Institute of Chartered Accountants Australia

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Dear Bruce

Managing Complexity in Financial Reporting

The Institute of Chartered Accountants in Australia (The Institute) welcomes the opportunity to comment on the FRC's Managing Complexity Task Force's Report (the Report).

The Institute commends the FRC's focus on complexity through a taskforce initiative and the subsequent publication of a paper. The Report effectively highlights the sources of complexity and has stimulated debate on managing this complexity within the Australian context. We note that most of the issues and recommendations to manage complexity focus on the large end of the market and do not address the concerns of small to medium organisations (including not-for-profits).

We consider there are 4 main ways to manage complexity in the Australian environment

1. Continue to encourage the International Accounting Standards Board (IASB) to establish a framework for presentation and disclosure and within this framework address the issue of performance reporting

2. Participate in the development of guidance on materiality when assessing disclosures to assist preparers and their auditors.

3. Maximise opportunities to simplify legislation associated with the annual report, such as remuneration reporting.

4. Evaluate the application of IFRS for all reporting entities, considering overseas experiences with alternative simpler recognition and measurement frameworks.

Further detail on our rationale for the above is described under the appropriate section in the Appendix.

If you require further information or advice on these views, please contact by email Kerry.hicks@charteredaccountants.com.au.

Yours sincerely

Yasser El-Ansary CA
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Appendix

Comments

1. Are there any additional sources of reporting complexity which should be considered by the task force and the FRC, and if so what?

We agree with the main sources of reporting complexity as identified in the Report. With regard to '2.Complexities in the reporting framework', we agree that general purpose financial reports are often required where the users' needs do not warrant it. We consider that the application of full IFRS recognition and measurement to all reporting entities (including the not-for -profit sector) provides an unreasonable burden for many of those entities. The area that many reporting entities struggle with in IFRS is the hybrid measurement framework of historical costs and fair values. Small to medium sized entities (not-for-profits in particular) are often resource poor and struggling to remain up to date with the latest IFRS developments.

With regard to '3.Changing attitudes of businesses and stakeholders', we note the behaviour amongst preparers and auditors of 'when in doubt, disclose' which we agree is to some extent explained by the increased aversion to risk in response to a more litigious business environment. However, we consider this attitude may be somewhat abetted by ASIC through the operation of its financial reporting surveillance program. The action of ASIC as well as how ASIC is perceived by preparers and auditors has an impact on their behaviour. While ASIC plays a very useful role by giving regular updates on what it considers its main focus areas, it gives no guidance on what it considers to be material disclosures. Thus preparers and their auditors often feel it is less risky (and quicker) to disclose everything rather than trying to make a judgement about what is material. A judgement they that perceive may be challenged by ASIC. This attitude leads to the voluminous and often 'boilerplate' disclosure contained in financial reports which can detract from material disclosures and deter proper review of these reports.

The issue of 'voluminous' and 'boilerplate' disclosures is not an Australian specific problem as evidenced by the many global consultation papers on disclosure including the consultation paper referred to in the Report issued by the International Auditing and Assurance Standards Board (IAASB) *The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications.* The *Feedback Statement* issued by the IAASB in January includes similar comments received from respondents as to the inadvertent influence regulators have in this area.

We also agree that presentation of results or performance reporting is a key source of complexity and note the Report's observations about the development of 'shadow reporting'. The whole area of performance reporting has been demanding review for some time now and we believe is best tackled by the IASB in its conceptual framework project. ASIC's Regulatory Guide 230 *Disclosing non-IFRS financial information guide* provides some useful guidance and examples for company management when faced with the issue of providing a clear explanation of their results within the context of IFRS.

2. Do you agree with the Task Force's conclusion that complexity is inevitable in the short term and accordingly that efforts should be concentrated on strategies to assist stakeholders to better manage this complexity?

We agree that a significant proportion of business has become increasingly complex and an inevitable consequence is the increasing complexity of financial reporting. Further, because our requirements are largely driven from overseas, the ultimate aim of reducing complexity, for the listed market at least, is not solely within our control. Hence managing complexity is most appropriate in the short term at least.

However, not all businesses are complex and we consider that action could be taken across Australia and New Zealand to reduce the complexity of financial reporting across the SME and not- for- profit sectors. Part of this work has been done, with the AASB's introduction of the Reduced Disclosure Regime (RDR). However, there is still scope to do a lot more in this area, particularly if the work currently being done by the AASB on special purpose financial reporting results in the removal or modification of the current requirements.

3. Do you have any comments on the strategies to better manage complexity as suggested by the Task Force.

We broadly agree with the strategies to better manage complexity. We agree with the common sense approach of 'unbundling' of reporting as outlined in '1 Making better use of developments in information technology' . Any areas, currently dealt with in our local legislation, could easily be amended to use the website more rather than including information in annual reports. This would include the governance requirements, which would involve approaching both the ASX and the ASX Corporate Governance Council with such a request, as we understand that the Corporate Governance Principles will be undergoing a revision in 2012/2013.

Other areas in the annual reports that could be managed better in terms of complexity are the disclosures in the remuneration report. We understand that Treasury are working on draft legislation in this area. However, we consider the FRC and the AASB could be extremely helpful in performing a preliminary assessment on the Treasury recommendations to ensure they are 'simpler' and 'less complex' before such legislation is issued for public scrutiny.

As noted in the IAASB's *Feedback Statement* the only real long term solution to the problem of complexity requires a truly collaborative approach amongst stakeholders. Standard- setters, preparers, auditors and regulators must collaborate in order to make the much needed progress in this area. Many stakeholders globally have recognised the need for the development of a presentation and disclosure framework. We support the development of such a framework by the IASB in full consultation with all stakeholders.

We recommend that the FRC participate in the development of guidance on the assessment of materiality for disclosure purposes. This guidance together with education should be directed squarely at the 'if in doubt, disclose' behaviour so prevalent amongst preparers and auditors. Guidance could be developed in conjunction with standard setters and regulators and include specific examples of what is considered to be immaterial and boiler plate disclosures. The guide could explore the concepts of relevance and understandability as opposed to completeness when assessing disclosures. Such a guide would assist preparers and auditors in making judgements about what may constitute a material disclosure.

A business judgment rule defence may help to reduce the incidence of immaterial and boiler plate disclosure. The issue of disclosure however is we believe best tackled in the presentation and disclosure framework.

With regard to XBRL or SBR as it is more commonly known in Australia, we are unaware that the introduction of mandatory lodgement overseas has resulted in a reduction of complexity or the efficient management of complexity. If this can be shown we agree that methods to encourage the adoption of SBR in Australia should be considered. These include mandatory adoption but also incentives such as reduced filing fees and extended lodgement dates should be considered.

We agree that all interested stakeholders need to urge the IASB to establish a presentation and disclosure framework and review performance reporting urgently. This need has been recognised globally by standard setters, the Institute and other stakeholders. In order for this to be successful we agree with the need in Australia to establish more effective relationships with the IASB through industry bodies, standard setters and other groups. The reporting of performance should also be addressed within this framework. The uncertainties surrounding the term 'other comprehensive income' and the actual meaning of 'performance' is a great source of complexity for users and preparers alike.

One area not addressed specifically in the recommendations is that regarding the complexity in accounting standards for non-listed entities. We support the AASB's development of RDR as an alternative to IFRS, as well as the research work it is undertaking on non-reporting entities. However we note that RDR only exempts entities from disclosures and not recognition and measurement. Even with RDR as it currently stands, we consider that more exemptions to disclosures can be made for non-publicly accountable entities.

Further, we consider the FRC and/or AASB should evaluate the application of IFRS for all reporting entities, considering overseas experiences with alternative simpler recognition and measurement frameworks. This comment is based on member feedback over a number of years from the small to medium and not-for-profit sectors. One such framework, with international recognition is IFRS for SMEs. The IASB is currently undertaking a post-implementation review of this standard. We encourage the AASB to contribute to this review in an open and consultative manner in order to achieve a result that would be acceptable in an Australian and New Zealand context. We anticipate that this will include amendments to recognition, measurement and disclosures.

4. Do you have any suggestions for the financial reporting terms and definitions that should be encouraged for development (Suggested strategy# 4)

No comment

5. Please indicate 'quick wins' that you believe could be achieved in managing complexity which could be delivered in the current Australian legislative framework and IFRS?

Quick wins could be achieved by focusing on the Australian legislative areas, such as those recommendations above relating to location of governance requirements, as well as areas included in the annual report, such as remuneration reporting.

6. Are there any other issues that the Task Force should consider?

No