

## **Policy Implications of SPFSs Research Report and a Road Map to Implementation**

1. At its February 2013 meeting, the Board discussed the policy implications of the results of research into the financial reporting practices of certain types of lodging entities and made some tentative decisions as to the way forward. This paper provides a context for:
  - (a) further progressing the discussion with a view to finalising and confirming those decisions; and
  - (b) discussing and agreeing to a roadmap for implementation of the policy implications of the research report.

### **Background**

2. The research was commissioned by the AASB pursuant to comments received in relation to ED 192 *Revised Differential Reporting Framework* proposals that the focus of Australian Accounting Standards be changed from reporting entity to general purpose financial statements (GPFs). Implementation of the proposals would have meant that the reporting entity concept would no longer be used in Australian Accounting Standards for differential reporting purposes. Some commentators did not agree with ED 192's proposals, noting that the reporting entity concept works well in differentiating between those entities that should prepare GPFs and those that need not. This use of reporting entity was envisaged by Statement of Accounting Concepts (SAC) 1 *Definition of the Reporting Entity*, and entities are expected to apply SAC 1 in determining whether they are reporting entities or not.
3. ED 192 also included proposals regarding the clarification of the meaning of GPFs in the Australian context.

### **Issues identified**

4. In summary, the most recent draft of the research report provided to the Board at its December 2012 meeting indicates:
  - (a) significant inconsistencies in reporting among lodging entities and a substantial incidence of special purpose financial statements (SPFSs). For example, in the case of large proprietary companies, findings indicate that nearly 80% of entities lodge SPFSs with the Australian Securities and Investments Commission (ASIC);
  - (b) that recognition and measurement requirements of applicable accounting standards appear not to have been rigorously followed by a substantial minority of lodging entities; and
  - (c) the quality of accruals is lower for SPFSs than for GPFs.

### **Board deliberations**

5. Deliberations of the research findings at the February 2013 AASB meeting resulted in a general agreement among members that:
  - (a) in view of the high incidence of SPFSs amongst lodged financial statements, the reporting entity concept has not been applied as intended by SAC 1 in identifying entities that should prepare GPFs; and

- (b) a considerable proportion of SPFSs appear not to have applied the recognition and measurement requirements of all applicable Australian Accounting Standards<sup>1</sup>.
6. The Board also noted the significant incidence of SPFSs in the context of financial reporting by grandfathered large proprietary companies. As the grandfathering of such entities does not stem from accounting standards, any change in their reporting would need to arise from legislative change.
  7. The Board discussed the manner in which it might continue to use the reporting entity concept as the basis for its own deliberations in setting GPFS requirements; and the potential for that concept to be used as a benchmark by other regulators in identifying whether entities should be required to prepare and lodge GPFSs. There was general agreement in regard to the future role of the reporting entity concept as proposed in ED 192, in that:
    - (a) the AASB would use the concept as the underpinning concept for GPFS requirements and as the basis for its own deliberations; and
    - (b) other regulators could use the concept as a benchmark to identify entities that should be required to prepare and lodge GPFSs (whether under Tier 1 or Tier 2).

However, no explicit decision was made by the Board as to the future status of SAC 1 and the form in which the guidance on 'reporting entity' for use by other regulators should be developed.
  8. The Board tentatively decided that it should aim to proceed with the implementation of ED 192's proposals in relation to the change of the application focus of Australian Accounting Standards from 'reporting entity' to GPFSs and the clarification of GPFSs in the Australian context. However, the Board expressed the need for any change to be carefully managed (see below – an implementation road map)
  9. Regarding the role of the AASB as a standard setter, there was general agreement amongst members that:
    - (a) the AASB mandate is to set accounting standards for preparing GPFSs under Tier 1 and Tier 2; and
    - (b) setting reporting requirements for SPFSs is a matter between the preparer and identified users that are not dependent on GPFSs.

### **An implementation roadmap**

10. In dealing with issues noted in paragraph 5 above, members agreed that both the AASB and other regulators [including the ASIC, the Treasury and the Australian Charities and Not-for-profits Commission (ACNC)] have roles to play. The implementation of ED 192's proposals would need to be preceded by extensive liaison and coordination work with those other regulators. The liaison would be in the broader public interest and would be necessary in order to avoid possible unwarranted consequences of the implementation of proposals.
11. Members were of the view that a strategy or road map would need to be drawn up to set out the work to be undertaken by the AASB and other regulators with a view to an orderly transition to an improved and more coordinated financial reporting regime for Australia.

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1 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* in addition to complying with AASB 101, AASB 107, AASB 108 and AASB 1048 should comply with the recognition and measurement requirements of accounting standards.

12. Possible elements of the roadmap could be as follows:
- (a) the AASB staff should liaise with other regulators with a view to coordinating the Board's and other regulators' efforts in dealing with the issues emerging from the research. Liaison efforts would begin with the ASIC, Treasury and the ACNC and expand to other regulators. Issues that should be discussed include:
    - (i) the ways in which the implementation of ED 192's proposals would affect financial reporting of lodging entities, in particular, the potential effect of public availability of financial statements on the nature of those financial statements;
    - (ii) the manner in which regulators could assist in a coordinated transition to the new reporting regime. This, for example, could include:
      - deregulation, if implementation of ED 192's proposals was expected to unreasonably increase the reporting burden of lodging entities without commensurate benefits; and
      - regulation, for example in relation to grandfathered large proprietary companies where creation of a level playing field in regard to similar types of entities would entail so;
    - (iii) the implications of references to Australian Accounting Standards in legislation or regulation, clarifying that:
      - a reference to preparation in accordance with Australian Accounting Standards would mean all Australian Accounting Standards and not a subset of them;
      - a reference to a subset of Australian Accounting Standards would entail specifying those Standards; and
      - whether references to Australian Accounting Standards, or a subset of them, is of a 'stationary' or 'ambulatory' nature;
    - (iv) the implication of references to financial statements as opposed to other forms or structures of financial information;
    - (v) the measures that regulators could adopt in drafting new legislation to ensure that:
      - entities that should prepare GPFs and make them publicly available, in fact do so; and
      - entities that need not prepare GPFs are clear as to related reporting requirements; and
    - (vi) the clarification that the reporting entity concept might continue to be used by regulators in identifying entities within their jurisdiction that should prepare GPFs and that guidance under SAC 1 would be available in one form or another to help in this regard;
  - (b) the AASB should consider a draft document setting out the public policy implications of the research report after the Board's current deliberations on the issue and once the outcome of liaison with regulators as described in (a) above is known. It is to be considered whether such a document needs to be published concurrently with the publication of the final research report; and

- (c) the AASB should consider publishing an Exposure Draft to reexpose ED 192's proposals in the light of research findings and the outcome of liaison with regulators.
13. It is too early as yet to provide a timeline for implementation of the various elements of the roadmap at this stage, pending further discussions and decisions by the Board in regard to policy implications. Members would need to discuss the time line of key milestones in the implementation process.

#### **Recent liaison activities**

14. In regard to liaison with regulators, AASB staff had a meeting with the ASIC staff, with participation of research contractors, to discuss the research findings and possible policy implications. A verbal presentation of matters arising from this meeting and any other liaison activities in relation to other regulators will be made at the April 2013 AASB meeting. A brief discussion has been held with Treasury officials who have signalled that they would like to be involved in discussions once ASIC has reviewed the research findings.

#### **Questions for the Board:**

- 1. Does the Board agree with, and confirm, the summary of its decisions at the February 2013 meeting as set out in paragraphs 5 to 9 above?**
- 2. What is the Board's view in regard to the future status of SAC 1 and the form in which the guidance on 'reporting entity' for use by other regulators should be developed (see paragraph 7 above)?**
- 3. Does the Board agree with the tentative road map in paragraph 12 above for implementation of the policy implications of research results?**