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Secretary
Financial Reporting Council
The Treasury
Langton Crescent
PARKES ACT 2600

26 July 2012

Dear Sir/Madam

BDO SUBMISSION -MANAGING COMPLEXITY IN FINANCIAL REPORTING

BDO is pleased to provide the Financial Reporting Council (FRC) with its comments on the Report from the FRC Managing Complexity Task Force dated 29 May 2012 (Report). BDO's response reflects our position as auditors and business advisers to listed and privately held companies, not-for-profit entities (NFPs), and other businesses.

The Report concludes that complexity is inevitable and that all that can be done is to manage complexity. While this conclusion may be largely true when dealing with listed companies, complexity is a significant issue for unlisted entities including NFPs. BDO believes there are immediate actions available to the regulators and standard setters which would reduce complexity and its impact on this sector now and in the future.

The Report addresses 3 distinct topics impacting the clarity of financial reporting, rather than complexity as a single issue. These topics being:

1) complexity in financial reporting;

2) voluminous financial reports ("information overload"); and,

3) failure to disclosure adequate information to understand the financial report (boiler plate disclosure)

We believe that each of these topics is different and that there are actions that can be taken in Australia to improve the clarity of financial reporting, a number of which could be described as "quick wins".

1 Complexity in financial reporting

As stated in the Report continued complexity is inevitable. This is as a result of the drive by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to improve financial reporting. These actions are driven by a more complex business environment and the requirement to service the needs of investors, particularly in respect of ensuring comparability across entities operating in similar industries and markets.

A review of the IASB's work program clearly shows that complexity is about to move to a whole new level with new standards proposed for revenue, leases and financial instruments.

In a principles based framework it is possible that two entities, faced with similar transactions, will adopt differing accounting treatments. This issue can only be addressed by providing users of the financial report with adequate information as to: a) identify where this type of judgement has been applied; and b) to fully understand the judgement. This inevitably results in complex disclosure.

Complexity action points can be broadly categorised as follows:

1. Differential reporting and measurement for non public interest entities.
2. Improved education of users as to the key aspects of the new “complex” accounting standards.
3. Improved disclosure, to assist users understanding of complexity.

1.1 Actions to be taken for non-listed entity reporting - Differential reporting and measurement for non-public interest entities

The Report correctly states that Australia's ability to influence this drive towards complexity as it applies to listed entities is limited. The Report also notes that Australia is unique in that it has taken this complex mixture of rules and principles and applied it beyond listed entities. BDO believe that actions should be taken to reduce complexity for the non-listed sector.

The IASB recognised with its IFRS for SMEs project that it was inappropriate for full IFRS measurement requirements to be imposed on entities other than those classified as public interest entities (PIEs). The AASB, in rejecting Australian adoption of IFRS for SMEs has doggedly stayed with the premise of “one size fits all”.

BDO strongly urge the FRC to reconsider this “one size fits all” approach for non listed entities and to instead adopt a differential reporting model in Australia. This would include simplified measurement rules, as well as significantly reduced disclosure requirements.

BDO has serious concerns as to the cost benefit of forcing non-listed entities to apply the complex requirements associated with the presumed new revenue and lease standards as well as forcing consolidation as a mandatory requirement. We predict that if this strategy is followed the only solution will be to remove a large number of entities from any financial reporting requirements through significantly increasing the reporting thresholds. This would not ultimately be a good solution.

1.2 Actions to be taken for listed entity reporting

1.2.1 Improved education of users as to the key aspects of the new “ complex “ accounting standards

BDO believes that a basic issue in respect of financial reports being viewed as overly complex is that users and preparers are not appropriately educated as to the application and purpose of the new necessarily complex accounting standards.

We would recommend that an education/awareness program be undertaken to enable users and preparers to properly understand how all accounting standards work, emphasising in particular the areas where key judgements apply and the purpose and use of specific disclosures.

Such a program may include online references and examples produced by the Australian Government, the ASX and/or the professional bodies, as well as traditional training courses.

1.2.2 Improved disclosure to assist users understand complexity

A key issue in terms of understanding complex accounting treatments is arguably the disclosures contained within the financial report are:

- Too brief.
- Not written in simple English.
- Are simply boiler plate disclosures.
- Are swamped by other immaterial disclosures.

BDO believes that there are a number of action points that could be undertaken to improve this situation, including:

- A detailed management discussion and analysis (MD&A).
- A mandated format for MDA.
- Use of websites to expand on specific accounting issues.
- Greater regulator focus on inadequate disclosure/boiler plate disclosure.

The preparation of the annual report and its importance as the key communication mechanism with investors and stakeholders, harks back to a bygone era of paper publication. A time when this report was produced once a year, and was the only practical and efficient mechanism to communicate with shareholders.

Despite the internet, this basic philosophy of “everything must go into the annual report” still prevails. Many listed companies only use the internet to post the pdf of the financial report.

The Report suggests that the internet could be used to remove governance policies etc. from the annual report, in BDO’s view the internet should be used extensively to give additional information that supplements the financial report. This information could include:

- Detailed explanation of accounting policies.
- Detailed explanation of key judgements and estimates.
- Education and guidance as to the impact of electing a particular accounting treatment/policy.
- Detailed MD&A.

Use of MD&A

The financial report is arguably prepared by accountants for accountants. BDO believe that the needs of investors may be better served by requiring the preparation of an MD&A, setting out in plain English a commentary on the financial report and the key accounting judgements made.

The requirement for listed entities to produce an informative MD&A following a prescribed format should be set by the Australian government.

2 Information overload

The Report correctly states that financial reports contain voluminous information, of questionable benefit to users, which often contains disclosure that is not material. The paper correctly refers to the work of the IASB in respect of disclosure and in part lays the blame for disclosure of immaterial items with auditors and preparers.

BDO believes that there are two other parties that could significantly assist in the reduction of unnecessary disclosure, namely ASIC and the AASB.

2.1 Role of ASIC

Rightly or wrongly ASIC are viewed as taking a very hard line in respect of disclosure, whether it be through the ASIC surveillance program or the ASIC auditor inspection program. The threat of ASIC raising concerns about omitted disclosure has, in part, acted as a driver to include more disclosure rather than less.

We would urge ASIC to consider issuing a regulatory guide on disclosure, in part emphasising that immaterial disclosure is not necessary or useful to users.

2.2 Role of the AASB

2.2.1 Reduce disclosure requirements for non PIEs

The AASB, while rejecting the use of IFRS for SME's for non-publically accountable entities in Australia, have stuck with the minimum disclosures required by IFRS for SMEs as the backstop for the Reduced Disclosure Regime (RDR). These disclosures are significantly in excess of the requirements typically contained within a "special purpose report" prepared by a non-reporting entity. RDR includes extensive mandatory disclosures presenting disaggregated information, fixed asset tables etc.

In 2010 BDO complied the following comparison as part of our response to the AASB's proposed RDR regime:

	Number of disclosures
AASB 101, 107 and 108 (current special purpose)	185
IFRS for SMEs	310
Reduced Disclosure Regime	625
Full IFRS	1,550

The above table clearly shows that the AASB's decision to adopt RDR in preference to IFRS for SMEs increased the disclosure burden on Australian entities, and that any move to scrap "special purpose" reporting will significantly increase the complexity for non-public listed entities.

In preparing RDR the AASB adopted a "top down" approach to disclosure, starting with the full suite of IFRS disclosure and removing specific disclosure requirements, while maintaining a principle of never requiring less disclosure than was required by IFRS for SMEs.

We recommend that the AASB at the very least review the disclosure requirements of RDR, adopting a "bottom up approach", with additional disclosure only being required if its omission would materially impact the usefulness of the financial report,

BDO believes that a practical RDR product would be watched closely internationally, and would likely be widely copied, if it truly offered reduced disclosure and focused only on the "must have" disclosures rather than all of the "nice to have" items.

We fully support the Report's suggestion that Australia should be active on the international stage influencing the direction of financial reporting. However we believe that "actions speak louder than words" and that the development of a practical differential reporting regime for non-PIEs would help lead the development of useful financial reporting globally.

2.2.2 Retention and enhancement of AASB 1031 *Materiality*

AASB 1031 *materiality* has for a number of years provided both auditors and preparers a very useful workable definition of materiality and has typically been used as a means of justifying why a particular disclosure was not material, particularly in debates with the regulator. It is proposed that AAAB 1031 will be withdrawn by the AASB. BDO believes that this proposal is detrimental to the basic aim of reducing complexity and that instead AASB 1031 should be extended to explicitly cover materiality as it applies to disclosure. Again demonstrating, Australian thought leadership.

While the International Auditing and Assurance Standards Board (IAASB) has issued a very useful consultation paper on materiality, this is in the context of auditors addressing the risk of material misstatement due to inappropriate / inaccurate disclosure and the evidence an auditor should gather to appropriately reduce the risk of material misstatement in the context of the auditor's opinion. It is not appropriate that preparers of a financial report are forced to refer to an auditing standard for guidance and direction. Therefore we would urge the AASB to retain AASB 1031 until an equivalent standard is issued by the IASB.

3 Failure to disclosure adequate information in order for users to understand the financial report(boiler plate disclosure)

The Report correctly recognises that there is an issue with the quality of the current disclosures made by a number of entities, in that they are boiler plate in nature and do not give useful information to the user.

BDO believes there are a number of steps that could be taken to address this issue, most of which we have discussed above, these include:

- Guidance from ASIC.
- Education.
- Production of an informative MD&A.
- Supplementary, explanatory information to be published on a Companies website.

Given the persistent history of poor and/or “boiler plate disclosure” BDO believes it would be appropriate for ASIC to consider releasing a regulatory guide on disclosure, emphasising both expected disclosure and those items that are classified as non material.

If you wish to discuss any of the issues raised in this response, please contact myself on 07 3237 5948 or Wayne Basford on 08 6382 4715.

Yours faithfully

BDO Australia Ltd

Tim Kendall

Tim Kendall
Head of Audit

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