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AASB RESEARCH REPORT 12

**Financial Reporting Practices of
For-Profit Entities Lodging Special
Purpose Financial Statements**

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Foreword

The ability for directors of entities to self-assess their reporting requirements when required to publicly lodge financial statements is unique to Australia. This ability has been seen as a long-standing “right” and preparers, professional bodies and auditors have resisted many attempts at reform¹. Prior reform attempts have been further hampered by lack of evidence regarding the “harm” caused by special purpose financial statements (SPFS), where directors determine what information to provide to their users. Accordingly, the AASB commissioned this research into for-profit entities lodging public financial statements with the Australian Securities and Investment Commission (ASIC) in 2018, to determine how extensively SPFS are used and whether the quality of those SPFS is meeting the information needs of their users.

The findings from this research are critical to determining the need for, and extent of, reform. They indicate that the use of SPFS remains extensive at 71%² (2011: 66%) of for-profit large proprietary, small foreign controlled companies and unlisted public companies³ lodging with ASIC and that the quality of these SPFS also remains poor. These findings are disappointing, as they contradict anecdotal evidence provided to the AASB that the use of SPFS has been declining.

Through other evidence, the AASB has identified that there are users of SPFS of for-profit entities lodged with ASIC and that these users are most concerned with comparability of Recognition and Measurement (R&M) requirements⁴. This research report highlights an alarming lack of transparency as for 34% of examined entities⁵ preparing SPFS, the extent of

¹ For example, AASB Invitation to Comment ITC 12 *Request for Comment on a Proposed Revised Differential Reporting Regime for Australia* and IASB *Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities* (May 2007), AASB Consultation Paper (CP) *Differential Financial Reporting – Reducing Disclosure Requirements* (February 2010) and ED 192 *Revised Differential Reporting Framework* (February 2010).

² As part of this research the AASB has also engaged Illion Australia Pty Ltd (Illion) to use word recognition software to obtain a more complete picture of the extent of use of SPFS and Tier 2 - Reduced Disclosure Requirements (RDR) than provided by Research Report No. 1 for for-profit entities. Refer to Appendix 1 for detailed calculation.

³ Unlisted public companies exclude companies limited by guarantee and unlisted public non-profit entities.

⁴ Comparability of the R&M requirements in AAS was rated 88% in importance to primary users (users meeting the definition of primary users in AASB Practice Statement 2: Making Materiality Judgements) and 100% to other users (all other respondents). AASB Staff Paper: [Enhancing the revised Conceptual Framework and replacing Special Purpose Financial Statements, For-profit User and Preparer Survey Results](#), December 2018.

⁵ Sampling frame consisted of large proprietary companies, small foreign-controlled proprietary companies, for-profit unlisted public companies and other small proprietary companies directed by ASIC or shareholders to prepare financial reports.



compliance with R&M requirements is not clear. Accordingly, a user would be unable to determine what additional information they might need.

Notably, after a qualitative assessment of the detailed accounting policies of these 34%, 10% appear to be not following all R&M requirements in Australian Accounting Standards (AAS) in accordance with the view outlined by ASIC Regulatory Guide 85 *Reporting Requirements for Non-reporting Entities* (RG 85), 10% appeared to follow all R&M requirements and 14% still remained unclear. Such levels of non-compliance and lack of transparency warrant the AASB taking action, consistent with its legislative requirement to issue standards promoting comparability⁶.

The AASB initiated this research as a follow-up to AASB Research Report No. 1 *Application of the Reporting Entity Concept and Lodgement of Special Purpose Financial Statements* published in 2014 for financial reports lodged in 2011 – which focused on whether the factors identified as being indicative of existence of a “reporting entity” as defined in SAC 1 *Definition of the Reporting Entity*, explained an entity’s choice to prepare SPFS and indicated they did not.

In contrast, this research specifically examines the extent to which the SPFS prepared by for-profit private entities complies with the R&M requirements of AAS. Other implications from the research include:

- at least 76% of for-profit entities lodging SPFS with ASIC follow R&M requirements in full, although for 10% this required a qualitative assessment of the detailed accounting policies. Moving the remaining 10% (and up to 24% in the worst-case scenario that the unclear 14% are all not fully compliant) of entities lodging SPFS with ASIC to follow R&M requirements in full, consistent with ASIC RG 85, is less costly than having at least 76% transition to a modified R&M framework; and
- large proprietary companies with higher revenue and assets preparing SPFS tend to exhibit higher levels of compliance with R&M requirements and fewer cases of unclear R&M compliance disclosure statements. The recent doubling of the reporting thresholds for large proprietary companies therefore means that the proportion of large proprietary companies that are still required to lodge financial reports with ASIC and that prepare SPFS clearly complying with R&M requirements will increase, further reducing the impact of any future removal of SPFS for these types of entities.

⁶ Sections 224 and 227 of Australian Securities and Investments Commission Act 2001.



On behalf of the AASB, I would like to thank the researchers, who have devoted considerable energy to analysing the large sample of data that forms the basis for the findings presented in this Report. Their work has been critical in shaping the Board's proposals to improve financial reporting quality⁷ as follows:

- removing the ability for certain for-profit private sector entities to self-assess their financial reporting requirements when required to publicly lodge financial statements⁸;
- replacing the existing Tier 2 general purpose financial reporting requirements (Reduced Disclosure Requirements) to reduce the disclosure burden for all Tier 2 entities, including not-for-profit entities; and
- requiring entities continuing to prepare SPFS to make an explicit statement as to whether or not the accounting policies comply with all the R&M requirements in AAS.

Such collaboration demonstrates the value of high-quality empirical research that analyses data relevant to setting public policy for financial reporting, auditing and enforcement.

Company status brings the privilege of limited liability, with some corresponding obligations, including in some instances public lodgement of financial statements. These research findings help demonstrate that the high level of self-assessment and "exceptions"⁹ is no longer in the public interest.

Kris Peach

(Chair of AASB)

⁷ AASB ED 293: [Amendments to Australian Accounting Standards - Disclosure in Special Purpose Financial Statements of Compliance with Recognition and Measurement Requirements](#).

⁸ The exposure draft: AASB ED *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* will be issued shortly and AASB ED 295 [General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities](#) was issued on 1st August 2019 and is currently open for feedback and comments.

⁹ "... As far as possible, exceptions and qualifications to generally applicable norms of conduct in legislation ... should be eliminated." Recommendation 7.3 – Exceptions and qualifications, *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (February 2019).



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Executive Summary

Background

The AASB is currently examining the extent to which for-profit entities lodging SPFS (large proprietary companies, small foreign controlled proprietary companies and unlisted public companies excluding entities limited by guarantee and unlisted public not-for-profit companies) with the ASIC will be impacted by the AASB proposals contained in [ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Problems*](#).

This Research Report analyses the application of the reporting entity concept and the adoption of SPFS, particularly by entities lodging financial statements with the ASIC. This report does not cover entities that have their equity interests traded in a public market, such as listed companies, and some other entities with 'public accountability'¹⁰.

The Report's findings in relation to reporting practices are intended to inform any future discussion by public-policy makers, regulators and the AASB on the application of reporting entity concept and what that concept implies for financial statements lodged with regulatory bodies. This report aims to provide the basis for the Board to evaluate the likely costs for entities associated with the potential simplification of disclosures for elimination of SPFS, as put forward in ITC 39, and for the soon-to-be published exposure draft proposing removal of SPFS for certain categories of for-profit entities. This report also aims to assist the Board's decision in relation to the exposure draft proposing simplified disclosures for For-Profit and Not-for-Profit Tier 2 Entities¹¹.

To achieve this objective, this research focuses on those for-profit entities lodging SPFSs with the ASIC for the most recent 2018 financial year period and provides evidence on whether those reports apply full R&M requirements of the AAS. This Research Report supplements AASB Research Report No.1 [Application of the Reporting Entity Concept and Lodgement of Special Purpose Financial Statements](#) (RR1) published in 2014, which

¹⁰ Entities with 'public accountability' are defined in [AASB 1053 Application of Tiers of Australian Accounting Standards](#) – in particular, refer to Appendix A *Defined Terms* and Appendix B *Public Accountability* of AASB 1053.

¹¹ The exposure draft: AASB ED *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* will be issued shortly and AASB ED 295 [General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities was issued](#) on 1st August 2019 and is currently open for feedback and comments.



documented the application of reporting entity concept and the lodgement of SPFS with ASIC for the period between 2008 and 2011¹².

Key findings

Overall Compliance with all R&M requirements: Stage 1 findings, based on manually scanning the statement of R&M compliance by entities in the *basis of preparation* note, suggest that 65.9% of the examined entities clearly stated that they are in compliance with R&M requirements, 33.6% did not clearly state whether they comply with R&M requirements and less than 0.5% stated that they are not in compliance with R&M requirements.

The Stage 2 qualitative assessment of financial statements shows that for the 34% of financial statement not clearly indicating compliance from Stage 1, 10% met the qualitative criteria and appeared to comply with R&M requirements, 10% appeared to not comply with R&M and 14% remained unclear based on the criteria. The aggregated results of stage 1 and stage 2 indicate that in total, 76% of the sampled financial statements appeared in compliance with R&M.

¹² RR1 covers the period 2008-2011 financial years. Comparison between the results from RR1 and this report for type of report focuses on financial statements lodged in the financial year ended in 2011 (detail refer to [RR1](#)) and for the most recent 2018 financial year period (detail refer to Appendix 1 of this report).

Summary of compliance with R&M by category of entities:

		Compliance with R&M	Non-compliance with R&M	Unclear	Total
Large Proprietary Companies	Stage 1*	68.8%	0.4%	30.8%	100.0%
	Aggregate Stages 1 and 2**	75.4%	9.6%	15.0%	100.0%
Proprietary Controlled by Foreign Companies	Stage 1	70.50%	0.60%	28.90%	100.00%
	Aggregate Stages 1 and 2	79.3%	7.7%	13.0%	100.0%
Unlisted Public Entities	Stage 1	59.6%	-	40.4%	100.0%
	Aggregate Stages 1 and 2	75.0%	6.7%	18.3%	100.0%
Other Small Proprietary Companies ¹³	Stage 1	54.90%	1.40%	43.70%	100.00%
	Aggregate Stages 1 and 2	73.2%	16.9%	9.9%	100.0%
Total	Stage 1*	65.9%	0.5%	33.6%	100.0%
	Aggregate Stages 1 and 2	76.0%	10.0%	14.0%	100.0%
<p>*Stage 1 is based on the statement of R&M compliance by entities in the basis of preparation note to the financial statements. **Stage 2 is based on the qualitative assessment of financial statements for their compliance with the R&M requirements.</p>					

Compliance with R&M by entity size: The findings in this report indicate that overall, level of compliance with R&M increase with increases in the size, measured by value of assets and reported annual revenue, of the entities. The level of non-compliance and uncertainty

¹³ Other small proprietary entities refer to those small proprietary entities that being directed by AISC or shareholders to prepare financial reports. The direction may be general or may specify the particular requirements that the company is to comply with. This category of entity is not within the scope of soon to be issued AASB ED *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities*.



decreases with the increase in entity size. The positive association between compliance and size is observed in all three categories of the entity.

The recent doubling of the reporting thresholds for large proprietary companies means that the proportion of large proprietary companies that are still required to lodge financial reports with ASIC will reduce¹⁴. Further, given the higher levels of compliance with R&M requirements by entities with greater revenue and assets, the proportion of large proprietary companies that are still required to lodge financial reports with ASIC and that prepare SPFS clearly complying with R&M requirements will increase after the doubling thresholds. The impact of any future removal of SPFS for these types of entities is therefore expected to reduce.

Comparison with Research Report No. 1

RR1 published in June 2014, reviewed the number of companies lodging each type of financial statements with the ASIC for the years 2009-11.

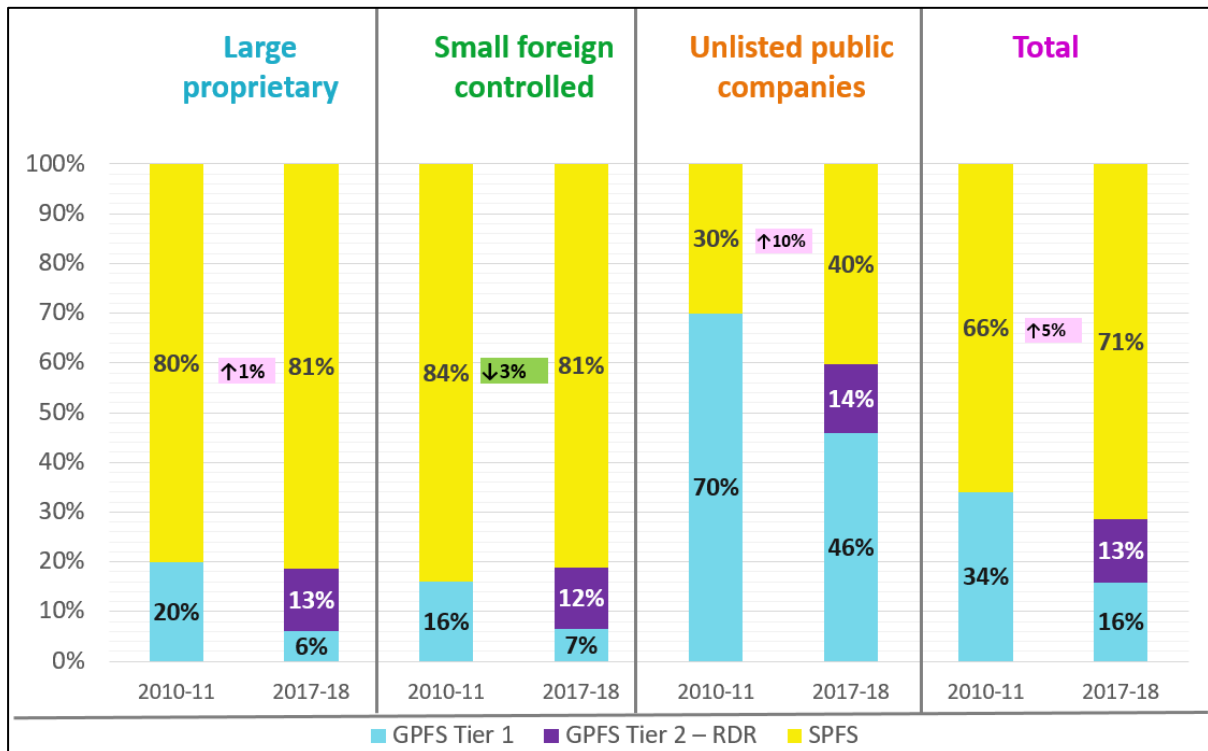
A comparison of overall percentage of certain categories of entities preparing each type of report between 2018 data and results presented in RR1 is shown in the diagram below. Comparing with RR1, overall, there is a slight increase in the percentage of entities lodging SPFS, from 66% in 2011 to 71% in 2018. The increase is mainly contributed by the growing number of SPFS lodged by unlisted public entities (from 30 to 40%). For large proprietary entities, the percentage of SPFS remains fairly stable and there is a percentage decrease for small proprietary entities controlled by foreign companies. However, a direct comparison

¹⁴ Treasury recently doubled the size threshold for determining whether proprietary companies are 'large' or 'small'. As a result, effective from 1 July 2019, many previously large proprietary companies will no longer be required to prepare and lodge annual financial statements with the Australian Securities and Investments Commission (ASIC). In particular, approximately one third of proprietary companies that lodged audited financial reports with ASIC for the 2017-18 financial year will no longer be required to lodge financial reports under the increased thresholds



between the two reports needs to be made with caution due to differences in research focus and sampling strategies¹⁵.

Figure 1 Comparison with Research Report No. 1: Summary of Large Proprietary, Small Proprietary controlled by Foreign companies and Unlisted Public Companies Lodging Each Type of Financial Statements in 2010/11 and 2017/18



Next steps

- The AASB Board’s proposals to improve financial reporting quality¹⁶ and to remove the ability for for-profit entities to publicly lodge SPFS, which will be issued as exposure draft: *AASB ED Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities*. The complementary exposure draft proposing simplified disclosures for all Tier 2 entities, including those that might need to transition from SPFS, *AASB ED 295 General Purpose Financial Statements – Simplified*

¹⁵ RR1 determined the incidence of type of financial report (GPFS or SPFS) lodgements by both for-profit and not-for-profit (NFP) entities with ASIC and examined the transparency of disclosures in relation to application of R&M. RR1 also examined the disclosures stipulated in RG 85 to gain insights into reporting practices of those companies lodging SPFS. This Research Report, however, assesses the extent of compliance with R&M in SPFSs of for-profit entities lodging with ASIC.

¹⁶ AASB ED 293: Amendments to Australian Accounting Standards - *Disclosure in Special Purpose Financial Statements of Compliance with Recognition and Measurement Requirements*.



Disclosures for For-Profit and Not-for-Profit Tier 2 Entities was issued on 1st August 2019 and is currently open for feedback and comments¹⁷.

¹⁷ As the project proposing the removal of SPFS for certain categories of entity will take some time, AASB proposed an interim measure to amend AAS to require entities preparing SPFS to make an explicit statement as to whether or not the accounting policies applied in the SPFS comply with all the R&M requirements in AAS. The AASB ED 293 Amendments to Australian Accounting Standards – [Disclosure in Special Purpose Financial Statements of Compliance with Recognition and Measurement Requirements](#) (July 2019) is currently open for feedback and comments.



1. Introduction and Background

The AASB is currently examining the extent to which for-profit entities lodging SPFS with the ASIC will be impacted by the AASB proposals contained in ITC 39. This research provides the basis for the Board to evaluate the likely costs for entities associated with the potential elimination of SPFS as put forward in ITC 39 and the soon to be published exposure draft proposing removal of SPFS for certain categories of for-profit entities¹⁸. By eliminating Statement of Accounting Concept 1 *Definition of the Reporting Entity* (SAC 1) which enables the preparation of SPFSs, the result will be closer alignment with the terminology in International Financial Reporting Standards (IFRS) and better consistency, comparability and transparency of financial reports prepared by entities in Australia (ITC 39, AASB, 2018, paras. 7–8).

To achieve this objective, this research focuses on those for-profit entities lodging SPFSs with the ASIC for the most recent 2018 financial year period and provides evidence on whether those reports apply full R&M of the AAS. In doing so, the research also provides indirect evidence on the extent to which entities lodging with the ASIC are more likely to prepare and lodge general purpose financial statements (GPFS) (Tier 1 or Tier 2) or SPFSs¹⁹.

Recent research undertaken into recognition, measurement and disclosure in SPFSs presents two key findings relating to the quality of SPFSs that offer important background for this research. First, prior research indicates great variation in the financial reporting choices made by small and medium-sized entities (Carey et al. 2014a)²⁰. Specifically, of the entities producing SPFSs examined in Carey et al. (2014a), more than 60% stated they apply R&M, around 20% of the SPFSs appear not to have applied R&M, and approximately 15% of companies were found to provide no indication of whether they applied R&M. Second, the analysis also shows that the accruals recognised by companies that lodged SPFSs that did not state application or stated non-application of R&M are of lower quality²¹ than those recognised by companies that lodged SPFSs and stated application of R&M.

There is also considerable evidence to indicate that approaches adopted by entities in applying the reporting entity concept vary widely (Carey et al. 2014b), leading to considerable variation in the nature and extent to which accounting standards are applied

¹⁸ AASB ED *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities*

¹⁹ Refer to Appendix 1 for detail.

²⁰ The publication Carey et al. (2014a) refers to the RR1: *Application of the reporting entity concept and lodgement of special purpose financial statements*.

²¹ Consistent with a large body of research literature (e.g. Dechow & Dichev, 2002; Dechow, 1994), the quality of accruals is examined by modelling the extent to which profit reported by these companies for a period provides some explanation of the following period's operating cash flows.



by entities (Potter et al. 2019). For example, according to Carey et al. (2014b), the principles-based factors identified in SAC 1 as indicative of the existence of a reporting entity do not systematically explain the decision by entities to apply the concept. Further, Potter et al. (2019) examine the decision by entities to adopt the requirements in [AASB 1053 Application of Tiers of Australian Accounting Standards](#). Focussing on financial reports lodged with the ASIC by large proprietary companies, this research documents a low level of adoption of Reduced Disclosure Requirements (RDR) set out in AASB 1053 (Tier 2 GPFS) during the 2010–2015 period with only 7% of companies adopting this reporting choice during that time. The majority of companies switching to Tier 2 GPFS had previously prepared GPFS applying the recognition, measurement and disclosure requirements set out in AAS (Tier 1 GPFS), consistent with the suggestion that applying AASB 1053 presents a lower cost reporting option relative to the preparation of Tier 1 GPFS. The report also documents a low number of firms moving to Tier 2 GPFS from SPFS, suggesting that companies in our sample may view the costs of moving from SPFS to Tier 2 GPFS to outweigh the benefits of doing so. Potter et al. (2019) also find, consistent with earlier research, the content of SPFSs are generally of lower quality relative to GPFSs (Tier 1 or Tier 2), where quality is proxied by disclosures in the accounting policy note and the timeliness of the lodgement with the regulator.

More recent analysis by AASB staff of financial reporting by non-publicly accountable entities in Australia lodging financial reports with the ASIC indicates a greater adoption of GPFS Tier 2 than was reported in Carey et al. (2014a), with around 135 of large proprietary companies adopting this form of reporting in their financial reports²². This increase in the adoption of Tier 2 reporting, coinciding with a small reduction in the adoption of Tier 1 GPFS by these entities, suggests a significant movement of entities from GPFS Tier 1 to GPFS Tier 2 since 2011. This movement is consistent across large proprietary companies and small foreign controlled proprietary companies, while the preparation of SPFS by unlisted public companies appears to have increased. This can be seen from Table 1.1 below, in which the relevant reporting choices by 3 categories of entities are shown. The data presented in the 2011 columns are based on a random sample of lodgements to the ASIC for that year and are taken from Carey et al. (2014a). Data from the 2018 columns are based on the information provided by Illion Australia Pty Ltd and based on population counts for entities lodging reports with the ASIC during 2018²³.

²² Refer to Appendix 1 for detail.

²³ As part of this research, the AASB engaged Illion Australia Pty Ltd to use word recognition software to obtain a more complete picture of the extent of use of SPFS and Tier 2 - Reduced Disclosure Requirements (RDR) than provided by Research Report No. 1 for for-profit entities.



Table 1.1 Reporting choices by non-publicly accountable entities (%)

Legal Status of Entity	SPFS		GPFS Tier 1		GPFS Tier 2	
	2011	2018	2011	2018	2011	2018
Large proprietary entities	80	81	20	6	N/A	13
Small proprietary entities controlled by foreign companies	84	81	16	7	N/A	12
Unlisted public companies	30	40	70	46	N/A	14
Total	66	71	34	13	N/A	16

The research discussed above provides support for the next phase of the project by the AASB, which has resulted in the release of the ITC 39. In this document, the Board seeks to facilitate broader consultation on the proposed approach to address two main problems:

1. to remove the SAC 1 and the reporting entity concept, thereby enabling greater comparability with wording contained in the IASB's conceptual framework; and
2. to remove the option for entities to elect to produce SPFSs when publicly lodging financial statements.

To enable more informed deliberation about the removal of the option to prepare SPFSs, a greater understanding of the impacts on entities of doing so is required. This is the key objective of this research.

2. Research Design and Sampling Procedures

2.1 Sampling Frame

The sampling procedure outlined in this research report is based around a sampling frame²⁴ supplied to the AASB by a private data provider Illion, and identification of observations within the Illion database that are entities preparing SPFS. As one of the primary objectives is to examine the application of R&M requirements of the AAS by for-profit entities lodging SPFS with the ASIC²⁵, the report does not address entities that have their equity traded in

²⁴ The sampling frame is the component of the population from which the sample is drawn. As is explained in later sections, some elements are excluded from the sampling frame in order to draw the sample of entities for analysis.

²⁵ Refers to ASIC RG 85 for detail.



public markets, such as listed companies, and some other entities that have ‘public accountability’ as these entities are already required to fully comply with all AAS²⁶.

Upon request from the AASB in October 2018, Illion identified 16,941²⁷ financial reports in their database to be utilised by the research team for sampling purposes. These entities comprised large proprietary companies, small proprietary companies controlled by a foreign company, unlisted public companies other than those limited by guarantee and non-profit companies, small proprietary companies requested by ASIC to supply a financial report, and a number of other listed companies (mainly not-for-profit entities and therefore excluded from this research).

As the key objective of the sampling strategy is to identify only for-profit entities preparing SPFSs and because Illion’s database does not contain a separate field or variable specifically identifying entities’ type of financial report prepared (i.e. SPFS, GPFS or RDR), word recognition software using custom script was utilised to scan all financial reports in the Illion database to enable identification of different categories of financial report types. The word recognition software scanned for different combinations of key words such as “not a reporting entity”, “special purpose financial statement”, “reduced disclosure”, “regulatory guide 85” and other similar key words²⁸ in each of the 16,941 financial reports in the database²⁹. While the word recognition procedure identified 8,866 entities that prepare SPFS, however, possibly due to the scanning procedures used on some of the financial reports during the creation of PDF files, the word recognition software was unable to recognise and identify the status of 3,112 financial reports. Accordingly, this group of financial reports was termed “unreadable”.

2.2 Stratified Random Sample

The sampling strategy is premised on the assumption that Illion’s sampling frame contains the population of non-reporting entities preparing SPFSs for four categories; specifically large proprietary companies, small proprietary entities controlled by foreign companies, unlisted public companies and other small proprietary companies. To ensure representativeness of entities included in Illion’s sampling frame, the data was subjected to a stratification procedure. The financial reports identified in Illion’s sampling frame are

²⁶ Among the entities that AASB 1053 *Application of Tiers of Australian Accounting Standards* deems to have public accountability are disclosing entities and registered managed investment schemes, which are required to lodge financial statements with ASIC.

²⁷ Refer to Appendix 1 for detail.

²⁸ Illion’s word recognition software utilised around 20 different keywords (in different combinations) to identify non-reporting for-profit entities preparing SPFSs. Refer to Appendix 3 for detail.

²⁹ This report focuses on the preparation of SPFS by the four types of for-profit private entities (as detailed in Table 2.1).

sampled separately from each category of legal status with a 90% confidence interval (CI) and then summed by the entities' financial report type (i.e. "SPFS" and "Unreadable"), yielding a final overall sample size of 615 financial reports (see Table 2.1 below).

Table 2.1 Stratified Random Sample of Illion's Sampling Frame by Entity's Legal Status

Legal Status of Entity	Sampling Frame	SPFS Sample	Sampling Frame	Unreadable
	SPFS	90% CI	Unreadable	Sample 90% CI
Large Proprietary Companies	4,718	94	961	87
Small Proprietary controlled by Foreign Companies	1,850	91	650	84
Unlisted Public Companies ³⁰	1,026	88	560	82
Other Small Proprietary	126	55	52	34
Total	7,720	328	2,223	287
Sample Size with 90% Confidence Interval	615			

The confidence interval (CI) - also called the margin of error - indicates the level of surety provided about the financial reports selected from the population. The CI is expressed as a percentage and represents how often the true percentage of the population would lie within the confidence interval. In other words, the 90% confidence level means there is 90% certainty that the financial reports selected are representative of that population group (i.e. the four categories of entities preparing SPFSs that this report focuses on).

The above-mentioned CI could be due to a range of factors or biases that are inherent in the population of for-profit entities preparing SPFSs and are not taken into consideration when sampling. For example, revenue, total assets and employees of some entities could be below the large proprietary company *Corporations Act 2001* thresholds, or some entities might cluster within certain industry groups which are not considered when drawing the sample. Notwithstanding these biases, the stratification procedure undertaken in this study ensures the sample has a good degree of representativeness of the population of non-reporting for-profit entities preparing SPFSs by legal structure.

This research report builds on Carey et al. (2014a) by providing additional information on reporting by for-profit entities preparing SPFSs. Although both research reports provide important insights into the nature and extent of application of R&M, direct comparisons

³⁰ Refer to footnote 3.



between this study and Carey et al. (2014a) need to be made with caution. This research focuses only on the application of R&M in SPFSs by for-profit entities lodging with ASIC, whereas RR1's objective was to determine the extent of lodgement by both for-profit and not-for-profit entities lodging either GPFS or SPFS with ASIC, thereby providing evidence on the incidence of the type of financial report lodgements made by entities across a number of legal structures and the disparity among these financial reports. The sampling strategies used in both studies also impede making direct comparisons. The Carey et al. (2014a) study used a simple random sample of 1,546 entities drawn from the 2008-09 population counts of both for-profit and not-for-profit entities lodging either GPFS or SPFS with the ASIC, whereas this study uses a stratified sample strategy that was targeted at only identifying for-profit entities lodging SPFSs, thus providing a more comprehensive assessment of the application of R&M among entities lodging SPFSs across a variety of for-profit legal structures. More importantly, the assessment procedures of the application of R&M requirements differ across both studies (for more details, see Section 2.4 Critical Measures), providing some limitations to making direct comparisons on these important measures.

2.3 Final Usable Sample for Data Analysis

As the precision of the word recognition software utilised by Illion was not foolproof on the scanned PDF financial report files, the final sample of 328 "SPFS" and 287 "unreadable" financial reports were further checked for accuracy by type of financial report and legal status. These additional checks revealed that eleven of the 328 SPFSs required exclusion³¹, yielding a usable sample of 317 SPFS financial reports. An examination of the "unreadable" group showed that of the 287 financial reports, almost 46% of the sample from this group were either GPFS or RDR reports with a further 10 reports excluded for various data-related reasons. Given this high proportion, a replacement sample of 136 financial SPFS reports was requested from Illion to augment the final sample of financial reports from the "unreadable" group. The augmented sample of 136 revealed that 14 reports needed to be excluded from our sample³², yielding a usable sample of 584 financial reports from both the "SPFS" and "unreadable" groups. Table 2.2 provides a summary of the composition of the final sample used for the analysis.

³¹ Four were GPFS reports, one report was from a public company limited by guarantee entity, and six SPFS reports were missing required information.

³² There 13 SPFS reports prepared by Public Companies Limited by Guarantee and one GPFS report identified in the augmented sample.

Table 2.2 Summary of Derivation of Final Usable Sample for Analysis

	SPFS Sample	Unreadable Sample	Total
Sample sizes requested from Illion	328	287	615
Number of reports filtered out from sample due to following reasons:			
GPFS reports	4	76	-
RDR reports	-	56	-
No Details	-	4	-
Public Company Limited by Guarantee	1	-	-
Various data missing (Missing Pages; FS Numbers missing)	6	6	-
Sub-Total of Usable Sample:	317	145	462
Replacement Sample of 136 SPFSs	136	-	-
Number of reports filtered out:			
GPFS reports	1	-	-
Public Company Limited by Guarantee	13	-	-
Sub-Total of Usable Sample:	122	-	122
Final Usable Sample			584

2.4 Critical Measures

In an effort to gain insights into the reporting decisions and practices of for-profit entities lodging SPFSs, the focus of this research is on disclosures made by entities in the “basis of preparation” and/or “significant accounting policies note”, typically, Note #1 to the financial statements, and specifically, the extent to which entities clearly state compliance with R&M, whether the entities clearly state non-compliance with R&M or whether, upon review of the relevant note by the research team, it is still unclear whether the entity is indicating compliance. An assumption was made that the relevant coding would be made from the perspective of a sophisticated user of financial statements.

In doing so, the complex and subjective nature of the task is noted. There is significant variation in the wording used by entities in the notes describing their relevant accounting policies. In some instances, statements were made by entities indicating explicitly stating compliance with “Recognition and Measurement” requirements for accounting standards, but this was less common. On most occasions, wording in the note was broader, and often referred to compliance with, or in accordance with “accounting standards” or similar, thus requiring judgment by the research team. In addition, it is also noted that where entities do not state clearly that they comply with R&M, it is possible that they may in fact comply. As



such, Section 4 of this report contains results of the second stage of analysis, wherein substantive compliance with R&M is ascertained via a detailed examination of the lodgements made by entities. This second stage assessment supplements the first stage of the research as reported in Section 3, which focuses on the stated compliance with R&M by entities.

As such, throughout close and ongoing consultation with the AASB technical staff, detailed instructions were provided to the research team to indicate those entities that should be deemed to have stated compliance with R&M. Examples of this wording are provided below, with phrases highlighted where possible to indicate the key features of the wording which were deemed to have stated compliance.

At a general level, if an entity has stated that they have complied with the AAS/basis of accounting of AAS/R&M requirements of AAS, except for specific standards, they are deemed to have stated compliance where all of the excluded standards are disclosure standards.

Further examples are provided below:

*The financial report has been prepared in accordance with AASB 101, AASB 107, AASB 108, AASB 1031, AASB 1048 which apply to all entities required to prepare financial reports under the Corporations Act, 2001, **and other applicable Accounting standards and Urgent Issues Group Interpretations with the exception of the disclosure requirements** in the following:*

*The financial report has been prepared in accordance with Corporations Act, 2001, **the basis of accounting specified by all AAS and Interpretations**, the disclosure requirements of AASB 101, AASB 107 and AASB 108.*

*The financial report has been prepared in accordance with Corporations Act, 2001, **the basis of accounting specified by all AAS and Interpretations**, the disclosure requirements of AASB 101, AASB 107, ASB 108, AASB 1048 and AASB 1054 which apply to all entities required to prepare financial reports under the Corporations Act 2001.*

*The directors have, however, prepared the financial report **in accordance with all accounting standards** and those disclosures considered necessary by the Directors to meet the needs of the member:*

- o AASB 101*
- o AASB 107*



- o AASB 108
- o AASB 1048
- o AASB 1054

The directors have, however, prepared the financial report in accordance with all accounting standards and other professional reporting requirements in Australia, with the following exceptions:

- o AASB 7
- o AASB 12
- o AASB 136
- o AASB 124
- o AASB 132

... as certain disclosures required by those standards have not been made.

The directors have prepared the financial report in accordance with AAS and other professional reporting requirements with the exception of certain disclosure requirements of the following standards:

The directors have prepared the financial statements in accordance with AAS and other financial reporting requirements with some disclosure exceptions.

In addition to these instructions, the AASB technical staff noted that with respect to the coding of the R&M measure, statements which indicate compliance with the *Corporations Act 2001* do not of themselves indicate compliance with R&M, but more likely, indicate compliance with the 5 specified disclosure standards mentioned in AAS as relevant to SPFS.

The instructions provided to the research team also indicated that entities should only be categorised as 'Unclear' in the R&M measure when the basis of preparation is not clear. If, for example, the financial statements state compliance with measurement requirements of a number of standards but make no reference to recognition requirements, it should be coded 'unclear'. The following additional examples were provided to illustrate when an entity should be categorised as 'Unclear':

These financial statements have been prepared in accordance with the requirements of the Corporations Act 2001 and the following AAS: AASB 101, AASB 107, AASB 108, AASB 110, AASB 1048, AASB 1054. No other AAS and authoritative pronouncements of the AASB have been applied;



The measurement requirements of all applicable Accounting standards, Australian accounting interpretations and other authoritative pronouncements of the AASB have been applied in the preparation of this report.

The financial statements have been prepared in accordance with the significant accounting policies disclosed below, which the directors have determined are appropriate to meet the needs of the member;

The financial statements are therefore SPFS that have been prepared in order to meet the requirements of the Corporations Act 2001.

The subsequent stage of the research (Section 4), involves closer review of the disclosures made by the entities to verify the nature and extent of actual compliance with R&M. This review was undertaken for those entities that were, at this stage of the research, coded as “unclear” with respect to their stated compliance with R&M.

For entities deemed to have clearly stated compliance with R&M by the researchers, AASB staff reviewed a random sample to confirm the substantive compliance with R&M, and also that the auditor did not qualify their audit opinion on the basis of non-compliance with R&M. Where there was no audit report, a qualitative assessment of the accounting policies was performed. No exceptions were noted from this review, suggesting that the stated compliance with R&M in the significant accounting policies note is a good indication of substantive compliance with R&M.



3. Results: Stage 1 Assessment of Stated Compliance with R&M

3.1 Recognition and Measurement

Table 3.1 provides a breakdown of for-profit entities identified in our analysis that state they are applying R&M requirements of the AAS. As discussed earlier in the report (see 2.4 Critical Measures), researchers assessed whether entities should be deemed to ‘Stated Non Application’ of R&M, ‘Stated Application of R&M’, or whether the application of R&M was considered to be ‘Unclear’. Several random samples of entities were submitted to the AASB at different stages of the research coding process for assessment. Table 3.1 shows the frequency breakdown of the application of R&M by for-profit entities after refinement of coding following post-AASB reviews.

Table 3.1 Stated Application of R&M by For-Profit Entities

All Entities	Freq.	%
No	3	0.52
Yes	385	65.92
Unclear	196	33.56
Total	584	100

Table 3.1 shows that 385 (66%) of for-profit entities preparing SPFS in the sample are deemed to have explicitly stated in the “basis of preparation” to the financial statements that they follow R&M requirements of the AAS, while less than 1% of the sample clearly state they did not comply with R&M requirements of the AAS. For approximately one third of the sample it was unclear whether they apply R&M requirements in their financial statements.

3.2 Stated Application of R&M by Entity Type

Table 3.2 contains results of compliance with R&M by entity type. The panels below indicate a relatively uniform picture of reporting across the entity types comprising the sample. Put another way, the reporting choices by any particular entity do not appear to be driving the overall results³³.

³³ The Pearson chi-square statistic ($\chi^2(6) = 8.7632$, $Pr = 0.187$) shows there is no statistically significant difference between the entity’s legal structure and R&M.



Table 3.2 Frequency Distribution of R&M by Entity Type

Large Proprietary	Freq.	%
No	1	0.42
Yes	165	68.75
Unclear	74	30.83
Total	240	100

Small Proprietary Controlled by Foreign Companies	Freq.	%
No	1	0.59
Yes	119	70.42
Unclear	49	28.99
Total	169	100

Unlisted Public	Freq.	%
No	0	0.00
Yes	62	59.62
Unclear	42	40.38
Total	104	100

Other Small Proprietary³⁴	Freq.	%
No	1	1.41
Yes	39	54.93
Unclear	31	43.66
Total	71	100

In Tables 3.3 and 3.4, results are presented by auditor type, grouped by Big-4 and non-Big-4 firms. The total reports subject to audit by entity type were 557, of which 57.3% were audited by Big-4 and 42.7% by non-Big-4 firms. With the exception of small proprietary companies, more than 90% of reports in each entity type audited by Big-4 firms were deemed to state compliance with R&M. Further, where a report was audited by a Big-4 auditor, the stated compliance with R&M did not vary significantly across type of entity.

³⁴ Under the requirements of Sections 293 and 294 of the *Corporations Act 2001*, the ASIC or shareholders with 5% or more of the voting capital may direct a small proprietary company to prepare financial statements.



Table 3.3 Frequency Distribution of R&M by Big-4 Auditor

All Entities	Freq.	%
No	-	-
Yes	296	92.79
Unclear	23	7.21
Total	319	100

Large Proprietary	Freq.	%
No	-	-
Yes	122	94.57
Unclear	7	5.43
Total	129	100

Small Proprietary Controlled by Foreign Companies	Freq.	%
No	-	-
Yes	87	93.55
Unclear	6	6.45
Total	93	100

Unlisted Public	Freq.	%
No	-	-
Yes	52	94.55
Unclear	3	5.45
Total	55	100

Other Small Proprietary	Freq.	%
No	-	-
Yes	35	83.33
Unclear	7	16.67
Total	42	100

More variation in stated compliance was identified in the reports audited by non-Big-4 auditors. For each entity type, reports coded unclear were greater in number than those deemed to have clearly stated compliance with R&M. Unlike the results for reports audited by Big-4 firms that show stated compliance with R&M did not vary significantly across type



of entity, entities audited by non-Big-4 firms show statistically significant variation in stated compliance across entity type³⁵.

Table 3.4 Frequency Distribution of R&M by Non-Big-4 Auditor

All Entities	Freq.	%
No	2	0.90
Yes	79	33.33
Unclear	156	65.82
Total	237	100

Large Proprietary	Freq.	%
No	1	1.06
Yes	36	38.30
Unclear	57	60.64
Total	94	100

Small Proprietary Controlled by Foreign Companies	Freq.	%
No		
Yes	30	45.45
Unclear	36	54.55
Total	66	100

Unlisted Public	Freq.	%
No		
Yes	10	20.41
Unclear	39	79.59
Total	49	100

Other Small Proprietary	Freq.	%
No	1	3.70
Yes	3	11.11
Unclear	24	85.19
Total	28	100

³⁵ The Pearson chi-square statistic ($\chi^2(6) = 18.665$, $Pr = 0.005$) shows there is a statistically significant difference between use of Non-Big-4 auditor and entity's legal structure on application of R&M.



3.3 Stated Application of Recognition & Measurement (R&M) by Size

The results are also reported by entity type and size, with size shown by total revenue, total assets and employee numbers (Tables 3.5-3.9). For each size proxy, results are presented within relevant size categories (Tables 3.5, 3.7, 3.9). In each case, means, medians and standard deviations are also reported (Tables 3.6, 3.8). Given the low level of entities coded as not complying with R&M, the remainder of the analysis in this section will focus on those entities deemed to be in compliance, or for which compliance is not clear.

The majority of entities in the sample are relatively small as measured by revenue, with more than 60% reporting revenues of less than \$25m in their most recent report (Table 3.5). Almost 45% of the entities sampled have assets less than \$12.5m (Table 3.7).

Regarding the stated compliance with R&M, entities deemed to clearly state compliance with R&M are consistently larger³⁶ than those entities for which compliance is considered not clear (Tables 3.6, 3.8). More than 70% of the entities for which compliance with R&M is unclear, report revenue of less than \$25m in their most recent report (Table 3.5). This picture is consistent across entity type. For our size proxy based on total assets, the results are consistent, with approximately 57% of the entities coded as unclear, reporting less than \$12.5m assets (Table 3.7). Smaller entities as measured by total assets are also less likely to clearly state application of R&M, with more variation also identified in reports produced by large proprietary companies. The results based on employee numbers are less predictive (Table 3.9).

³⁶ As measured by the medians and means of the relevant size proxies.



Table 3.5 Stated Application of R&M by Total Revenue and Legal Entity Status

Recognition and Measurement								
All Entities (n=584)	No	%	Yes	%	Unclear	%	Total	%
<\$25m	2	66.7	214	55.6	139	70.9	355	60.8
\$25m-\$50m	0	0	46	12.0	25	12.8	71	12.2
\$50m-\$100m	0	0	54	14.0	21	10.7	75	12.8
>\$100m	1	33.3	71	18.4	11	5.6	83	14.2
Total	3	100	385	100	196	100	584	100
Pearson chi2(6) = 22.3447 Probability = 0.001								
Large Proprietary (n=240)								
	No	%	Yes	%	Unclear	%	Total	%
<\$25m	0	0	32	19.4	24	32.4	56	23.3
\$25m-\$50m	0	0	37	22.4	24	32.4	61	25.4
\$50m-\$100m	0	0	41	24.9	17	23.0	58	24.2
>\$100m	1	100	55	33.3	9	12.2	65	27.1
Total	1	100	165	100	74	100	240	100
Pearson chi2(6) = 16.9682 Probability = 0.009								
Small Proprietary Controlled by Foreign Companies (n=169)								
	No	%	Yes	%	Unclear	%	Total	%
<\$25m	1	100	106	89.1	47	96.0	154	91.1
\$25m-\$50m	0	0	5	4.2	1	2.0	6	3.5
\$50m-\$100m	0	0	5	4.2	0	0	5	3.0
>\$100m	0	0	3	2.5	1	2.0	4	2.4
Total	1	100	119	100	49	100	169	100
Pearson chi2(6) = 22.8377 Probability = 0.829								
Unlisted Public (n=104)								
	No	%	Yes	%	Unclear	%	Total	%
<\$25m	0	0	43	69.4	40	95.2	83	79.8
\$25m-\$50m	0	0	1	1.6	0	0	1	1.0
\$50m-\$100m	0	0	6	9.7	2	4.8	8	7.7
>\$100m	0	0	12	19.3	0	0	12	11.5
Total	0	100	62	100	42	100	104	100
Pearson chi2(6) = 11.6984 Probability = 0.009								

(Table continues on next page)



Recognition and Measurement

Other Small Proprietary (n=71)	No	%	Yes	%	Unclear	%	Total	%
<\$25m	1	100	33	84.6	28	90.3	62	87.3
\$25m-\$50m	0	0	3	7.7	0	0	3	4.2
\$50m-\$100m	0	0	2	5.1	2	6.5	4	5.7
>\$100m	0	0	1	2.6	1	3.2	2	2.8
Total	1	100	39	100	31	100	71	100

Pearson chi2(6) = 2.6052 Probability = 0.857



Table 3.6 Stated Application of R&M by Total Revenue and Legal Entity Status – additional descriptive statics

All Entities (n=584) by Total Revenue						
	Mean	Median	SD	Min.	Max.	
R&M						
No	72,724,847	2,624,305	124,000,000	130,485	215,400,000	
Yes	79,682,905	13,171,466	191,000,000	-11,000	1,874,000,000	
Unclear	23,175,661	2,386,042	40,600,000	0	240,200,000	
Large Proprietary (n = 240) by Total Revenue						
	Mean	Median	SD	Min.	Max.	
R&M						
No	215,400,000	215,400,000		215,400,000	215,400,000	
Yes	129,000,000	62,111,328	222,000,000	0	1,874,000,000	
Unclear	49,385,179	32,873,371	49,400,000	0	240,200,000	
Small Proprietary Controlled by Foreign Companies (n = 169) by Total Revenue						
	Mean	Median	SD	Min.	Max.	
R&M						
No	2,624,305	2,624,305		2,624,305	2,624,305	
Yes	11,425,021	762,000	28,800,000	-11,000	208,300,000	
Unclear	5,961,633	333,534	20,900,000	0	142,700,000	
Unlisted Public (n = 104) by Total Revenue						
	Mean	Median	SD	Min.	Max.	
R&M						
No						
Yes	123,600,000	6,243,635	274,000,000	0	1,203,000,000	
Unclear	5,192,397	231,348	13,600,000	0	64,488,876	
Other Small Proprietary (n = 71) by Total Revenue						
	Mean	Median	SD	Min.	Max.	
R&M						
No	130,485	130,485		130,485	130,485	
Yes	11,103,195	215,479	25,400,000	0	115,400,000	
Unclear	11,818,334	121,669	32,300,000	0	145,400,000	



Table 3.7 Stated Application of R&M by Total Assets and Legal Entity Status

Recognition and Measurement								
All Entities (n=584)	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	1	33.3	149	38.7	112	57.1	262	44.9
\$12.5-\$25m	0	0	52	13.5	32	16.3	84	14.4
\$25m-\$50m	1	33.3	48	12.5	27	13.8	76	13.0
>\$50m	1	33.3	136	35.3	25	12.8	162	27.7
Total	3	100	385	100	196	100	584	100
Pearson chi2(6) = 35.3718 Probability = 0.000								
Large Proprietary (n=240)								
	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	0	0	12	7.3	13	17.5	25	10.4
\$12.5-\$25m	0	0	29	17.6	25	33.8	54	22.5
\$25m-\$50m	0	0	31	18.8	21	28.4	52	21.7
>\$50m	1	100	93	56.3	15	20.3	109	45.4
Total	1	100	165	100	74	100	240	100
Pearson chi2(6) = 29.1923 Probability = 0.000								
Small Proprietary Controlled by Foreign Companies (n=169)								
	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	0	0	88	74.0	39	79.6	127	75.1
\$12.5-\$25m	0	0	10	8.4	3	6.1	13	7.7
\$25m-\$50m	1	100	8	6.7	2	4.1	11	6.5
>\$50m	0	0	13	10.9	5	10.2	18	10.7
Total	1	100	119	100	49	100	169	100
Pearson chi2(6) = 15.162 Probability = 0.019								
Unlisted Public (n=104)								
	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	0	0	25	40.3	34	81.0	59	56.7
\$12.5-\$25m	0	0	7	11.3	2	4.8	9	8.7
\$25m-\$50m	0	0	7	11.3	2	4.8	9	8.7
>\$50m	0	0	23	37.1	4	9.4	27	25.9
Total	0	0	62	100	42	100	104	100
Pearson chi2(6) = 11.4636 Probability = 0.075								
(Table continues on next page)								



Recognition and Measurement

Other Small Proprietary (n=71)	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	1	100	24	61.5	26	83.8	50	70.4
\$12.5-\$25m	0	0	6	15.4	2	6.5	8	11.3
\$25m-\$50m	0	0	2	5.1	2	6.5	4	5.6
>\$50m	0	0	7	18.0	1	3.2	9	12.7
Total	1	100	39	100	31	100	71	100

Pearson chi2(6) = 6.649 Probability = 0.355



Table 3.8 Stated Application of R&M by Total Assets and Legal Entity Status - additional descriptive statics

All Entities (n=584) by Total Assets					
	Mean	Median	SD	Min.	Max.
R&M					
No	157,300,000	26,839,605	250,000,000	133,138	445,000,000
Yes	218,500,000	21,803,199	779,000,000	0	7,040,000,000
Unclear	93,881,728	8,358,917	719,000,000	0	9,665,000,000
Large Proprietary (n = 240) by Total Assets					
	Mean	Median	SD	Min.	Max.
R&M					
No	445,000,000	445,000,000		445,000,000	445,000,000
Yes	295,900,000	66,732,066	801,000,000	0	5,981,000,000
Unclear	164,300,000	23,326,239	1,120,000,000	15,734	9,665,000,000
Small Proprietary Controlled by Foreign Companies (n = 169) by Total Assets					
	Mean	Median	SD	Min.	Max.
R&M					
No	26,839,605	26,839,605		26,839,605	26,839,605
Yes	32,067,900	4,572,049	109,000,000	0	850,300,000
Unclear	33,307,578	4,032,393	103,000,000	100	517,000,000
Unlisted Public (n = 104) by Total Assets					
	Mean	Median	SD	Min.	Max.
R&M					
No			1,380,000,00		
Yes	486,600,00	22,786,836	0	0	7,040,000,000
Unclear	46,586,433	1,799,578	208,000,000	0	1,328,000,000
Other Small Proprietary (n = 71) by Total Revenue					
	Mean	Median	SD	Min.	Max.
R&M					
No	130,485	130,485		130,485	130,485
Yes	11,103,195	215,479	25,400,000	0	115,400,000
Unclear	11,818,334	121,669	32,300,000	0	145,400,000



Table 3.9 Stated Application of R&M by Number of Employees and Legal Entity Status

Recognition and Measurement								
All Entities (n=231)	No	%	Yes	%	Unclear	%	Total	%
<50	1	100	68	42.5	19	27.1	88	38.1
50-100	0	0	25	15.6	25	34.3	50	21.2
>100	0	0	67	41.9	26	38.6	94	40.7
Total	1	100	160	100	70	100	232	100

Pearson chi2(4) = 12.7713 Probability = 0.012

Large Proprietary (n=225)								
	No	%	Yes	%	Unclear	%	Total	%
<50	1	100	64	41.3	18	26.1	83	36.9
50-100	0	0	25	16.1	25	36.2	50	21.8
>100	0	0	66	42.6	26	37.7	92	41.3
Total	1	100	155	100	69	100	225	100

Pearson chi2(4) = 12.4763 Probability = 0.014

By Number of Employees						
All Entities (n = 231) by Employees	Mean	Median	SD	Min.	Max.	
R&M						
No	16	16		16	16	
Yes	236	71	535	0	4,850	
Unclear	115	83	119	0	680	
Large Proprietary (n =225) by Employees						
R&M						
No	16	16		16	16	
Yes	243	73	542	0	4,850	
Unclear	116	83	119	0	680	

NB: Employee numbers are not disclosed in Form 388 for Small Proprietary Controlled by Foreign Companies, Unlisted Public Companies and Other Small Proprietary Companies



4. Stage 2 Assessment of Substantive Compliance with R&M

For all entities coded as 2 (“unclear”) at the first level assessment, AASB staff performed a qualitative assessment of the accounting policies to ascertain the compliance with R&M requirements. The reasons for the conclusions reached in each case are documented. In this regard, the assessment undertaken by the AASB involved the following:

1. For entities coded as “1” (clearly compliant) at the stage 1: AASB staff reviewed a random sample to confirm accuracy of coding, and that the auditor did not qualify their audit opinion on the basis of non-compliance with R&M requirements in the AAS. Where there was no audit report, a qualitative assessment of the accounting policies was performed per step 2 below.
2. For all entities coded as “2” (unclear) at the stage 1 assessment, AASB staff performed a qualitative assessment of the accounting policies to ascertain the compliance with R&M requirements. The reasons for the conclusions reached in each case were documented. In this regard:
 - a. If any policy was assessed to be not complying with the requirements of AAS the entity was coded as “0” at the second step, i.e. not complying with AAS. Some of the common examples found were relating to:
 - i. non-compliance with AASB 112 *Income Taxes* where entities did not recognise deferred tax assets or liabilities or calculated these based on the pre-IFRS version of the income tax standard;
 - ii. non-compliance with AASB 116 *Property, Plant and Equipment* where assets were not depreciated based on the useful lives of the assets;
 - iii. recoverable amount as per AASB 136 *Impairment of Assets* was calculated on an undiscounted basis.
 - b. Entities were classified as clearly complying with R&M requirements of AAS and thus were coded as ‘1’ at the second level of assessment, only if:
 - i. accounting policies were included for all relevant items, they were sufficiently detailed and were consistent with R&M principles of AAS;
 - ii. no obvious non-compliance was identified; and
 - iii. audit report is clean in relation to compliance with R&M.
 - c. In all other instances, entities were classified as unclear even at the second level of assessment and thus coded as ‘2’. Examples are:
 - i. Accounting policies were too brief to make any judgement.



- ii. Accounting policies were inconsistent with AAS for some items, e.g. for Property, Plant and Equipment or Loans and receivables, but there were no related balances presented in the financial statements. Therefore, it was unclear whether R&M requirements of AAS have been complied with or not.
- iii. Accounting policies were not given for all items presented in the Statement of financial position, Statement of profit or loss and/or other comprehensive income, which made it difficult to assess whether R&M requirements in AAS were complied with or not.
- iv. In any other case of doubt over compliance, for example, where any entity stated compliance with only 'selective accounting standards', and it was difficult to ascertain which standards the entities complied with and there seemed no obvious non-compliance with R&M requirements of AAS as per the review of accounting policies.
- v. Where an accounting policy choice is provided under accounting standards and there was not sufficient information regarding which accounting policy choice the entity has followed.

Based on the above analysis, there are 196 entities for which stated compliance with R&M was deemed unclear from stage 1 (Table 3.1). These entities provide the focus for stage 2 analysis. Table 4.1 contains the breakdown of the findings from stage 2.

Table 4.1 Substantive Compliance with R&M by “unclear entities”

All Entities	Freq.	Percent
No	52	26.53
Yes	60	30.61
Unclear	84	42.86
Total	196	100

As shown in Table 4.1, for those entities coded in stage 1 as “unclear” with respect to their stated compliance with R&M, 60 entities were subsequently found to comply with R&M in the financial report. For the remaining 136 entities, compliance was deemed to be unclear, or the reports were found to be non-compliant.

Table 4.2 provides additional analysis by entity type and shows a consistent level of variation in substantive compliance with R&M across entity type. Put another way, entity type does not appear to drive substantive compliance with R&M.



Table 4.2 Frequency Distribution of R&M by Entity Type

Large Proprietary	Freq.	%
No	22	29.7
Yes	16	21.6
Unclear	36	48.7
Total	74	100

Small Proprietary Controlled by Foreign Companies	Freq.	%
No	12	24.5
Yes	15	30.6
Unclear	22	44.9
Total	49	100

Unlisted Public	Freq.	%
No	7	16.7
Yes	16	38.1
Unclear	19	45.2
Total	42	100

Other Small Proprietary	Freq.	%
No	11	35.5
Yes	13	41.9
Unclear	7	22.6
Total	31	100



Tables 4.3 and 4.4 report results by type of auditor – Big-4 and non-Big-4. These show significantly greater variation in the substantive compliance by entities with auditors that are non-Big-4.

Table 4.3 Frequency Distribution of R&M by Big-4 Auditor

All Entities	Freq.	%
No	1	4.4
Yes	13	56.5
Unclear	9	39.1
Total	23	100

Large Proprietary	Freq.	%
No	1	14.2
Yes	3	42.9
Unclear	3	42.9
Total	7	100

Small Proprietary Controlled by Foreign Companies	Freq.	%
No	-	-
Yes	1	16.7
Unclear	5	83.3
Total	6	100

Unlisted Public	Freq.	%
No	-	-
Yes	3	100.0
Unclear	-	-
Total	3	100

Small Proprietary	Freq.	%
No	-	-
Yes	6	85.7
Unclear	1	14.3
Total	7	100

Table 4.4 Frequency Distribution of R&M by Non-Big-4 Auditor

All Entities	Freq.	%
No	43	27.6
Yes	44	28.2
Unclear	69	44.2
Total	156	100

Large Proprietary	Freq.	%
No	17	29.8
Yes	11	19.3
Unclear	29	50.9
Total	57	100

Small Proprietary Controlled by Foreign Companies	Freq.	%
No	8	22.2
Yes	13	36.1
Unclear	15	41.7
Total	36	100

Unlisted Public	Freq.	%
No	7	17.9
Yes	13	33.3
Unclear	19	48.8
Total	39	100

Small Proprietary	Freq.	%
No	11	45.8
Yes	7	29.2
Unclear	6	25.0
Total	24	100

Tables 4.5 and 4.6 report the results of stage 2, by size and entity type, with size proxied by Total revenue (table 4.5) and Total assets (Table 4.6). Evident from Table 4.5 is that 60 of the 196 entities (30.6 percent) coded “unclear” at stage 1, were subsequently found to comply with R&M. Of the remaining 136 entities that were found to either be “non-compliant” or “unclear” at stage 2, a clear majority of entities were smaller, with reported total revenue at or below \$50m. This result carried across each entity type and is consistent with the findings reported in Table 4.6.



Table 4.5 Stated Application of R&M by Total Revenue and Legal Entity Status

Recognition and Measurement								
All Entities (n=196)	No	%	Yes	%	Unclear	%	Total	%
<\$25m	33	63.5	44	73.3	62	73.8	139	70.9
\$25m-\$50m	10	19.2	4	6.7	11	13.1	25	12.8
\$50m-\$100m	6	11.5	7	11.7	8	9.5	21	10.7
>\$100m	3	5.8	5	8.3	3	3.6	11	5.6
Total	52	100	60	100	84	100	196	100
Large Proprietary (n=74)	No	%	Yes	%	Unclear	%	Total	%
<\$25m	4	18.2	3	18.7	17	47.2	24	32.4
\$25m-\$50m	10	45.5	4	25.0	10	27.8	24	32.4
\$50m-\$100m	5	22.7	5	31.3	7	19.4	17	22.9
>\$100m	3	13.6	4	25.0	2	5.6	9	12.3
Total	22	100	16	100	36	100	74	100
Small Proprietary Controlled by Foreign Companies (n=49)	No	%	Yes	%	Unclear	%	Total	%
<\$25m	12	100.0	15	100.0	20	90.8	47	96.0
\$25m-\$50m	0	0	0	0	1	4.6	1	2.0
\$50m-\$100m	0	0	0	0	0	0	0	0
>\$100m	0	0	0	0	1	4.6	1	2.0
Total	12	100	15	100	22	100	49	100
Unlisted Public (n=42)	No	%	Yes	%	Unclear	%	Total	%
<\$25m	7	0	14	87.5	19	100.0	40	95.2
\$25m-\$50m	0	0	0	0	0	0	0	0
\$50m-\$100m	0	0	2	12.5	0	0	2	4.8
>\$100m	0	0	0	0	0	0	0	0
Total	7	100	16	100	19	100	42	100
Other Small Proprietary (n=71)	No	%	Yes	%	Unclear	%	Total	%
<\$25m	10	100	12	66.7	6	66.7	28	75.7
\$25m-\$50m	0	0	3	16.6	0	0	3	8.1
\$50m-\$100m	0	0	2	11.1	2	22.2	4	10.8
>\$100m	0	0	1	5.6	1	11.1	2	5.4
Total	10	100	18	100	9	100	37	100



Table 4.6 Application of R&M by Total Assets and Legal Entity Status

Recognition and Measurement								
All Entities (n=196)	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	30	57.7	35	58.4	47	55.9	112	57.1
\$12.5-\$25m	9	17.3	8	13.3	15	17.9	32	16.3
\$25m-\$50m	9	17.3	8	13.3	10	11.9	27	13.8
>\$50m	4	7.7	9	15.0	12	14.3	25	12.8
Total	52	100	60	100	84	100	196	100
Large Proprietary (n=74)	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	4	18.2	0	0	9	25.0	13	17.6
\$12.5-\$25m	7	31.8	5	31.3	13	36.2	25	33.8
\$25m-\$50m	9	40.9	5	31.3	7	19.4	21	28.4
>\$50m	2	9.1	6	37.4	7	19.4	15	20.2
Total	22	100	16	100	36	100	74	100
Small Proprietary Controlled by Foreign Companies (n=49)	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	11	91.7	12	80.0	16	72.7	39	79.6
\$12.5-\$25m	1	8.3	1	6.7	1	4.6	3	6.1
\$25m-\$50m	0	0	1	6.7	1	4.6	2	4.1
>\$50m	0	0	1	6.7	4	18.1	5	10.2
Total	12	100	15	100	22	100	49	100
Unlisted Public (n=42)	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	5	71.4	13	81.4	16	84.1	34	80.9
\$12.5-\$25m	0	0	1	6.2	1	5.3	2	4.8
\$25m-\$50m	0	0	1	6.2	1	5.3	2	4.8
>\$50m	2	28.6	1	6.2	1	5.3	4	9.5
Total	7	100	16	100	19	100	42	100
Other Small Proprietary (n=31)	No	%	Yes	%	Unclear	%	Total	%
<\$12.5m	10	90.9	10	76.9	6	85.7	26	84.0
\$12.5-\$25m	1	9.1	1	7.7	0	0	2	6.4
\$25m-\$50m	0	0	1	7.7	1	14.3	2	6.4
>\$50m	0	0	1	7.7	0	0	1	3.2
Total	11	100	13	100	7	100	31	100



5. Conclusion

The purpose of this research is to provide evidence to inform the deliberations of the AASB as it considers two main problems:

1. Whether to remove the SAC 1 and the reporting entity concept, thereby enabling greater comparability with wording contained in the IASB's conceptual framework; and
2. Whether to remove the option for entities to elect to produce SPFSs when publicly lodging financial statements.

To enable more informed deliberation about the removal of the option to prepare SPFSs, a greater understanding of the impacts on entities of doing so is required. It is hoped that the evidence contained in this report on the stated compliance with R&M by for-profit entities lodging SPFS, will assist the AASB in this regard.



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Appendix 1 Extent of SPFS Use for Lodgement by Certain For-Profit Entities

The initial population of financial statements (21,428) that Illion acquired from ASIC under the AASB's direction covers a broader range of entity categories with the consideration of potential needs for future projects. The extent of SPFS use was examined for three categories of for-profit entities, i.e. large proprietary companies, small foreign controlled proprietary companies and unlisted public companies the AASB was particularly interested in³⁷. The filtering procedure to obtain the total number of financial statements lodged by these three categories of entities during 2017/18 financial year is detailed in the Table A1 below³⁸.

To determine the extent of use of SPFS, GPFS and Tier 2 – RDR, the AASB engaged Illion to use optical character recognition (OCR) software to determine the type of financial report lodged by the above entities with ASIC. The results summarised in Table A2 set out the number of each type of report lodged by the three categories of entities.

³⁷ Unlisted public companies exclude companies limited by guarantee and unlisted-public non-profit companies.

³⁸ The population size has been corroborated with ASIC data.



Table A1 Filtering procedure to determine Financial Statements lodged by Large Proprietary Companies, Small Foreign Controlled Proprietary Companies and Unlisted Public Entities

	No. of financial statements (2017-18 financial year)
Total number of financial statements Illion acquired from ASIC	21,428
<i>less</i>	
Duplicates ³⁹	(832)
Registered Managed Investment Schemes ⁴⁰	<u>(3,655)</u>
	16,941
Missing Classification Code	(29)
Supplementary Companies ⁴¹	(115)
Limited by Guarantee Companies ⁴²	(3,415)
Other Not-for-profit Entities ⁴³	(50)
Listed Public Company	(203)
Tier 2 Public Company Limited by Guarantee	(51)
Other Small Proprietary Companies ⁴⁴	(281)
Total	<u>12,797</u>
Total Number of Financial Statements lodged by:	
Large Proprietary Companies	6,763
Small Proprietary Controlled by Foreign Companies	2,932
Unlisted Public Entities ⁴⁵	3,102
	<u>12,797</u>

³⁹ Identified through the OCR recognition process.

⁴⁰ Registered managed investment schemes are defined to have defined to have public accountabilities and therefore must prepare Tier 1 GPFS. Refers to Appendix B Public Accountability in [AASB 1053 Application of Tiers of Australian Accounting Standards](#).

⁴¹ Companies who have submitted revised financial statements.

⁴² Other Not-for-profit entities include non-profit proprietary companies (PNPC), unlisted public non-profit company (ULSN) and non-profit unlisted public & superannuation trustee company (ULSS), based on ASIC organisation subclass code.

⁴³ Limited by guarantee companies are assumed to be not-for-profit entities due to the limitation on distribution of dividends.

⁴⁴ Refer to footnote 13.

⁴⁵ Unlisted public entities excluding companies limited by guarantee and unlisted public non-profit companies.



Table A2 Summary of Type of Financial Report by Category of Entity

Category of Entity	Type of financial report (2017/18)				Total
	GPFS	RDR	SPFS	Unreadable by OCR	
Large Proprietary	351	733	4,718	961	6,763
Small Proprietary Entities controlled by Foreign companies	151	281	1,850	650	2,932
Unlisted Public	1,166	350	1,026	560	3,102
Total	1,668	1,364	7,594	2,171	12,797

As the precision of the OCR recognition software utilised by Illion was not foolproof on the scanned PDF financial report files, there were 2,171 financial reports classified as “unreadable”.

The AASB staff reviewed a sample of “unreadable” financial reports. In most cases, the OCR recognition software not being able to read the financial report was due to the low-quality scan of the original financial reports. Other reasons identified through a manual check of “unreadable” financial reports included: 1) changing of type of reporting during the financial year⁴⁶; 2) inconsistencies in the type of report indicated in auditor’s report, directors’ declaration and/or financial report; and 3) no clear indication of type of report. Due to data limitations and the absence of any clear indication that the composition of “unreadable” reports (i.e. the percentage of each type of report for each entity category) is different from those clearly identified by the OCR recognition software, we have used the clear OCR percentages as the basis for allocating the “unreadable” reports to each entity category.

The “unreadable” pool was therefore allocated to each type of report based on the weighted-average of each type of reporting in a given category of entity, as demonstrated in the following Table A3:

⁴⁶ One entity indicate that they changed from preparing SPFS to RDR during the year



Table A3 Allocation of “Unreadable” to Each Type of Financial Report/Category of Entity

	Type of financial report (2017/18)					Unreadable by OCR	Total
	GPFS	RDR	SPFS	subtotal			
Large Proprietary	351	733	4,718	5,802		961	6,763
Weighted-average	6%	13%	81%	100%			
Allocation of “unreadable” by weighted-average	58*	121	782	961			
Subtotal	<u>409</u>	<u>854</u>	<u>5,500</u>	<u>6,763</u>			
	6%	13%	81%	100%			
Small Proprietary Entities controlled by Foreign companies	151	281	1,850	2,282		650	2,932
Weighted-average	7%	12%	81%	100%			
Allocation of “unreadable” by weighted-average	43	80	527	650			
Subtotal	<u>194</u>	<u>361</u>	<u>2,377</u>	<u>2,932</u>			
	7%	12%	81%	100%			
Unlisted Public	1,166	350	1,026	2,542		560	3,102
Weighted-average	46%	14%	40%	100%			
Allocation of “unreadable” by weighted-average	257	77	226	560			
Subtotal	<u>1,423</u>	<u>427</u>	<u>1,252</u>	<u>3,102</u>			
	46%	14%	40%	100%			
Total	2,026	1,642	9,129	12,797			12,797
	16%	13%	71%	100%			

Example of calculation: $6\% \times 961 = 58$. Allocation of “unreadable” by weighted – average for each type of financial report within each category of entity was calculated in the same way as the example.

To confirm the reliability of the OCR recognition results, the AASB staff conducted a series of sample check procedures to confirm the financial reports were classified accurately into each type of report. To do so, AASB staff randomly selected a sample out of the pool of GPFS, RDR and SPFS and manually verified the type of report by reviewing the financial reports and an indication for the type of report contained within. Normally, the type of report is disclosed in the notes to the financial statements in Note 1 (e.g. Basis of preparation or Summary of accounting policies). Given that the Board and stakeholders are most interested in the extent to which SPFS being used, we also performed an additional



sample check for the SPFS specifically, with the researchers manually checking the type of report for 328 financial reports that were classified as SPFS by Illion's OCR recognition software. The researchers concluded that the incidence of misclassification of type of report was not statistically significant.



Appendix 2 Impact of Doubling Threshold for Large Proprietary Companies

The size thresholds for large proprietary companies reporting under the *Corporation Act 2001* (Corporations Act) have been doubled, effective for the financial years beginning on or after 1 July 2019. Under section 45A of the Corporations Act, large proprietary companies are required to prepare an annual financial report, a director's report and an auditor's report with the ASIC. The changes introduced to the thresholds are summarised as follow:

	Threshold for Financial years ending on or before 30 June 2019	Threshold for financial years beginning on or after 1 July 2019
Consolidated revenue for the financial year of the company and any entities it controls	\$25 million or more	\$50 million or more
The value of the consolidated gross assets at the end of the financial year of the company and the entities it controls	\$12.5 million or more	\$25 million or more
The number of employee the company and any entities it controls at the end of the financial year	50 or more	100 or more

A proprietary company is large if it satisfies at least two of the above three tests. With the doubled threshold, approximately one-third of the large proprietary companies which lodged audited financial statements (with at least 1,541 entities lodging SPFSs⁴⁷) in the 2018 financial year with ASIC no longer need to lodge their financial statements.

⁴⁷ This number shows the minimum decrease in number of entities lodging SPFS after the doubling size threshold. It is estimated based on the financial statements that are clearly identified as SPFSs, excluding allocation of "unreadable" to the pool of SPFS. This number could be higher given that a certain portion of "unreadable" financial statements are in not SPFSs.



Appendix 3 List of Keywords Used for Word Recognition Software by Illion

Primary Search

Special Purpose Financial Statements

- AASB 101; AASB 107; AASB 108; AASB 1048; AASB 1054 or AASB 101; AASB 107; AASB 108; AASB 1054
- Emphasis of matter – basis of accounting
- non reporting entity
- not a reporting entity
- no users dependent
- no users dependent on general
- Regulatory Guide 85
- RG 85
- SAC 1
- special purpose
- special purpose consolidated financial statement
- special purpose financial record
- special purpose financial statement
- special-purpose financial statement
- SPFS
- this is a special purpose ...
- unlikely to exist users
- Other combinations of pluralisms, hyphens, inclusion of "consolidated" between "purpose" and "financial, case insensitive

General Purpose Financial Statements

- comply/ complying with International Financial Reporting Standards
- comply/complying with Australian Accounting Standards
- comply/complying with IFRS
- general purpose consolidated financial statement
- general purpose financial record
- general purpose financial statement
- general-purpose financial statement
- IFRS
- International Financial Reporting Standards
- Tier 1
- Other combinations of pluralisms, hyphens, inclusion of "consolidated" between "purpose" and "financial, case insensitive



Tier 2 – Reduced Disclosure Requirements

- RDR
- reduced disclosure
- standards reduced
- Tier 2
- Tier 2- RDR
- Tier 2 -GPFS
- Other combinations of pluralisms, hyphens, case insensitive

Secondary Search

After the primary search for keywords, Illion analysed the results of "NONE" types and ran a secondary search for keywords for those none files using a different method. The reason this method was employed was that it better targeted challenging scans, including:

- Low definition scans
- Mis-orientated scans
- Bad scans - words are incorrect with unnecessary spaces and characters e.g. "cool dogs" is displayed as "coo ld o gs"

In the secondary search, Illion primarily looked for keywords: "General Purpose", "Special Purpose", and "RDR" as these were the primary keywords that caught most of the results in the first run. This yielded some improvements which were spot checked and then consolidated into the final results. The remaining "NONE" types of financial statements were then classified as "unreadables".