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Dear Tony

Invitation to Comment: XRB A1 (For Profit Entities Update)

Grant Thornton New Zealand Limited (Grant Thornton) is pleased to provide the External Reporting Board (XRB) with its comments on External Reporting Board Standard A1 *Accounting Standards Framework (For-Profit Entities Update)* (the ED). We have considered the ED along with the accompanying Invitation to Comment (ITC) and set out our comments below.

Grant Thornton's response to both the ED and the ITC reflects our position as auditors and business advisers both to listed companies and privately held companies and businesses in New Zealand.

Summary

In the ITC the XRB indicated that "it is keen to ensure that the ED appropriately operationalizes its established policy, and is clear and understandable to the users of the standard". Our analysis of the ED suggests that these objectives will be met.

We can see no fatal flaws other than a continued reluctance to acknowledge the presence and usefulness of IFRS for SMEs which could (even at this late stage) be introduced as a fifth tier to see what the uptake of this standard setting solution might be.

While we can appreciate a reluctance for change given the decisions made by the Australia Accounting Standards Board, in a New Zealand context we see failing to recognise IFRS for SMEs as a lost opportunity. Please refer to the attached IFRS for SMEs Fact Sheet for an analysis of the take up of IFRS for SMEs around the world.

If the take up for IFRS for SMEs is low during the proposed transitional period (ie when Tier 3 and Tier 4 are still in existence), then the XRB would then have a clear mandate to only proceed with its Reduced Disclosure Regime (RDR). However, if the take up of IFRS for SMEs is high – then it might force further consideration of this regime for both small and large entities going forward. As things currently stand we find it bizarre that IFRS for SMEs will only be permissible for entities that are not "large".

We find it somewhat ironic that For-Profit (FP) entities now end up being a default classification – namely it is everything other than a Public Benefit Entity (PBE). That said, we believe it's a definition will work for single entities. We are monitoring with great interest how the mixed ownership model for “group reporting” will be resolved. Whatever is finally decided will create tension and additional compliance costs, so we encourage to XRB to make a quick decision on this, so that there is sufficient time to consider the financial reporting consequences.

The concept of “freezing” the application of new standards coming into effect on or after 1 January 2012 makes sense to us. Why force change on an entity that is more than likely going to change its basis of accounting anyway? It will be interesting to see how many reporting entities take advantage of this concession; we anticipate many of clients will to circumvent the increased disclosures required in IFRS 12.

Other matters

In Appendix B the XRB lists the applicable standards, and helpfully acknowledges the dates of release. However in reviewing that list NZ IFRS 3 was quite revised in 2008 and we think it would be useful to recognise this in the listing as “NZ IFRS 3 (2008)”.

In Appendix D where SSAP-6 is cited, why are the words in brackets “to be withdrawn” present when it is also cited on page 53 without any such commentary? Our recommendation is that the words in the brackets (ie to be withdrawn) be removed.

Responses to specific questions posed by the Board are answered in Appendix 1 to this letter.

If you have any questions, or wish us to amplify our comments on the ITC or the ED, please contact me in our Auckland office on (09) 308 2534.

Yours sincerely
Grant Thornton New Zealand Ltd

Mark Hucklesby
National Technical Director

Appendix 1

Feedback on specific questions asked

1. **Do you agree that establishing Tier 1 as the default tier for for-profit entities, and then allowing entities to elect to be in a lower tier if they meet the criteria for that tier, is an appropriate way to operationalise the tier approach? If not, what approach would you suggest (please be specific)?**

We agree that this is the logical place to start the analysis. The decision tree that a single entity must follow is clearly outlined; for a group it is less so, but for the time what has been proposed is, in our opinion, adequate.

2. **Do you agree that establishing Tier 3 and Tier 4 as interim tiers for entities currently reporting in accordance with NZ IFRS Diff Rep and Old GAAP respectively is an effective way of maintaining the status quo within the tier structure until such time as the legislative amendments are enacted? If not, what approach would you suggest (please be specific)?**

We agree that establishing a Tier 3 and Tier 4 is appropriate for the time being. However, we believe that an opportunity has been lost not introducing a Tier 5 (namely IFRS for SMEs) into the structure.

Our vision of Tier 5 is that it would be a tier that applies to all entities other than those that fall into Tier 1.

Given that IFRS for SME's is ready to go right now, we think this Tier could be introduced by the planned 1 November 2012 effective date noted in the ED. Furthermore, with the anticipated revision of IFRS for SMEs we really do believe it provides another viable and appropriate reporting solution for reporting entities in New Zealand.

3. **The definition of public accountability and the size criterion for large for-profit public sector entities contained in paragraphs 12-18 of the ED reflect the decisions of the XRB Board and are the same as those included in the 2011 Consultation Paper. Are there any issues relating to the way in which the definitions have been expressed in the ED (not the policy underlying them) that the XRB Board should consider before finalising the definitions (please be specific)?**

While we understand the rationale behind using expenditure as a basis for determining large for-profit public sector entities, we believe an asset test should also be included so that you end up with either an expenditure threshold or an asset threshold.

For example, if you had an entity that was holding assets principally for capital gain, would it not make sense to include it? Some may argue that this is not an operating objective of PBEs, but for some organisations we believe it is. For example, why do many PBEs invest in forests?

Our recommendation is that the asset test be included to support the expenditure threshold test and that the total asset threshold be set at \$60 million or more at each reporting date.

4. Is the definition of expenses in paragraph 18 of the ED clear and understandable?

For the avoidance of doubt it might be worth indicating that expenses does not include dividends to shareholders as this is covered in the statement of movements in equity.

We note that in paragraph 18 that "...the total expenses are those recognised in the profit and loss section of the Statement of Profit or Loss and Other Comprehensive Income". Without wanting to be too pedantic here, we accept that you can have a profit and loss component if a decision is made to present a single Statement of Comprehensive Income (SOCI). However, if a reporting entity chose to present its SOCI as a stand-alone primary financial statement, does the wording as drafted in paragraph 18 still make sense? Our view is that both scenarios should be explicitly dealt with.

5. Do you agree that, as a general approach, the criteria for Tier 3 and Tier 4 should be the same as the existing criteria for entities to apply NZ IFRS Diff Rep or Old GAAP respectively? If not what approach would you suggest (please be specific)?

Yes, solely on the basis that we have a two out of three criteria test currently. Had the test simply been based solely on either revenue or total assets exceeding a specific threshold, our recommendation to the XRB would have been to increase the thresholds that were established in 2007.

6. Do you agree that, notwithstanding the general approach, the definition of public accountability applying to Tier 3 and Tier 4 should be the same (wider) definition of public accountability applying to Tier 1 and Tier 2? If not what approach would you suggest (please be specific)?

Yes. We do wonder whether there are some community trusts that might now fall into the definition of public accountability (due to holding assets in a fiduciary capacity for a broad group of outsiders, as one of its primary businesses). For example – what about the money raised in special purpose trusts created by various banks to help the citizens of Christchurch after the earthquakes?

7. Do you agree that the NZ IFRS Diff Rep suite of standards should be frozen effective 1 March 2012 but with adoption of any changes to NZ IFRS after that date allowed? If not what approach would you suggest (please be specific)?

We agree. This is a smart and logical decision to make. While it is true that the standards that come into effect for periods on or after 1 January 2012 are likely to

have a minimal impact the same cannot be said for the avalanche of standards that will come into effect for reporting periods commencing on or after 1 January 2013.

8. Do you agree that:

- (a) Entities that have public accountability (as defined) should be required to report in accordance with NZ IFRS in the annual reporting period an entity becomes publicly accountable?**

Yes.

- (b) Entities that meet the criteria for Tier 2 may elect to apply NZ IFRS RDR from the annual reporting period in which they meet those criteria?**

Yes.

- (c) For-profit public sector entities that are reporting in accordance with Tier 2 and subsequently become large (as defined) should be able to continue to apply NZ IFRS RDR for the current and next annual reporting period? If not what approach would you suggest (please be specific)?**

Yes.

9. Do you agree that XRB A1 (FP Entities Update) should become effective as soon as possible after it is issued and that application should be allowed for current reporting periods? If not what approach would you suggest (please be specific)?

Yes, we agree there should be an immediate effective date. This is a sensible and pragmatic decision that has our full support.