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FRC Chairman
The Treasury
Langton Crescent
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Email: frcsecretary@treasury.gov.au

Dear Ms Wood,

Managing Complexity in Financial Reporting

The Australian Institute of Company Directors (Company Directors) welcomes the opportunity to comment on the report by the Financial Reporting Council's (FRC) Managing Complexity Task Force titled *Managing Complexity in Financial Reporting* (the Report), released by the FRC on 29 May 2012.

Company Directors is the second largest member-based director association worldwide, with over 31,500 individual members from a wide range of corporations; publicly-listed companies, private companies, not-for-profit organisations, charities and government and semi-government bodies. As the principal Australian professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

This Report highlights the causes and effects of the increase in the complexity of financial reporting in Australia. However, Company Directors does not agree with the premise in the Report that "complexity is inevitable in the short term". We believe that addressing two key areas (namely: getting the right entities reporting the right information, and extending the business judgement rule to include those judgements made by directors in the preparation of the financial statements), would go a long way to mitigating the issue of increasing complexity.

These two areas are discussed in greater detail below.

1. **The right entities need to comply with International Financial Reporting Standards (IFRS)**

   In the April 2012 results of our Director Sentiment Index[1], nearly one-third of director respondents held the belief that the IFRS is dysfunctional to some degree. Company Directors has always advocated[2] and continue to advocate, that IFRS

[1] Director Sentiment Index, April 2012, Refer to Company Directors website, http://www.companydirectors.com.au/Events/Director-Sentiment-Index

[2] Refer to Company Directors submission to the Australian Accounting Standards Board dated 22 April 2010 in response to ED 192 – Revised Differential Reporting Framework. This submission is included in the policy section of our website at, http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues

should not be applied to all entities in Australia. Australia is one of only a few jurisdictions that require all reporting entities (listed and non-listed) to apply IFRS or "IFRS equivalent" standards. In the majority of other economies, this requirement only applies to listed entities.

We believe that it is necessary to revisit this position in Australia and only require publicly accountable entities to apply IFRS. For non-publicly accountable entities we continue to advocate that they should be allowed to adopt the IFRS for SMEs accounting standard, which has been issued by the International Accounting Standards Board. This standard is a better and more relevant system of accounting principles compared to "full" IFRS, given it provides a simpler measurement and recognition requirement compared to the Australian Accounting Standards Board reduced disclosure regime (RDR). The RDR only provides relief with respect to the provision of disclosures, and these entities are required to continue to apply the full recognition and measurement requirements of IFRS.

We note that of those entities that are entitled to adopt the RDR not many have in fact adopted it. A recent survey by Grant Thornton showed that only 24% of respondents were likely to adopt any of the simplifications to financial reporting as a result of the *Corporate Reporting Reform Act, 2010*[3].

The Report proposes the introduction of a glossary of commonly used ratios and financial reporting terms, and states that entities should be encouraged to use these terms. There is a risk that such a glossary could needlessly increase the compliance obligation on entities. We suggest it may be more beneficial to encourage entities to develop their own glossaries reflective of those issues and accounting treatments that are key to understanding their financial statements and accompanying note disclosures.

The principles highlighted in our joint publication, *Underlying Profit, Principles for reporting of non-statutory financial information*[4] provide a framework for entities to prepare consistent and comparable disclosures to assist users in understanding those issues that may not be effectively addressed in the financial statements.

2. Extending the business judgement rule in Australia

The Director Sentiment Index, referred to above, also found that "most directors still believe that director liability and compliance requirements (based on current legislation) will negatively impact their willingness to serve on a board".

Until there is an appropriate director liability regime in Australia, it is unlikely that there will be a significant change to current financial reporting practices, and financial statements will continue to be cluttered with immaterial and in some cases "boilerplate" disclosures. A potential solution would be to give consideration to the extension of the business judgement rule which is set out section 180(2) of the *Corporations Act 2001* to include the judgements and elections that directors make in the preparation of the financial statements. The business judgement rule is currently limited to breaches of section 180(1) of the *Corporations Act 2001* – the duty of care and diligence.

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3 Grant Thornton, *Simplifying Financial Reporting Survey,* December 2011

4 *Underlying Profit: Principles for reporting of non-statutory profit information,* 2009, the Australian Institute of Company Directors and the Financial Services Institute of Australasia.

IFRS is a principles-based framework, and many of the accounting standards require entities to make elections as to the accounting treatment for recording their transactions, particularly with respect to recognition and measurement. These standards further require certain estimates to be made in the calculation of the values to be recorded[5]. This results in directors using judgements when making those elections. However, there is currently no protection provided to directors under the *Corporations Act 2001*, should it be determined, at some later date that those accounting elections were in error. We believe this is particularly harsh where the directors have acted in good faith and informed themselves about the subject matter.

Section 295(4) of the *Corporations Act 2001* details the requirements of the directors declaration in respect of the financial statements and accompanying notes. This section requires directors to state whether in their opinion the financial statements "provide a true and fair view" of the financial performance and financial position of the entity (if not additional disclosures are required).

However, ASIC in its regulatory guide, RG230 "Disclosing non-IFRS financial information" states that it believes that only in rare circumstances would the accounting standards not provide a "true and fair view" (RG230.31-RG230.35). ASIC guidance is not a statement of law. Rather it is an expression of the regulators view of preferred practice. Nevertheless, this potentially limits the willingness of directors to make such disclosures. There is a need by regulators to acknowledge that strict adherence to the accounting standards may not lead to true and fair and understandable financial statements and may lead to the opposite of what they are trying to achieve.

Company Directors believe that the provision of adequate safe harbours and a broad-based business judgement rule relating to the judgements made in the preparation of the financial statements will go a long way to providing directors with the appropriate protection, resulting in more meaningful corporate disclosures.

We trust that the comments in our submission will be of assistance to you. Company Directors would be happy to elaborate on any of the points made in this submission should this be required.

Yours sincerely,

John H C Colvin
Chief Executive Officer & Managing Director

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[5] This is evidenced in the note to the financial statements, Significant judgments and estimates (AASB101 Presentation of Financial Statements, para 125).