resources.

Q1 (a) – Do you agree with the two categories we identified and the five strategic areas within them? If you disagree, how do you think the IASB should develop its agenda, and why?

The FRC generally agrees with the categories and areas identified. As noted above, NFP issues should be considered in the development of financial reporting.

The strategic area of post implementation reviews is strongly supported.

Q1 (b) – How would you balance the two categories and five strategic areas? If you have identified other areas for the IASB's agenda, please include these in your answer.

The FRC believes that completion of the conceptual framework should be a strategic priority for the IASB, because it will assist the IASB in setting standards that are principles-based, internally consistent and internationally convergent (as noted in the Agenda Consultation 2011). Attempting to determine conceptual issues at the level of standards prior to the completion of the conceptual framework project may result in inconsistencies between standards, lack of understandability and, consequently, extensive disclosures. The framework should address gaps in the current accounting standards, such as asset and liability measurement and elevate conceptual issues which are currently delegated to the standards level, such as other comprehensive income. This will improve the framework integrity, consistency in practices and comparability.

FRC stakeholders have identified "complexity in financial reporting" as an item the IASB should consider adding to its list of projects. Some national standard-setters are already performing research on this matter as it is perceived to be important for meeting the needs of users of financial reports.

The FRC's Reducing Complexity Task Force is of the view that the increasing complexity of reporting reflects the reality of the increasingly complex and more global corporate operating environment. This complexity reflects the accumulated effects of economic, political and regulatory changes that have accelerated in recent times. The increases in reporting complexity largely reflect

the more complex strategies and information systems necessary to manage changes in business complexity.

Given these preliminary conclusions, the Task Force believes that greater immediate benefits can be gained by identifying ways in which reporting complexity can be better managed, rather than reduced per se, to mitigate its effects. The Task Force believes that management of the complexity of reporting can be achieved by:

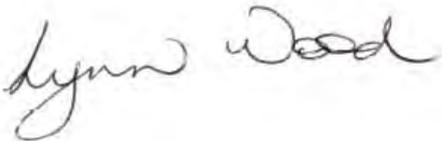
- (i) focusing on improvements in the content of reports, that can be made notwithstanding the complex matters being reported on, and
- (ii) considering how best to communicate the content of reports.

That said, the Task Force emphasises that over the longer term the reduction of financial reporting complexity should remain a key focus and objective of the FRC and that this can be achieved through influencing future changes to the financial reporting and regulatory reporting frameworks and requirements.

On the other hand a lower priority could be given to the integration of XBRL and IFRS.

We hope that these comments will be useful to you in your deliberations in developing the future work agenda of the IASB. I am of course happy to answer any questions you may have, and invite you to contact me at any time should that be the case.

Yours sincerely

A handwritten signature in cursive script that reads "Lynn Wood".

Lynn Wood
FRC Chairman