Possible policy implications of the results of research into accounting by certain types of lodging entities

Introduction

1. ED 192 *Revised Differential Reporting Framework* issued by the AASB in February 2010 included proposals for:
   (a) establishing a second tier comprising Reduced Disclosure Requirements for preparing general purpose financial statements (GPFSs); and
   (b) changing the focus of application of Standards from reporting entity to GPFSs and clarifying the meaning of GPFSs in an Australian context.
2. The proposal in paragraph 1(a) gave rise to publication of AASB 1053 *Application of Tiers of Australian Accounting Standards* in June 2010.
3. The comments from constituents on the proposals in paragraph 1(b), particularly the divergence of views as to the functionality of the reporting entity concept, led to the Board deferring its decision on those proposals pending further research into the incidence and nature of special purpose financial reporting among entities that lodge financial statements.
4. A research project, involving external contractors, was initiated to profile the characteristics of lodging entities and their accounting policies with a view to shedding more light on:
   (a) whether there is a consistency in the current treatment of entities as non-reporting entities; and
   (b) the nature of the accounting policy choices being made by those entities.

Purpose of this paper

5. This paper is prepared with a view to:
   (a) providing, as the context for discussion, a summary of the results of the research work based on the latest draft research report;
   (b) identifying issues in the area of financial reporting by lodging entities particularly in regard to entities lodging with the Australian Securities and Investments Commission (ASIC);
   (c) identifying measures that can be adopted by the AASB in dealing with those issues;
   (d) identifying possible policy options that fall within the mandates of other regulators; and
   (e) recommending a course of action to deal with the issues identified involving both the AASB and other regulators.
6. It is intended that on conclusion of Board's deliberations on the policy implications of the research report, the final research report and related Board policy recommendations be published concurrently.

Summary of research findings

7. The (draft) report provides analyses of the reporting practices of entities lodging financial statements with the ASIC. A sample of 1,546 entities, drawn randomly with a 95% confidence interval, is used to provide results that can be generalised across the following five populations of lodging entities:
   (i) Large Proprietary Companies (LPCs);

(ii) Small Proprietary Companies that are required to lodge reports with the ASIC (SPCs - ASIC);

(iii) Small Proprietary Companies controlled by a foreign entity (SPC - foreign owned);

(iv) Unlisted Public Companies other than Companies Limited by Guarantee (UPCs other than CLGs); and

(v) unlisted public Companies Limited by Guarantee. (CLGs).

8. Table 1 shows the population and samples classified by type of lodging entities for years 2008 and 2009. More years of data is used in the research – the sampling is based on only the 2008 and 2009 data.

Table 1: Break up of population and samples of lodging entities

2008-2009	LPCs	SPCs-foreign owned	SPCs-ASIC	UPC other than CLGs	CLGs	Total
Population	5097	131	2237	3884	9673	21,022
Sample	394	95	340	347	370	1,546

9. The (draft) report also includes findings in relation to the nature of financial statements lodged by Co-operatives and Associations with Consumer Affairs Victoria (CAV) and the final version of the report is expected to also include findings in relation to financial statements lodged by Associations and Co-operatives with relevant New South Wales and Queensland regulators.

10. The following table shows the population and samples classified by types of entities lodging with CAV for 2010. Samples were drawn randomly based on a 95% confidence interval (about 20% of the sample related to years 2011, 2009 and 2008).

Table 2: Break up of population and samples of entities lodging with CAV

Type of Entity	Sample size	Sample Proportions (%)	Population size	Population Proportions (%)
Prescribed Associations	51	13%	36,938	Combined total 92%
Non-Prescribed Associations	307	77%		
Co-Operatives	6	2%	707	2%
Fundraisers	25	6%	1,415	4%
Patriotic Funds	11	2%	613	2%
TOTAL	400	100%	39,673	100%

11. This paper focuses on the research results relating to reporting practices of entities lodging with the ASIC. Where relevant to the discussion, it also draws on the results of research into financial statements lodged with CAV. The following provides a summary of the research results.

Application of the reporting entity concept

12. The (draft) report concludes that measures that act as proxies for the factors identified in the Statement of Accounting Concepts (SAC) 1 *Definition of the Reporting Entity* as indicative of the existence of a reporting entity, do not systematically explain the application of the concept by lodging entities. In other words, the decision as to whether an entity classifies itself as a

reporting entity or a non-reporting entity appears to be driven by factors other than those identified in SAC 1.

13. The (draft) report also provides anecdotes that enhance the understanding of the extent of variation with which the reporting entity concept is applied.

Financial reporting practices

14. The (draft) report analyses the financial reporting practices of lodging entities across two primary dimensions:
    (a) application of recognition and measurement requirements and, separately, when relevant the disclosure requirements set out in Australian Accounting Standards; and
    (b) the quality of accruals raised by LPCs.

15. Examining the dimension of quality is intended to assist in understanding any differences that exist between the entities producing GPFSs and those producing special purpose financial statements (SPFSs).

Incidence of SPFSs

16. The report reveals significant inconsistencies in reporting among lodging entities with a substantial incidence of SPFSs. In the case of LPCs, 20% lodge GPFSs. A similar percentage of GPFSs are also reported for lodging SPCs-foreign owned and SPCs-ASIC. Table 3 depicts the percentages of entities lodging GPFSs and SPFSs by different types of entities.

Table 3: Percentages of GPFSs and SPFSs lodged

	LPCs	**SPCs-foreign owned**	**SPCs-ASIC**	**UPC other than PCLGs**	**UPCLGs**
GPFS	20%	16%	24%	70%	65%
SPFS	80%	84%	76%	30%	35%
Total	100%	100%	100%	100%	100%

17. There is also a high incidence of SPFSs in relation to lodgements with CAV. Based on disclosure in the financial statements, the highest incidences of SPFSs relate to prescribed associations and cooperatives, respectively standing at 59% and 50%. However, in many cases no clear statement was made as to the nature of financial statements lodged. The following table depicts the nature of financial statements lodged with CAV per statements made by different types of lodging entities.

Table 4: Financial reporting by entities lodging with CAV

Type of Entity	**GPFSs %**	**SPFSs %**	**No clear statement**	**Total**
Prescribed Associations	16%	59%	25%	100%
Non-Prescribed Associations	0%	9%	91%	100%
Co-operatives	0%	50%	50%	100%
Fundraisers	30%	35%	35%	100%
Patriotic Funds	0%	18%	82%	100%

18. Staff note that the incidence of SPFSs could increase with new legislation. For example, the Australian Charities and Not-for-profits Commission (ACNC) notes[1] that it is consulting on the final details that will be required for annual information statements and financial reports from 2013–14 onwards, including the type of reporting (general or special purpose) that will be allowed. The Co-operatives National Law and forthcoming Co-operatives National

1 ACNC *Guide for board members and others who manage charities*, November 2012.

Regulations (now at draft stage) also have the potential to increase the incidence of SPFSs in relation to Co-operatives.

Application of recognition and measurement requirements

19. There are indications that recognition and measurement requirements of applicable accounting standards have not rigorously been followed by LPCs that prepare SPFSs[2]. Results suggest that a substantial minority do not clearly state application of recognition and measurement requirements and there is no clear indication of application by some LPCs. Those LPCs that state application of recognition and measurement requirements of accounting standards disclose varying degrees of adherence to the following mandatory standards that are primarily presentation and disclosure standards. These standards apply to all entities, including non-reporting entities, required to prepare financial statements in accordance with Part 2M.3 of the *Corporations Act 2001*.

- AASB 101 *Presentation of Financial Statements*
- AASB 107 *Statement of Cash Flows*
- AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- AASB 1031 *Materiality*
- AASB 1048 *Interpretation and Application of Standards.*

20. Where financial statements of LPCs do not include a clear statement of application of recognition and measurement requirements, further analysis of notes to the financial statements indicated varying degrees of disclosures in regard to the application of recognition and measurement requirements on tax effect accounting, consolidation, financial instruments, share-based payments and long service leave entitlement provisions and related party disclosures. The (draft) report concludes that the extent to which these entities applied the recognition and measurement requirements in accounting standards remains an open question.

21. A similar pattern emerges from the analysis of application of recognition and measurement requirements of accounting standards by categories of lodging entities other than LPCs, in that, in relation to entities in each category:

- a majority state application of recognition and measurement requirements;
- a substantial minority state non-application;
- there is no clear indication of application by some; and
- those that state application of recognition and measurement requirements of accounting standards disclose a varying degree of adherence to the mandatory standards noted in paragraph 19 above.

Assessing the quality of accruals

22. The report assesses the quality of accruals raised in financial statements of LPCs. Results suggest that the quality of accruals is directly related to the extent to which the recognition and measurement requirements in accounting standards are applied in preparing those financial statements:

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2 ASIC Regulatory Guide RG 85 *Reporting requirements for non-reporting entities*, clarifies that non-reporting entities that are required to prepare financial reports in accordance with Chapter 2M of the *Corporations Act 2001*, should comply with the recognition and measurement requirements of accounting standards.

(a) GPFSs exhibit a higher quality compared with SPFSs that clearly state application of recognition and measurement requirements; and

(b) SPFSs that clearly state application of recognition and measurement requirements exhibit a higher quality when compared with SPFSs that do not state application; or SPFSs that state non-application.

These results suggest that the application of recognition and measurement requirements in accounting standards improves the predictive potential of the amounts recognised within the financial statements.

Identifying the issues

23. A considerable proportion of SPFSs do not apply all applicable accounting standards. It is not possible to establish whether those SPFSs are meaningful as they are not prepared in accordance with any known accounting framework. The retention of the simpler SPFS option would be expected to be a disincentive for the adoption of Tier 2 requirements by entities that should otherwise prepare GPFSs.

24. The research results indicate that the reporting entity concept is not applied as intended in identifying entities that should prepare GPFSs. In fact, the results show that many indicators set out in SAC 1 that are expected to underlie the directors' decisions to treat an entity as a reporting entity, seem not to be used in their assessment processes.

25. A distributional analysis of entities lodging SPFSs with the ASIC by size thresholds (trading revenue, total assets and number of employees) and by different levels of debt (level of creditors, bank debt and total liabilities) sheds further light on the extent the reporting entity concept is effectively applied in identifying entities that should prepare GPFSs. Table 5 (next page) provides stratification by those threshold factors.

Table 5: Distributional analysis of entities lodging SPFRs

Revenue	LPCs[*]		SPCs-Foreign		UPCs other than CLGs		CLGs	
	%	Cum[**]%	%	Cum%	%	Cum%	%	Cum%
<= $5m	10.6	10.6	47.0	47.0	70.3	70.3	100.0	100.0
> $5m & <= $10m	4.1	14.7	19.5	66.5	2.7	73.0		
> $10m & <= $25m	14.4	29.0	21.6	88.1	6.8	79.7		
> $25m & <= $50m	27.5	56.5	5.4	93.5	2.7	82.4		
> $50m & <= $100m	18.0	74.5	4.3	97.8	5.41	87.8		
> $100m & <= $200m	13.7	88.2	2.2	100%	12.2	100%		
> $200m & <= $300m	4.1	92.3						
> $300m	7.7	100%						
	100.0%		100.0%		100.0%		100.0%	
Total Assets	%	Cum%	%	Cum%	%	Cum%	%	Cum%
<= $12.5m	15.7	15.7	72.1	72.1	67.6	67.6	95.9	95.9
> $12.5m & <= $25m	20.2	36.0	10.8	82.9	6.7	74.3	2.4	98.4
> $25m & <= $50m	25.5	61.4	6.6	89.5	3.8	78.1	1.6100%	
> $50m & <= $100m	16.2	77.6	3.8	93.4	6.7	84.8		
> $100m & <= $250m	11.4	88.9	4.2	97.6	4.8	89.5		
> $250m	11.1	100%	2.4	100%	10.5	100%		
	100.0%		100.0%		100.0%		100.0%	
Employees Number	%	Cum%	%	Cum%	%	Cum%	%	Cum%
0	11.5	11.5		-		-		-
> 0 & <= 50	12.4	23.9		-		-		-
> 50 & <= 100	18.5	42.4		-		-		-
> 100 & <= 500	34.4	76.7		-		-		-
> 500	23.3	100%		-		-		-
	100.0%			100.0%		100.0%		100.0%
Creditors	%	Cum%	%	Cum%	%	Cum%	%	Cum%
<= $5m	35.6	35.6	80.3	80.3	69.0	69.0	97.1	97.1
> $5m & <= $10m	19.4	55.0	7.8	88.1	5.8	74.8	1.9	99.0
> $10m & <= $25m	21.4	76.4	6.6	94.7	16.1	90.9	1.0	100%
> $25m & <= $50m	21.7	98.1	5.4	100%	6.9	97.7		
> $50m	1.9	100%			2.3	00%		
	100.0%		100.0%		100.0%		100.0%	
Bank Debt	%	Cum%	%	Cum%	%	Cum%	%	Cum%
<= $5m	52.9	52.9	86.6	86.6	75.0	75.0	100.0	100.0
> $5m & <= $10m	9.7	62.6	3.5	90.2	6.7	81.7		
> $10m & <= $25m	15.6	78.2	4.5	94.8	7.7	89.4		
> $25m & <= $50m	18.0	96.2	2.4	97.2	1.0	90.4		
> $50m	3.8	100%	2.8	100%	9.6	100%		
	100.0%		100.0%		100.0%		100.0%	
Total Liabilities	%	Cum%	%	Cum%	%	Cum%	%	Cum%
<= $12.5m	36.8	36.8	83.3	83.3	76.9	76.9	96.8	96.8
> $12.5m & <= $25m	18.9	55.8	6.6	89.9	3.9	80.8	1.6	98.4
> $25m & <= $50m	17.1	72.8	5.2	95.1	7.7	88.5	0.8	99.2
> $50m & <= $100m	11.5	84.3	4.9	100%	2.9	91.4	0.8	100%
> $100m & <= $250m	8.6	92.9			8.6	100%		
> $250m	7.1	100%						
	100.0%		100.0%		100.0%		100.0%	

(*) Dotted lines signify current thresholds for LPCs
(**) Cum = Cumulative

26. The significant incidence of SPFSs amongst financial statements lodged on the public registers raises the following questions:

(a) is there a wide range of users or potential users for these financial statements that has prompted the regulator to require lodgement and facilitate access to lodged financial statements by the public? If so, why are they in the nature of SPFSs?

(b) if there is not a wide range of users or potential users for these financial statements, then why are they made available to the public?

27. Table 6 shows for some types of lodging entities that prepare SPFSs the percentages that would need to move to GPFSs if they were to prepare GPFSs on exceeding certain size thresholds. The size thresholds used in the analysis are set at 100% above the current size thresholds for LPCs. For example, based on increased revenue, asset and employees number thresholds, respectively 43.5%, 64.2% and 57.7% of LPCs that currently prepare SPFSs would move to GPFSs if they exceed the increased thresholds.

Table 6: SPFS preparers that would move to GPFSs on exceeding certain thresholds

	LPCs %	**SPCs –Foreign owned %**	**UPCs other than CLGs %**	**CLGs %**
Revenue				
>$50m	43.5	6.5	17.61	0
Total assets				
>$25m	64.2	17.0	25.8	0
Employee Number				
>100	57.7	-	-	-

Grandfathered large proprietary companies

28. Grandfathered LPCs are required to prepare a financial report but are exempt from lodging it with the ASIC if they meet certain conditions under the Corporations Act. However, they would need to have their financial reports audited before the reporting deadline specified in the law in order to maintain the lodging exemption. It is estimated that there are about 1500 LPCs that are classified as grandfathered.[3]

29. Financial statements prepared by grandfathered LPCs are only made available to members and are not available to the public. Their financial statements could, therefore, be classified as SPFSs if public availability is seen as a necessary condition for a set of financial statements to be classified as GPFSs. The prevalence of SPFSs amongst this group is an issue of significance that would need to also be discussed when the Board considers the policy implications of the research report.

30. Concerns have been expressed that[4]:

(a) the relief granted to grandfathered companies creates an inconsistent regulatory framework for proprietary companies that potentially gives grandfathered companies an unfair competitive advantage; and

(b) granting relief to grandfathered exempt proprietary companies conflicts with Government policy that proprietary companies with economically significant operations should be required to lodge financial reports.

31. Accordingly, the incidence of a large proportion of SPFSs amongst lodged financial statements without an underlying meaningful reporting framework is a significant issue that needs to be addressed. The availability of lodgement exemption to grandfathered proprietary companies exacerbates the incidence of SPFSs. The issue of high incidence of SPFSs should be addressed by coordinating regulatory efforts with other regulators. Some of the measures

3. *Behind closed doors: an exclusive club is determined to stay private*, the Age newspaper, 21 July 2012.
4. *Corporate and Financial Services Regulation Review Proposal Paper*, The Treasury, November 2006, page 44.

that could be adopted would fall under the AASB mandate while other measures would need to be adopted by other regulators.

32. The following considers the possible policy implications of the research (draft) report.

Possible policy implications

33. Based on the conclusions of the research (draft) report, the functionality of the reporting entity concept as a tool in the hands of preparers should be questioned. The premise is that users that are dependent or could be dependent on external financial statements in making resource allocation decisions should not be disadvantaged by preparers not applying the Australian Accounting Standards that are intended to serve those users. The realisation of this premise would only be possible if the tasks of determining who should report and the standards to be followed are not left to the preparers themselves. These are tasks for regulators.

34. Of significant relevance is the approach to regulation adopted in other jurisdictions. Australia is the only jurisdiction known to use the reporting entity concept in the application paragraphs of its standards to distinguish between reporting requirements that apply to reporting entities and those that apply to non-reporting entities.

35. It also seems there are not many comparable jurisdictions in terms of the Australian approach to financial reporting regulation. Generally, other countries either do not regulate unlisted and similar entities or they require preparation of GPFSs (sometimes under a tiered reporting system) based on local GAAP or international GAAP.

36. The research also reveals that, in many cases, financial reporting is being treated as a compliance exercise. It is apparent that financial statements templates are often used for lodged financial statements, with standardised accounting policy notes. This may also lead to questions about the meaningfulness of related audit reports.

The AASB's mandate

37. ED 192 proposed changing the focus of application of Standards from reporting entity to GPFSs. As ED 192 notes, this would mean SPFSs would not fall within the ambit of Australian Accounting Standards and it would be up to the users and regulators of SPFSs to identify relevant reporting requirements for preparing SPFSs. The AASB would only promulgate accounting standards for use in general purpose financial reporting.

38. ED 192 also proposed clarifying the meaning of GPFSs in an Australian context. In summary, it proposed that financial statements that satisfy the following two conditions are GPFSs:

    (a) they are publicly available, whether under a legal mandate or voluntarily and

    (b) they are either:

        (i) prepared in accordance with all applicable Australian Accounting Standards [Tier 1 or Tier 2] under a legal mandate or held out to be so prepared; or

        (ii) required to be GPFSs under a legal mandate or held out to be GPFSs.

    Financial statements held out as having been prepared in accordance with Australian Accounting Standards or held out as being GPFSs to any party would be GPFSs. This is because there is an expectation that financial statements held out as GPFSs would be relied upon by users to make economic decisions and should, therefore, faithfully report what is expected to be reported in GPFSs.

39. The research results indicate that the reporting entity concept, as a means of differentiating between the entities that should prepare GPFSs and those that need not, is not being applied as envisaged under SAC 1. This result and the high incidence of SPFSs amongst lodged

financial statements should help inform the AASB in progressing ED 192 proposals summarised above. The implementation of these proposals would be relevant to both corporate and non-corporate regulation.

The role of the reporting entity concept

40. Table 7 summarises the current role and the envisaged future role of the reporting entity concept in Australian financial reporting:

Table 7: Current and future roles of the reporting entity concept

Current role	Future role as envisaged under ED 192 proposals
Used by preparers and regulators in identifying when an entity should prepare GPFSs and to circumscribe the boundaries of that entity.	To be used by the AASB as the underpinning concept for GPFS requirements and as the basis for its own deliberations. To be used as a benchmark by other regulators in identifying entities that should be required to prepare and lodge GPFSs (whether under Tier 1 or Tier 2).
Used in application paragraphs of Australian Accounting Standards for differential reporting purposes. Reporting entities must apply all Australian Accounting Standards and non-reporting entities apply a subset of them, that is, AASB 101, AASB 107, AASB 108, AASB 1031[5] and AASB 1048.	The reporting entity concept would no longer be used to operationalise differential reporting. The focus of application of Australian Accounting Standards (whether Tier 1 or Tier 2) would move from 'reporting entity' to 'GPFSs'.

41. Under SAC 1, the reporting entity concept is concerned with both determining the boundaries of the entity and identifying the entity that should prepare GPFSs. There is no concept in the IASB revised framework or the IASB's latest proposals[6] on reporting entity that would make the reporting entity to refer to an entity that should prepare GPFSs. On implementing ED 192 proposal to change the application focus of Standards to GPFSs, the status of SAC 1 in relation to the future role of reporting entity concept would need to be made clear.

42. At its December 2012 meeting, in deliberating on the revised IASB framework, the AASB decided:

(a) to retain SAC 1 in its current form given references to 'reporting entity' in application paragraphs of Australian Accounting Standards; and

5. At its February 2012 meeting, the AASB decided to propose the withdrawal of AASB 1031 in the light of the guidance on materiality in other Australian Accounting Standards and the revised IASB Conceptual Framework, which is to be incorporated into the AASB Conceptual Framework.

6. IASB ED/2010/2 *Conceptual Framework for Financial Reporting, The Reporting Entity*, March 2010, describes a reporting entity as a "circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided".

(b) in relation to the wording of the Foreword to the revised AASB Framework (applicable to for-profit-entities only), where the Foreword refers to the use of the definition of 'reporting entity' in AASB 1053, reference should also be made to SAC 1.

43. While the reason for retaining SAC 1 noted in paragraph 42(a) above would become redundant on the change of application of standards from reporting entity to GPFSs, its continued use under paragraph 42(b) would be consistent with ED 192 proposals in regard to the future role of the reporting entity concept.

44. However, a clarification of the status of SAC 1 in the context of implementing ED 192 proposals would be necessary. Would SAC 1 remain part of the revised AASB Framework in an amended form or would its role be reduced to a Guidance document?

Existence of potential users

45. The AASB Glossary of defined terms identifies the definitions of 'reporting entity' and 'general purpose financial statements' as:

> "An entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial statements for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries."
>
> "Financial statements that are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs."

46. 'Expectation of the existence of users' as opposed to just 'existence of users' is an issue of importance in the definition of the reporting entity in the Australian context. The research report notes that discussions with practitioners highlighted a variation in the understanding of the application of the reporting entity concept, and that, in particular practitioners are generally divided as to whether a reporting entity is an entity that 'does have' dependent users, or whether a reporting entity is one in respect of which it is 'reasonable to expect' the existence of those users. Such differences of views exist despite the fact that SAC 1, AASB 101.7 and AASB 1053 in defining the reporting entity are clear that the 'expectation of existence of users' should be the basis for determining whether the entity is a reporting entity or not.

47. The 'expectation of existence of users' makes potential users the subject matter of GPFSs. In changing the application of Australian Accounting Standards from reporting entity to GPFSs, the significant role of 'potential users' in making a set of financial statements GPFSs should not be overlooked. As noted in footnote 6 to this paper, the IASB's proposed definition under the revised framework refers to the financial information about reporting entity having "the potential to be useful to existing and potential equity investors, lenders and other creditors".

Other regulators' mandates

48. Prima facie, Table 5 above suggests that, if the revenue, gross assets and employee number were much higher than the current thresholds for LPCs (revenue \$25m, gross assets \$12.5m, employees 50), as proxies for entities being classified as reporting entities, a significant portion of LPCs who do not currently prepare GPFSs would be required to prepare GPFSs. Table 6 above provides an indication of the shift from SPFSs to GPFSs if entities exceeding twice the current size thresholds for LPCs were required to prepare GPFSs.

49. An important implication of adopting ED 192 proposals cited in paragraph 38 above would be that financial statements required to be prepared under a legal mandate in accordance with Australian Accounting Standards and lodged on a public register, such as that of the ASIC, would be GPFSs. Should relevant regulators assess that such a requirement would be onerous

for some lodging entities that are currently preparing SPFSs, they may need to consider deregulation by reassessing the characteristics of the entities that must lodge.

50. Small proprietary companies and some companies limited by guarantee have already benefited from deregulation. Consideration could be given to adoption of similar measures in relation to other types of lodging entities. Further deregulation of proprietary companies that currently lodge SPFSs may become necessary, for example, by raising the size thresholds for these companies.

51. In some cases, regulation rather than deregulation would be warranted. For example, to create a level playing field, current exemptions applying to grandfathered LPCs would need to be reconsidered by corporate regulators. Corporate regulators have in the past argued for repealing the exemption for grandfathered LPCs[7]. The AASB's current efforts in reforming and rationalising financial reporting in Australia provides a more flexible reporting framework for preparing GPFSs that would be conducive to initiating regulatory measures in relation to grandfathered proprietary companies. In particular, the introduction of Reduced Disclosure Requirements under AASB 1053 has provided regulators with the choice of the less burdensome Tier 2 reporting requirements for preparing GPFSs for non-publicly accountable entities.

52. Various scenarios for deregulation may be envisaged. For example, a rather radical measure in relation to for-profit non-publicly accountable entities could be the deregulation of all lodging entities other than unlisted public companies. This would significantly reduce the reporting burden of many lodging entities but it would deregulate some of the entities that are currently lodging GPFSs.

Staff recommendations to the Board

53. Staff have the following recommendations to seek the Board's view and direction as to the way forward.

    (a) Progress ED 192 proposals to the Standard stage by publishing proposals for a Standard, in regard to the change of the focus of the application of Australian Accounting Standards (Tier 1 and Tier 2) from the reporting entity to GPFSs. The AASB should clarify that it only deals with the promulgation of accounting standards for preparing GPFSs. The reporting requirements applicable to SPFSs would be determined by those who require or demand their preparation. The nature of any further due process would need to be considered in light of the research results and Board's policy recommendations. The ensuing Standard should have a long transition period (at least two years).

    (b) Provide clarification of the meaning of GPFSs in the Australian context to help ensure that:

        (i) lodging entities that should prepare GPFSs in fact do so;

        (ii) regulators are aware of the implications of any of their regulations that require preparation of financial statements in accordance with accounting standards; and

        (iii) in requiring lodgements of financial statements regulators should be focused on satisfying the information needs of a wide range of users that are not in a position to demand the information they require in making resource allocation

7. *Corporate and Financial Services Regulation Review Proposal Paper*, The Treasury, November 2006, page 44.

decisions. This would require extensive liaison between the AASB and other regulators in regard to both the corporate and non-corporate lodgement requirements.

(c) To facilitate and enhance the implementation of requirements arising from ED 192 proposals the AASB should:

(i) intensify its liaison and interaction with other regulators, including those regulating financial reporting in the non-corporate sector, to help ensure that future regulation is consistent with the AASB conceptual framework and accounting standards;

(ii) provide input to, and engage actively in, efforts by other regulators aimed at harmonising and rationalising reporting requirements for co-operatives, associations and other entities lodging with state-based regulators; and the ACNC in regard to regulating not-for-profit entities;

(iii) recommend to the Treasury, that consideration be given to further deregulating lodgement requirements for companies by substantially increasing (perhaps doubling) the current size thresholds to ease the burden of preparing GPFSs on smaller entities;

(iv) recommend to the Treasury that consideration be given to removing current inconsistencies in lodging requirements for LPCs arising from grandfathering provisions; and

(v) inform other regulators of the implications for the regulatory process of implementing ED 192 proposals, in particular, the critical role of those regulators in requiring the preparation and lodgement of GPFSs. An issue of significance would be the continued use of the reporting entity concept as envisaged under SAC 1, via an appropriate vehicle, in guiding such regulatory process.

Recommendations for further due process

54. While implementation of ED 192 proposals is recommended in the light of research results, staff think that further consultation with constituents in the form of an Exposure Draft (ED) would be warranted before making changes to Standards and other AASB pronouncements. The ED 192 proposals were previously canvassed in the light of differential reporting. The matter now at hand is the quality of reporting by entities subject to GPFS-oriented Standards. Progress of the Board’s decisions in this area should ideally happen concurrently with the deregulation recommended. However, if the latter does not happen, or is delayed, the Board should proceed with issuing its proposals in an ED.