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AASB RESEARCH REPORT 13

Parent, Subsidiary and Group Financial Reporting

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Any errors or omissions remain the responsibility of the principal authors.

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AASB Research Report Series

The AASB Research Centre promotes thought leadership in external reporting standard setting and policy making through in-depth analysis of financial reporting issues and related empirical work.

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Contents

Executive Summary

The Australian Accounting Standards Board (AASB) is working with other regulators in considering the Australian financial reporting framework. This Report addresses an important aspect of that framework, being whether current financial reporting requirements applicable to parent/subsidiary[1] structures are meeting user needs in a cost-effective way. The frameworks applicable to private sector for-profit entities, private sector not-for-profit entities and public sector entities are being considered separately.

➢ Private sector for-profit entities

This Report focuses on for-profit private sector corporate entities. The research findings indicate that:

- users most dependent on general purpose financial statements (GPFS) are generally satisfied with the summary financial information about the parent currently required to be disclosed in the consolidated financial statements and do not need complete sets of unconsolidated parent financial statements for their decision making; and
- users most dependent on GPFS need more information disclosed about subsidiaries in consolidated financial statements than is currently required, particularly if complete sets of subsidiary financial statements were to be no longer available to them. This includes financial information about:
  - material subsidiaries with material non-controlling interests (NCI) and/or significant going concern issues;
  - international operations (particularly because of any tax implications or profit repatriation constraints) and subsidiaries with financial characteristics different from the group; and
  - significant intra-group transactions, and dividend traps or other factors that may impact dividend paying capacity such as retained earnings and profit reserves of subsidiaries.

Accordingly, in light of the current disclosure requirements, users continue to need complete sets of subsidiary financial statements. Some also need to know whether other financial statements pertaining to group entities (including the group itself) exist and, where they do, those users need to see cross-references to them.

1 Appendix A of AASB 10 *Consolidated Financial Statements* defines ‘parent’ as “An entity that controls one or more entities”; and ‘subsidiary’ as “An entity that is controlled by another entity”.

Whilst the research reflected in this Report was limited to a sample of twelve investor/analysts and five credit providers (lenders), only three of the twelve investor/analyst users said they require complete sets of subsidiaries' financial statements. Five indicated they need more than summary financial information but not complete sets of financial statements. This indicates there is a need to review the current requirements in AASB 12 *Disclosure of Interests in Other Entities* in relation to subsidiary financial information. If AASB 12 or the Corporations Act is amended to provide the extra disclosures required by users in consolidated financial statements, it is recommended the relevant regulators reconsider the need for lodging subsidiary financial statements with the Australian Securities and Investments Commission (ASIC).

➢ Not-for-profit and public sector entities

Whilst the above research findings relate to private sector for-profit entities, the benefits for users of consolidation and other information pertinent to parent/subsidiary structures are considered to be equally relevant in relation to private sector not-for-profit entities and public sector entities. Further research is required to consider whether there is a need to align financial reporting requirements (both standards and regulations) arising from parent/subsidiary structures in those sectors with the for-profit private sector and whether the differences can be justified on sector-specific grounds.

Next Steps

- This Report provides input to the process through which the AASB (and potentially the Australian Auditing and Assurance Standards Board (AUASB)) will work with regulators, users, preparers and other stakeholders to reach a clear, effective, broadly accepted framework for financial reporting (and assurance) in Australia in respect of parent/subsidiary structures. Consistent with the research findings noted above in relation to the for-profit private sector, there is no indication that fundamental change to the framework relating to parent/subsidiary financial reporting is urgently warranted.
- The users' views on the additional disclosures needed will provide important input to the IFRS 12 *Disclosure of Interests in Other Entities* post-implementation review the International Accounting Standards Board (IASB) undertakes.
- Paragraphs 89 and 91 of this Report identify related areas for further consideration and future research. The extent to which that consideration and research is pursued will depend on stakeholders' views on the issues addressed in this Report and future AASB and other regulators' priorities.

Introduction

What are the issues and why are they important?

1. This Report reviews the suitability of current Australian Accounting Standards (AAS) and legislative requirements relating to the reporting of financial information about parents and subsidiaries as separate legal entities where consolidated financial statements[2] (including related disclosures) are available. This review is done in light of the fact that the different types of financial information (e.g. consolidated financial statements, and parent and subsidiary financial statements) are prepared from different views (economic versus legal, respectively) and provide varying levels of usefulness to their respective users. For example, where users are focused on an entity's economic power (control) consolidated financial statements are preferred, but where users are focused on legal rights unconsolidated financial statements are preferred.

2. The Report's aim is to address criticisms from some that the current requirements are too onerous for preparers, and burden users with information overload in some respects and information shortfalls in other respects. For example, some argue that because accounting standards prioritise substance over form (and therefore emphasise the importance of group over parent (unconsolidated)/subsidiary financial statements) and require the group financial statements to be primarily prepared from the entity's perspective rather than from the owners' perspective,[3] some important information is missing. They argue that to fill that information gap with complete sets of unconsolidated parent and subsidiary financial statements to supplement the consolidated financial statements would be onerous for preparers and/or result in information overload for users. Instead, they argue that requiring additional disclosures in the consolidated financial statements about the parent and its subsidiaries would satisfy existing information shortfalls, reduce overload and be less onerous.

3. In many cases in Australia if a parent prepares consolidated financial statements it is not required to prepare a complete set of (unconsolidated/separate) financial statements relating to itself.[4] However, summary financial information about itself as a separate legal entity is

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2 Appendix A of AASB 10 *Consolidated Financial Statements* defines 'parent' as "An entity that controls one or more entities"; 'subsidiary' as "An entity that is controlled by another entity"; and 'consolidated financial statements' as "The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity".

3 Often referred to in the literature as a proprietary perspective.

4 Parent entities governed by the Australian Prudential Regulation Authority (APRA) are required to prepare both consolidated and unconsolidated financial statements. Refer to Appendix B and Appendix C for an outline of the current accounting and regulatory requirements for the preparation of consolidated, parent and subsidiary financial statements.

required to be disclosed in a note to the consolidated financial statements.[5] Intermediate parents (that is, subsidiaries with their own subsidiaries) are subject to similar requirements. A bottom subsidiary in a group (that is, a subsidiary without its own subsidiaries) is required to prepare a complete set of subsidiary financial statements unless it is otherwise relieved.

4. This Report separately addresses parent financial reporting matters, subsidiary financial reporting matters, and matters related to pertinent disclosures in consolidated financial statements, whilst acknowledging the interrelationships among all three matters. As consideration of parent financial reporting might help inform the consideration of subsidiary financial reporting, parent financial reporting is addressed first.

5. In particular, the three key issues addressed in this Report are:[6]

   (a) **ISSUE 1**: Parent (unconsolidated) financial reporting: Where it is required, does the summary financial information about a parent currently disclosed in the consolidated financial statements of a group (in lieu of a complete set of unconsolidated financial statements, in accordance with Regulation 2M.3.01 of the Australian Corporations Act 2001) satisfy user needs in a cost effective way? Assessing the adequacy of summary financial information that most parents are currently required to disclose as a note in the consolidated financial statements involves assessing whether there are significant general purpose users who need the complete set of financial statements of the parent (instead of the summary financial information), or indeed whether they even need the summary financial information.

   (b) **ISSUE 2**: Subsidiary financial reporting: Should a subsidiary that is currently required to prepare and lodge complete sets of financial statements publicly continue to be required to do so, or would disclosure of summary financial information about the subsidiary in the consolidated financial statements (or indeed no additional financial information) satisfy user needs in a more cost effective way? The main impetus for considering this issue is the existence of the following current requirements:

      (i) the New Zealand (NZ) Companies Act 1993 (see paragraphs 48-52 and Appendix G below for an outline of NZ regulatory requirements and a comparison with Australia) no longer requires subsidiaries to prepare financial statements, and nor does it require disclosure of subsidiary summary financial information; and

5 If the parent is exempt under AASB 10 from preparing consolidated financial statements, it would typically be required to prepare a complete set of unconsolidated parent financial statements.

6 Depending on the outcome of the analysis of these issues, supplementary issues could include those listed in the table under paragraph 89 below.

(ii) only summary financial information about a parent is disclosed in consolidated financial statements under section 295(2) and Regulation 2M.3.01 of the Australian Corporations Act (see Issue 1 immediately above), however subsidiaries meeting the large proprietary company threshold must prepare full financial statements, unless subject to class order relief relating to wholly owned subsidiaries.

(c) **ISSUE 3**: Disclosures about risks associated with parent/subsidiary structures: Do current disclosure requirements (for example, in AASB 12 *Disclosures of Interests in Other Entities* and AASB 124 *Related Party Disclosures*) applicable to consolidated financial statements provide a sufficient (but not excessive) level of information to make the preparation of summary financial information about a parent or the preparation of complete sets of subsidiary financial statements redundant and enable users to adequately assess the risks arising from a group structure? Consideration of this Issue may provide useful input to the IASB's post-implementation review of IFRS 12 *Disclosure of Interests in Other Entities*, which the IASB is expected to undertake in due course in conjunction with post implementation reviews of IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements.*[7]

The relationship of this Report to other AASB projects

6. This Report is part of the larger Australian Financial Reporting Framework project[8] being undertaken by the AASB and the Auditing and Assurance Standards Board (AUASB) in phases, the objective of which is to assist in reforming the financial reporting framework in Australia for all sectors.[9] The goal of this Framework project is to achieve financial reporting that is clear, objective and comparable, balancing user needs and preparer costs. It also aims to reduce the burden on preparers by simplifying the requirements where appropriate and ensure the information they are required to provide is useful to them and their stakeholders. To achieve this the AASB along with the AUASB is working closely with other regulators to develop more consistent and operational criteria/thresholds grounded in sound principles that specify: (a) who needs to prepare and lodge external financial statements on the public record; (b) what needs to be reported (reporting requirements); and (c) what level of assurance is appropriate (assurance requirements). For example, the AASB is currently proposing the appropriate financial reporting requirements for for-profit companies lodging financial statements with Australian Securities and Investments Commission (ASIC) as a result of the revised reporting thresholds for large proprietary companies.[10] Similarly, the AASB is

7 https://www.ifrs.org/projects/work-plan/research-programme/#reviews.
8 https://www.aasb.gov.au/admin/file/content102/c3/AASB_Financial_Reporting_Framework_Project_Summary.pdf.
9 https://www.aasb.gov.au/admin/file/content102/c3/AASB-AUASB_Strategy_2017-2021.pdf.
10 See paragraph 7 for detail.

working with regulators in the not-for-profit private sector to rationalise reporting requirements for private sector not-for-profit entities, and likewise for the public sector.

7. One of the key outcomes of Phase 2 of this Framework project affecting the for-profit private sector in particular is the proposal to remove the current reporting entity concept in AAS and the option for entities to prepare special purpose financial statements (SPFS) when required to comply with AAS.[11] The current requirement that allows preparation of SPFS is proposed to be replaced by the introduction of a new general purpose financial statements (GPFS) Tier 2 – Simplified Disclosures framework (new Tier 2 framework) for certain categories of entities, including for-profit private sector entities that are currently required to report under Tier 2 of the differential reporting framework set out in AASB 1053 *Application of Tiers of Australian Accounting Standards*. The new Tier 2 framework is proposed in AASB ED 295 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* and is based on the *IFRS for SMEs*[12] disclosures, adapted for differences in recognition and measurement requirements between AAS and *IFRS for SMEs* (and to accommodate not-for-profit specific circumstances).

8. This Report completes the last of the planned Research Reports for the Board's Australian Financial Reporting Framework Project. The other Research Reports, Staff Papers and Discussion Papers in relation to the Australian Financial Reporting Framework Project include:

   (a) Research Report No.10 *Legislative and Regulatory Financial Reporting Requirements* (2nd Edition September 2019), the purpose of which is to identify the entities with financial reporting obligations under Federal and State/Territory legislation that will or may be captured by the AASB in Phase 2[13] of its project to revise the financial reporting framework in Australia and remove entities' ability to lodge SPFS with regulators;

   (b) Research Report No.7 *Financial Reporting Requirements Applicable for For-Profit Private Sector Companies* (May 2018), which aims to provide a better understanding of the current Australian requirements (together with an international comparison) for for-profit private sector companies including reporting challenges such as the 'reporting entity' concept, the basis on which the requirements were developed;

11 AASB ED 297 *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* is proposing to remove the ability of for-profit large proprietary companies, unlisted public companies (other than companies limited by guarantee) and small foreign-controlled companies to publicly lodge SPFS with ASIC. The ED is currently open for comment until 30 November 2019.

12 The IASB's *IFRS for SMEs* standard is tailored for small companies. It focuses on the information needs of lenders, creditors and other users of SME financial statements who are interested primarily in information about cash flows, liquidity and solvency. It takes into account the costs to SMEs and the capabilities to prepare financial information.

13 See paragraph 7 and the hyperlink in the first footnote to paragraph 6 for a brief explanation of Phase 2, and its relationship to Phase 1.

(c) Research Report No.12 *Financial Reporting Practices of For-Profit Entities Lodging Special Purpose Financial Statements* (September 2019), which investigates how extensively the option to prepare SPFS is adopted by for-profit large proprietary companies, small foreign controlled companies and unlisted public companies (other than companies limited by guarantee) lodging with ASIC and the level of compliance with the recognition and measurement requirements in AAS by these entities;

(d) Research Report No.6 *Financial Reporting Requirements Applicable to Public Sector Entities* (May 2018), which documents the financial reporting requirements applicable to public sector entities in Australia and how these compare internationally;

(e) AASB Discussion Paper *Improving Financial Reporting for Australian Public Sector* (June 2018), which presents possible reporting options for improving the current framework for public sector entities with illustrative frameworks to demonstrate the impact of these options;

(f) Research Report No.5 *Financial Reporting Requirements Applicable to Charities* (October 2017), which documents the financial reporting requirements applicable to charities in Australia and how these compare internationally;

(g) AASB Discussion Paper *Improving Financial Reporting for Australian Charities* (November 2017), which presents possible options (and demonstrates the impact of some of these possible options) for improving the current framework that charity stakeholders might find useful in providing input to the ACNC legislative review;

(h) *AASB submission to ACNC Legislative Review* (February 2018), which, after seeking the views of charity stakeholders through extensive outreach, recommends further work be undertaken by the ACNC, AASB and the AUASB, in consultation with the sector, to develop a suitable reporting framework for registered charities;

(i) Research Report No.11 *Review of Special Purpose Financial Statements: Large and Medium-Sized Australian Charities* (September 2019), which investigates how extensive the option to prepare SPFS has been adopted by charities lodging with ACNC and the level of compliance with the recognition and measurement requirements in AAS by these entities; and

(j) AASB Staff Paper *Comparison of Standards for Smaller Entities* (April 2018), which benchmarks six international pronouncements for smaller entities of the IASB, United Kingdom (UK) and New Zealand (NZ) and explores the options for modified accrual and cash bases of accounting as additional tiers of financial reporting requirements.

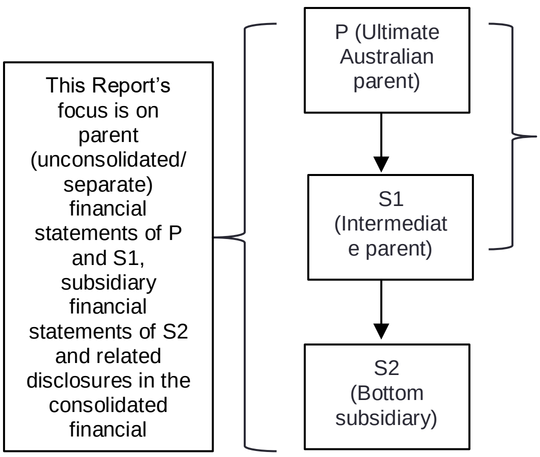
Scope

9. The following diagram depicts the scope of this Report. The diagram shows a simplified structure, where:

   (a) P (parent) is the ultimate Australian parent of a group preparing and lodging consolidated financial statements. Under the Corporations Act and ASIC's financial reporting requirements P is not required to prepare its complete set of parent (i.e. unconsolidated/separate) financial statements.[14]

   (b) Similarly, S1 (an intermediate parent, whether wholly or partly owned), is required to prepare consolidated financial statements[15] but not its unconsolidated/separate financial statements.

   (c) S2 (a bottom subsidiary, whether wholly or partly owned), is required to prepare a complete set of subsidiary financial statements.



- This Report provides an overview of the key regulatory and accounting requirements and assesses the relative usefulness of consolidated financial statements of P and S1 to understand and challenge the current requirements relating to separate (unconsolidated) financial statements/summary financial information of P and S1, and the (individual) financial statements of S2
- This Report does not address the suitability of current requirements (including the exceptions and exemptions from consolidation in AASB 10) relating to the consolidated financial statements of P and S1 except whether consolidated financial statements contain enough information to allow a user to assess the risks arising from the group structure.

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14 However, if a parent entity wishes to present a complete set of separate financial statements as an alternative to summary parent information that would be otherwise required by Regulation 2M.3.01, ASIC's class order 10/654 allows that.

15 S1 is not required to prepare consolidated financial statements if it is exempt under paragraphs 4 and Aus4.1 of AASB 10. S1 may also be relieved from the requirement to prepare and lodge audited financial statements under Chapter 2M of the Corporations Act where it enters into a deed of cross guarantee with its parent and meets certain other conditions as per ASIC Corporations (Wholly-owned Companies) Instrument 2016/785 and/or S1 is a small proprietary entity controlled by foreign companies and meets the exemption criteria as per ASIC Corporations (Foreign-Controlled Company Reports) Instrument 2017/204.

Financial reporting issues within scope

10. This Report makes recommendations in relation to the impact on users of the current requirements relating to subsidiary and parent financial information, particularly of for-profit private sector corporate reporting entities. This includes undertaking outreach to a selected group of users – see Appendices E and F of this Report.

11. This Report is not aiming to undertake a detailed post-implementation review of the requirements for summary financial information relating to parents, although that could be the subject of future research. Rather, this Report discusses the question of whether it would be appropriate to extend a similar requirement (i.e. disclosure of summary financial information rather than preparation of a complete set of financial statements) to subsidiaries. However, this Report might provide useful input to any post-implementation review that could be undertaken in the future.

Issues relating to intermediate parents

12. This Report does not separately discuss intermediate parents, although they are explicitly referred to in places. This is because the requirements applicable to an ultimate Australian parent are equally applicable to intermediate parents, unless such intermediate parents are exempted from the requirement to prepare consolidated financial statements under AASB 10 and required to prepare their separate/unconsolidated (parent) financial statements instead. To the extent such intermediate parents are exempt and prepare only separate/unconsolidated financial statements, the issues discussed in this Report in relation to subsidiary financial statements would be equally relevant for assessing the relevance to users of unconsolidated financial statements of such intermediate parents.

13. Accordingly, the discussion relating to subsidiary financial statements is most applicable to the bottom subsidiary in a group, which, unless exempted (see paragraphs C15-C24 of Appendix C for regulatory exemptions) is required to prepare subsidiary financial statements.

Nomenclature used in this Report

14. The nomenclature used in this Report is as follows:

    (a) The financial statements of a parent (whether ultimate or intermediate) that are not consolidated and will not be consolidated, sometimes referred to in the literature as holding company separate financial statements or parent-only financial statements, are described as 'parent financial statements' or 'unconsolidated financial statements' or even, where clarity is needed 'parent (unconsolidated) financial statements'.

(b) The financial statements of a bottom subsidiary in a group, sometimes referred to in the literature as individual financial statements, are described as 'subsidiary financial statements'.[16]

(c) The financial statements of a parent (whether ultimate or intermediate) that consolidate the parent's interests in subsidiaries (group financial statements) as if the group is a single economic entity are described as 'consolidated financial statements'.

Financial reporting issues excluded from scope

15. In relation to consolidated financial statements, this Report only considers the question of whether such statements prepared by reporting entities in accordance with current requirements (including disclosure requirements) provide sufficient but not excessive information to make the preparation of parent or subsidiary financial statements redundant and allow a user to assess the risks arising from the group structure. Accordingly, this Report does not question the suitability of current requirements relating to the preparation (nor the method of preparation of) consolidated financial statements and the related exception or exemptions from consolidation contained in AASB 10.[17] This is because the preparation of consolidated financial statements is often prescribed by legislation and is considered useful, which was re-affirmed by the IASB through its Conceptual Framework for Financial Reporting 2018 (referred to in this Report as 'revised Conceptual Framework'). Consolidated financial statements are accepted as best practice accounting for groups by international standard setters and are also submitted at local and international stock exchanges for listing and seeking investment overseas.

16. Furthermore, within the context of ASIC Regulatory Guide RG85 *Reporting Requirements for Non-reporting Entities* (July 2005), there has been some debate as to whether consolidation

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16 Financial statements of subsidiaries with no investments in subsidiaries but with investments in associates and/or joint ventures are also usually referred to in practice as individual financial statements. These are prepared using the principles of AASB 128 *Investments in Associates and Joint Ventures* and are required to be accounted for using the equity method of accounting. Paragraph 3 of AASB 128 defines equity method as "a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income."

17 Despite this, to understand the overall reporting requirements in Australia for parents, subsidiaries and groups, and to address the research questions, it is necessary to understand the accounting and legislative requirements relating to consolidated financial statements and appreciate the benefits of consolidated financial statements. Accordingly, this Report summarises those requirements and benefits without passing judgement on their suitability.

should be regarded as relating to recognition, measurement, presentation and/or disclosure.[18] AASB 10 is regarded by some as unclear on that issue. However, this matter will become less significant if the Board finalises the proposals in ED 297 to remove the ability to prepare SPFS. This is because parents currently lodging SPFS, that would now be required to lodge GPFS, would be required to consolidate (and equity account) and comply with full recognition and measurement requirements.[19] Furthermore, irrespective of whether consolidation is recognition, measurement, presentation and/or disclosure, internationally it is clear that a parent must consolidate unless it qualifies for the exception or one of the exemptions in IFRS 10 *Consolidated Financial Statements* (AASB 10). Accordingly, whilst acknowledged, this matter is not considered further in this Report.

17. Since the scope of this Report is focused on whether there are any financial reporting issues relating to parent/subsidiary structures that should be pursued more fully, it identifies indicative rather than definitive justifications for amending or retaining the current requirements (see, for example, the comments in paragraph 11). As a result there are a number of related aspects that have not been pursued in detail. Accordingly, in various places throughout this Report (and listed together in paragraphs 89-91) areas that could be the subject of future research are identified – for example, targeted outreach to ascertain preparers' views and assess possible costs.

18. The footnotes to paragraph 5 above refer to a table in paragraph 89 that identifies a number of potential supplementary issues that arise depending on the conclusions drawn in relation to Issue 1 (parent financial reporting) and Issue 2 (subsidiary financial reporting). These issues are also outside the scope of this Report, but could also form the basis of future research.

19. Similarly, in relation to Issue 3 (disclosures to facilitate assessment of risks), a post-implementation review of AASB 12 is beyond the scope of this Report. As a result, this Report is constrained in the extent to which it addresses that Issue.

20. Finally, because the Report's focus is on financial reporting issues, it does not analyse the implications of tax laws on corporate structures, including the laws relating to franked dividends.

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18 In that regard, it is perhaps relevant to note that paragraph 9 of AASB 2019-1 *Amendments to Australian Accounting Standards – References to the Conceptual Framework* states: "Tier 2 comprises the recognition and measurement requirements of Tier 1 (including consolidation and the equity method of accounting)…".

19 Refer to ED 297 for detail.

Sectors within scope

21. The primary focus of this Report is on reporting entities in the for-profit private corporate sector. Non-reporting entities[20] are being addressed in Phase 2 of the AASB's Australian Financial Reporting Framework project.[21] Consideration of the not-for-profit and public sectors has been commenced through Research Report No.5 and the subsequent Discussion Paper on charities and Research Report No.6 and the subsequent Discussion Paper on public sector entities respectively. For completeness, a brief discussion of each of these sectors is provided in paragraphs 83-88 below.

Jurisdictions within scope

22. In light of the approach NZ has taken with parent and subsidiary financial reporting, which is fundamentally different from the Australian approach, this Report documents the comparative requirements in NZ (see paragraphs 48-50, and Appendix G).

23. In due course, depending on AASB and other regulators' priorities, this Report could be supplemented by a broader international comparison of pertinent requirements, namely:

    (a) Canada;

    (b) Hong Kong;

    (c) Singapore;

    (d) South Africa;

    (e) the United Kingdom; and

    (f) the United States of America.

24. Selection of these jurisdictions would be consistent with other AASB Research Reports. These jurisdictions are relatively comparable in terms of regulatory rigour and are commonly compared with Australia in terms of financial reporting issues. Information about these jurisdictions could be used as input in identifying alternative regulations that could be considered for adoption in Australia.

20 A discussion of the reporting entity/non-reporting entity issue is contained in paragraph 7 above and paragraphs B2, B8, B11 and B20-B29 below.

21 As noted in paragraph 7 above, AASB ED 297 is currently open for comment until 30 November 2019. Refer to the first footnote to paragraph 7 for details.

Research Approach

Review of Relevant Material

25. A review of relevant material, including regulatory requirements, accounting requirements, research reports, internet articles, academic journals and case law considered relevant for the purposes of this Report was carried out. Where applicable, this Report cites the source of the information and provides hyperlinks that formed the basis for the observations made in this Report [Hyperlinks as accessed on 7 October 2019]. The results of the review are outlined in Appendices A (relating to business structures), B (relating to accounting standard requirements), C (relating to legislative regulatory requirements) and D (relating to the relative merits of consolidated, parent and subsidiary financial statements).

Outreach

26. Limited outreach conducted for the purpose of this Report was targeted at primary users of financial statements i.e. banks in their capacity as lenders and investors/analysts, to understand their information needs specifically in relation to companies that are part of a group structure.

27. The feedback was collected from the banks based on personal interviews with and/or written responses from representatives of the relevant departments of the banks. The feedback from investors/analysts was collected in the form of written responses to a set of questions. Detailed responses along with the questions raised with banks and investors/analysts are provided in Appendices E and F respectively.

28. In due course, as noted above, depending on AASB and other regulators' priorities, further outreach with preparers could be undertaken and results published as a supplement to this Report if they are found to differ from the research findings documented in this Report.

Reference to the Conceptual Framework in this Report

29. Although the IASB's revised Conceptual Framework has only been adopted in Australia for for-profit publicly accountable entities at the time of this Report, as noted in paragraph 7 above work is currently underway to replace the reporting entity concept currently in Australian Accounting Standards, and therefore references to the Conceptual Framework in this Report are to the AASB *Conceptual Framework for Financial Reporting* (May 2019).However, also where appropriate, reference is made in this Report to the current Australian Conceptual Framework that is applicable to non-publicly accountable entities, including the reporting entity concept in Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity*.

Overview of the financial reporting environment

30. The following sub-sections summarise (details are in the respective Appendices) the factors that give rise to parent/subsidiary relationships, the consequences such relationships have for the preparation of financial statements and current regulations (accounting and legislative – relating to both financial and non-financial reporting), and users' views on the relative merits of consolidated, parent and subsidiary financial statements. This is provided as a context before explicitly analysing each of the three issues that are the focus of this Report.

Factors affecting business structures

31. As context, because this Report is focused on parent-subsidiary structures in the for-profit private corporate sector, it is useful to consider the factors that give rise to such structures. Such a consideration is also relevant to any assessment of whether current financial reporting requirements cause distortions in structuring decisions. The factors are summarised in the following – see Appendix A for more detail.

32. In Australia, at a broad level, the four most common types of for-profit business structures are sole trader, partnership, trust and company.[22]

33. In choosing among those options, a general review of relevant material undertaken for the purpose of this Report suggests that various factors (such as decision making authority or degree of control intended to be exercised by the owners, tax considerations, profit sharing, cost and complexity of formation and ongoing compliance costs, and limited liability or otherwise) impact the choice. For example, whilst a simple sole trader structure has few reporting and administrative requirements, the more complex structures such as companies have more onerous record keeping, financial reporting and other 'red-tape' requirements. Effectively, the more onerous reporting requirements reflect the fact that the benefits of certain structures (such as companies, which have the benefits of access to public fundraising avenues and limited liability) comes with associated proportionate regulatory obligations (such as enhanced financial reporting requirements).

34. Once a company form is chosen, business activities could be structured, for example, as branches (within a single legal company structure) or subsidiaries (as separate legal entities within an economic group) and such a choice is typically determined based on market circumstances and strategic objectives of the group.[23]

22 https://www.business.gov.au/planning/business-structures-and-types/business-structures.
23 https://www.business.gov.au/planning/business-structures-and-types/business-structures.

35. The review of relevant material did not provide any evidence that suggests financial reporting requirements unduly influence the structures that businesses adopt. In relation to accounting standards, this is perhaps due to the fact that, from an accounting perspective, accounting standards typically look through the legal form of an entity to its economic substance and make it clear that business activities being carried on through branches, subsidiaries or various other structures does not absolve the group or management from its financial reporting obligations to meet the needs of users.

36. With the above background as context, paragraphs 37-56 summarise the current requirements for the preparation of financial statements applicable to parent/subsidiary corporate structures.

Current accounting requirements

37. Questions about the suitability of current accounting requirements applicable to the preparation of consolidated, parent and subsidiary financial statements, and the information they convey, are pertinent to this Report. Appendix B, summarised below, outlines those requirements.

38. Where parent/subsidiary relationships exist, as noted in paragraph 35, accounting standards tend to look through a legal structure and focus on the group as a single economic entity rather than the individual legal entities of which it is comprised. However, accounting standards do not entirely ignore information about individual legal entities in a group, as noted in the following discussion.

39. In relation to the broad accounting approach required to be adopted in financial statements (that is, consolidated financial statements or parent (unconsolidated) financial statements):

    (a) AASB 10 *Consolidated Financial Statements* applies to GPFS of parents that are reporting entities (whether ultimate or intermediate parents) and, with one exception and limited exemptions, requires a parent to prepare financial statements that consolidate subsidiaries and thereby depict the group as a single economic entity. The resulting financial statements are prepared principally from the entity's perspective rather than the owners' perspective (see the discussion in paragraphs B20-B28 of Appendix B below) – although the latter perspective is not completely ignored, for example in relation to the measurement and separate presentation of NCI as a component of equity; and

    (b) AASB 127 *Separate Financial Statements* also applies to GPFS of parents that are reporting entities (whether ultimate or intermediate), but only when a parent elects, or is required by local regulations, to present parent (unconsolidated) financial statements. They must be presented in addition to (not in lieu of) consolidated financial statements unless the parent is exempt from consolidation. AASB 127 provides a measurement choice – investments in subsidiaries are required to be accounted for at cost, in accordance with AASB 9 *Financial Instruments* (i.e. generally fair value) or using the equity method as described in AASB 128 *Investments in Associates and Joint Ventures*. In broad terms, in contrast to AASB 10, this requirement/choice is arguably more akin to preparing the financial statements from the owners' perspective because the financial statements recognise a single amount for the investment, representing only the owners' of the parent's share in the subsidiary rather than recognising the total assets, liabilities and equity of the subsidiary (including the share of any NCI therein).

40. The definition, recognition, measurement, presentation and disclosure requirements to be adopted in consolidated and parent (separate/unconsolidated) financial statements are specified in applicable accounting standards.

41. In relation to the pertinent disclosures in those complete sets of consolidated or parent (unconsolidated) financial statements:

    (a) AASB 12 *Disclosure of Interests in Other Entities*, expressed in high-level principle terms, applies to consolidated GPFS of parents (whether ultimate or intermediate) that are reporting entities prepared in accordance with AASB 10 and requires disclosure of information about interests in subsidiaries to enable users to evaluate the nature of, and risks associated with, those interests; and the effects of those interests on the reporting entity's financial position, financial performance and cash flows. Accordingly, AASB 12 incorporates information about separate legal entities into the consolidated financial statements. AASB 12 thereby acknowledges that legal boundaries could affect a parent's access to and use of assets and other resources of its subsidiaries such as due to restrictions on a parent's ability to access assets of its subsidiaries to settle liabilities of other entities within the group. However, disclosure of summarised financial information is only required of subsidiaries that have material NCI to the reporting entity.

    (b) AASB 124 *Related Party Disclosures* also applies to GPFS of parents (whether consolidated or unconsolidated) and bottom subsidiaries in a group (and entities that are not part of a group) that are reporting entities to ensure that "an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties" (paragraph 1 of AASB 124). Specifically, in relation to parent/subsidiary relationships, at a minimum AASB 124 requires such relationships to be disclosed in consolidated, parent and subsidiary financial statements irrespective of whether there have been transactions between them (paragraph 13 of AASB 124). Parents and subsidiaries are required to disclose related party transactions and balances, including commitments, in the parent and subsidiary financial statements – and therefore intra-group transactions and balances are disclosed in unconsolidated parent and subsidiary financial statements. Furthermore, in consolidated financial statements, under AASB 10, an investment entity might not be permitted to consolidate some subsidiaries, instead measuring an investment in subsidiary at fair value through profit and loss in accordance with AASB 9. Intra-group transactions and outstanding balances with non-consolidated subsidiaries are required to be disclosed in the investment entity's consolidated financial statements, because they are not eliminated on consolidation. In contrast, intra-group related party transactions and outstanding balances are not required to be disclosed in consolidated financial statements, as they are eliminated on consolidation.

42. In broad terms it seems that accounting requirements give primacy to the economic entity view (with only secondary regard to the legal entity view) and require financial statements to be prepared primarily from the entity's perspective (in contrast to the owners' perspective). This might cause some to express concern that user needs for information about individual legal entities within a group, whether from the entity's or owners' perspectives, are not adequately catered for – although other regulatory requirements might mitigate that concern, for example through the requirement specified in Regulation 2M.3.01 to disclose summary financial information about parent entities in the consolidated financial statements.

43. Within this context, paragraphs 44-56 below consider current legislative requirements and their interaction with accounting requirements to provide a basis for assessing whether together they lead to useful financial information of a parent entity and its subsidiaries that can be prepared and presented in a cost-effective way.

Current legislative requirements

44. Regulators of companies play an important role in the economy with the aim to facilitate and maintain a robust and sustainable commercial system. They do so by striving to balance the costs and benefits of regulation. Overtime, regulations have evolved to address issues pertinent to businesses that are structured as groups with parent/subsidiary relationships. In this regard, some regulations are directly related to financial reporting while others are only indirectly related but still throw some light on or have implications for financial reporting matters. Relevant different types of regulation are discussed in the sub-sections below.

Financial reporting regulations

45. The key legislative requirements relating to financial reporting under the Corporations Act are outlined in paragraphs C2-C9 of Appendix C of this Report along with a high-level diagrammatic representation at paragraph C26.

46. In summary, generally a parent is required to prepare consolidated financial statements as per accounting standards (AASB 10). The requirement to also prepare a complete set of unconsolidated financial statements (that comply with AASB 127) for such parents was removed in 2010 and replaced with a requirement to disclose only summary financial information about the parent in the consolidated financial statements.[24] However, Australian Financial Services (AFS) licensees and Australian Prudential Regulation Authority (APRA) regulated parents continue to be required to prepare both consolidated and unconsolidated financial statements, presumably due to the differences in the perceived nature of entities that AFS licensees are or those APRA regulates and the specific need to know what is legally available in those particular types of entities (in the event other assets in the group are not available).

47. Parents exempt from preparing consolidated financial statements under AASB 10 and bottom subsidiaries within a group (and entities that are not part of a group, which are outside the scope of this Report) must prepare complete sets of financial statements (the parent's are required to be unconsolidated and in accordance with AASB 127). With the exception of APRA regulated entities, ASIC further exempts certain wholly-owned subsidiaries from preparing and lodging audited financial statements if they have entered into a deed of cross guarantee with their parent, subject to certain conditions. This is on the basis that the deed of cross guarantee makes each party of a closed group jointly and severally liable for the debts incurred by each other.

Differences from NZ regulations

48. There are some fundamental differences between the above financial reporting requirements under the Australian Corporations Act 2001 and the NZ Companies Act 1993. In summary, those relevant to this Report are:[25]

    (a) **Ultimate parents:** In both NZ and Australia, ultimate parents are not required to prepare separate financial statements when consolidated financial statements are prepared. However in NZ, unlike in Australia, summary financial information about a parent is not required to be disclosed in the consolidated financial statements;

    (b) **Intermediate parents:** In NZ, unlike in Australia, intermediate parents are not required to prepare consolidated financial statements, separate financial statements or summary

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24 See paragraph C5 for a list of the summary information that is required to be disclosed. However, parent entities that wish to voluntarily prepare their complete set of separate financial statements in addition to consolidated financial statements are able to do so by adopting ASIC Class Order 10/654.

25 This is only a broad summary of the requirements for companies under the NZ Companies Act 1993. Each different type of entity is governed by its governing legislation. For example, exemptions for crown entities are set out in the Crown Entities Act 2004. The exemption for Financial Markets Conduct (FMC) reporting entities is set out in the Financial Markets Conduct Act 2013.

financial information when consolidated financial statements of a parent of the intermediate parent are prepared in accordance with NZ Companies Act 1993. In Australia, intermediate parents are required to prepare consolidated financial statements unless they meet the exemption criteria of paragraphs 4 and Aus4.1 of AASB 10. An intermediate parent may also be relieved from the requirement to prepare and lodge audited financial statements under Chapter 2M of the Corporations Act if they meet the conditions specified in ASIC Corporations (*Wholly-owned Companies*) Instrument 2016/785 and/or per ASIC Corporations (*Foreign-Controlled Company Reports*) Instrument 2017/204; and

(c) **Bottom subsidiaries in a group:** In NZ, unlike in many circumstances in Australia, bottom subsidiaries in a group are not required to prepare financial statements when consolidated financial statements of the group are prepared. Nor are consolidated financial statements required to disclose summary financial information about those subsidiaries.

49. The rationale for the approach in NZ, evident from the Commentary in the *Regulatory Systems (Commercial Matters) Amendment Bill* (which was the precursor to the 2017 Act of the same name), is to reduce compliance burdens. In particular, the first page of the Commentary states that the policy objective is to maintain the effectiveness and efficiency of the regulatory system and so reduce the chance of regulatory failure. It goes on to say "The amendments would achieve this objective by: … removing unnecessary compliance costs and costs of doing business."

50. Further details about the NZ requirements are outlined in Appendix G of this Report. Compared with Australia, NZ has given greater weight to reducing the financial reporting burden on preparers (or could be seen as consistent with a view that the Australian approach gives rise to information overload for users) – which differs from the preliminary indication we gleaned from our outreach to Australian users (see Appendices E and F below).

51. Australia should continue to monitor any implications of the NZ approach with a view to determining whether it would suit the Australian context, without unduly sacrificing user needs.

52. From the above description of Australian legislative requirements, it is evident that financial reporting regulations in Australia have evolved and arguably mitigate some concerns that accounting standards on their own do not pay adequate attention to user needs for financial information about individual legal entities within a group. However, questions still arise as to whether the summary financial information about a parent required to be disclosed in consolidated financial statements is an adequate substitute for a complete set of parent financial statements, and whether the relief from subsidiary financial statements where there

is a deed of cross guarantee provides sufficient information for users about subsidiaries. Before directly addressing these issues, the next sub-section discusses non-financial-reporting regulations that could have potential implications for financial reporting.

Non-financial-reporting regulations with potential implications for financial reporting

53. In addition to the regulations that are directly related to financial reporting discussed immediately above, as noted in paragraph 44, an understanding of regulations not directly related to financial reporting throw some light on how corporate groups are generally regarded by regulators (i.e. as a single economic entity or as separate legal entities), which might inform an assessment of financial reporting regulations for corporate groups. For example, it could be argued that such non-financial-reporting regulations should be considered in reviewing current financial reporting requirements.

54. Broadly, the outcome of the research undertaken for the purpose of this Report outlined in Appendix C highlights:

    (a) in relation to director's responsibilities (and minority shareholders' rights),[26] directors are required to act in the interests of the legal entity of which they are directors and understand the financial implications of their decisions at both the legal entity and group levels. Even though they must balance the interests of the legal entity and group as a whole, the regulations seem to put greater emphasis on the legal entity view. One of the possible reasons for this is to protect the interests of the minority shareholders of the legal entity;

    (b) in relation to related party transactions,[27] the regulations seem to emphasise a legal entity view, but have regard to the economic entity view;

    (c) in relation to insolvent trading by subsidiaries[28] and pooling arrangements in the event of liquidation,[29] regulations are broadly consistent with an economic entity view (because the parent may be held liable for debts incurred by the subsidiary in certain cases). In the case of pooling arrangements, each company in the group is taken to be jointly and severally liable for each debt payable by other companies in the group. (However, the pertinence of this item to this Report is limited, given the going concern

26 Section 181 of the Corporations Act requires directors to act in the best interest of the corporation and sections 232-233 provide rights to minority shareholders in cases where the affairs are conducted in an unfair manner.

27 Section 208 of the Corporations Act requires approval of a majority of shareholders not party to a contract for related party transactions.

28 Section 588V and 588W of the Corporations Act makes the parent liable for insolvent trading by a subsidiary.

29 Section 571 of the Corporations Act anticipates the liquidator making a pooling determination.

assumption (unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so) under paragraph 25 of AASB 101 Presentation of Financial Statements); and

(d) in relation to dividends,[30] regulations seem consistent with both a legal entity view and an economic entity view. Although the Corporations Act permits distribution of dividends on a solvency basis, the interaction with the *Taxation Administration Act 1953* effectively means payment of dividends is also dependent on the profit and net assets tests at the legal entity level and, in the case of a group, the ability to distribute dividends between companies within a group and ultimately outside the group is potentially dependent on the level of profits of each legal entity within the group.

55. Overall, the current non-financial-reporting regulations suggest that whether the economic entity view or the legal entity view has primacy is circumstance specific – but in many cases both views are relevant, albeit with one dominating the other in particular circumstances. However, in the context of protecting the interests of the minority shareholders and for determining what is legally available to lenders or creditors on insolvency (unless pooling arrangements are approved), the legal entity view assumes at least equal importance.

56. When taken as a whole, accounting requirements and regulatory (both financial and non-financial reporting) requirements broadly take an economic entity view, supplemented with some significant acknowledgements of the legal entity view, although there remains the potential to leave a shortfall of information for users if, for example, summary financial information about a parent is regarded as inadequate or where subsidiaries are subject to cross guarantees. The following section reports the outcome of research undertaken for the purpose of this Report into the needs of users and their views on the adequacy of current requirements in meeting those needs.

Findings from research into users' views

The relative merits of consolidated, parent and subsidiary financial statements for users

57. Paragraphs 58-61 summarise the outcome of a review of relevant material, undertaken for the purpose of this Report to identify the relative merits of the different types of financial statements (see Appendix D for more detail).

58. Consolidated financial statements present holistic financial information about a group. In contrast (but potentially complementarily) parent and subsidiary financial statements portray

30 Section 254T (1) of the Corporations Act prescribes conditions for declaring dividends.

the financial health and profitability of the respective parent or subsidiary, as legal entities separate from the rest of the group.

59. Parent and subsidiary financial statements are relevant to ascertain resources legally controlled by the parent and the subsidiary respectively. Such financial statements are typically more relevant for lenders such as banks who need to ascertain the loan servicing capacity of an individual (legal) borrower within the group and seek legal-entity specific information to make that assessment. However, the importance of consolidated financial statements should not be understated as they facilitate a broader understanding of the financial operations of the group and their implications for a subsidiary, for example, when the subsidiary has entered into a deed of cross guarantee with other group entities. Furthermore, since dividends from a legal entity are based on profit and net assets tests of that legal entity and the group underneath, consolidated financial statements are important. This may be especially so if a parent entity has no significant operations but has significant operating subsidiaries underneath.

60. From a director's perspective, since the directors need to understand the financial implications of their decisions at both the legal entity and group levels, consolidated financial statements and the parent and subsidiary financial statements all assume importance for them.

61. The findings from the review of relevant material reported in Appendices A (relating to business structures), B (relating to accounting standard requirements), C (relating to legislative regulatory requirements) and D (relating to the relative merits of consolidated, parent and subsidiary financial statements) and summarised above suggests that different sets of financial statements (consolidated, parent and subsidiary financial statements) – or at least financial information even if not complete sets of financial statements – are relevant to different or the same set of users depending on their information needs. There is no 'one size fits all' answer as to which type of financial statements/information would be more useful than another as it is circumstance based. Accordingly, the following two sub-sections consider the issues from the perspective of specific groups of users – lenders and investors/analysts.

Users – lenders

62. Based on the outcome of outreach undertaken for the purpose of this Report outlined in Appendix E (summarised here in paragraphs 63-65, it is apparent that the type of financial information used as input to decisions about lending to a parent or a subsidiary depends on specific circumstances.

63. Examples of factors that influence the need for complete sets of separate subsidiary or parent financial statements (and/or summary financial information thereon) and consolidated financial statements include risk grades, deeds of cross guarantee, debt subordination, group

structure, nature and operations of the borrowing entity, previous history of the borrower, current outstanding facilities, and the nature of the lending facility requested.

64. In relation to a subsidiary as the borrowing entity, in addition to consolidated financial statements, banks as lenders find the information in a subsidiary's complete set of financial statements useful as they need to understand to whom they are legally lending within the group, and to whose assets there is legal recourse in the case of default. That is, if banks have recourse to only the assets of the individual subsidiary to whom they are lending, then the individual financial statements of that subsidiary would be specifically required. Summary financial information in this case would not be an adequate substitute. It seems that this is often the case, even where there are cross guarantees. This indicates that lenders primarily rely on an assessment of the legal borrowing entity's loan servicing capacity, and regard an assessment of security/guarantees as a secondary lending strategy.

65. In relation to a parent as the borrowing entity, the feedback received from banks relating to parent (unconsolidated) financial statements is broadly consistent with that made about subsidiary financial statements. The outreach indicates that, in addition to consolidated financial statements, in some cases banks may find summary financial information about the parent sufficient and in other cases more details about the parent (even a complete set of financial statements) may be needed. It is apparent that non-disclosure of additional financial information about the parent (as is the case in NZ) would not be acceptable to lenders. However, the extent to which these views should influence any conclusions in this Report should be moderated by the point noted in paragraph 77 that lenders might have the ability to directly obtain the financial information they need.

Users - investors/analysts

66. Based on the outcome of outreach undertaken for the purpose of this Report outlined in Appendix F (summarised here), in contrast with banks as lenders, it is apparent that investors/analysts place significantly more reliance on consolidated financial statements, including the disclosures therein, whether their decisions are in relation to the parent or subsidiary entity.

67. In relation to parent entities, all twelve investors/analysts surveyed seem to be satisfied with the current requirement of disclosure of summary financial information about the parent in the consolidated financial statements and stated they do not need complete sets of parent financial statements for their decision making. Only one of the twelve expressed a need for additional summary financial information, for example, operating cash flow movements.

68. However, in relation to subsidiary financial statements, of the twelve investor/analyst respondents, only three stated they need complete sets of subsidiary financial statements for their decision making. Of the other nine:

(a) two stated that summary financial information about subsidiaries, similar to what is required for parents in consolidated financial statements, would suffice;

(b) five indicated that such summary information about subsidiaries would not be sufficient. They require more detailed financial information particularly for material subsidiaries with material NCI or where material subsidiaries have financial characteristics different from the group; and

(c) two mentioned they do not need subsidiary financial statements[31] for analysis purposes.

69. Overall, the investors/analysts surveyed indicated that the current requirements for disclosure of summary financial information about a parent are sufficient. The additional information they need about a subsidiary (or even a complete set of subsidiary financial statements) is circumstance specific. For example, the information needs of a significant proportion of the investors/analysts is affected by whether they are an investor in a parent or a subsidiary or whether there are cross guarantee arrangements between the group entities. The greatest need for information was particularly identified in relation to:

(a) material subsidiaries with material NCI and/or significant going concern issues;

(b) groups with international operations (particularly because of any tax implications or profit repatriation constraints) or subsidiaries with financial characteristics different from the group;

(c) significant intra-group transactions, and dividend traps or other factors that may impact dividend paying capacity such as retained earnings and profit reserves of subsidiaries; and

(d) whether other financial statements pertaining to group entities (including the group itself) exist and, where they do, cross-references to them.

70. To conclude, while our outreach to banks indicates they often give primacy to separate complete sets of financial statements of a parent and its subsidiaries depending on circumstances, consolidated financial statements remain relevant for them. Investors/analysts give primacy to consolidated financial statements and did not indicate a need for complete sets of parent financial statements. In light of the current disclosure requirements, investors/analysts continue to need complete sets of subsidiary financial statements. Some also indicated they need to know whether other financial statements pertaining to group entities (including the group itself) exist and, where they do, cross-references to them. Thus, the outreach results broadly support the findings from the

31 It was unclear from the survey whether they also did not need other subsidiary specific financial information.

review of relevant material outlined in paragraphs 58-61 that the relative importance of the different types of financial statements depends on the type of primary user (lender or investor/analyst) and their respective information needs. In weighing up the differences between banks and investors/analysts it is pertinent to note that often banks have a greater ability to directly obtain the information they need (as discussed more fully in paragraph 77).

Summary of the financial reporting environment

71. The above 'Overview of the financial reporting environment' for parent/subsidiary structures section outlining:

    (a) factors affecting business structures;

    (b) current accounting requirements;

    (c) current legislative requirements; and

    (d) findings from research into users' views,

    provides some support for the view that while, depending on circumstances, financial information about both the economic group and individual legal entities is relevant, the current regulations do not always result in sufficient information being provided in consolidated financial statements (particularly in relation to the individual legal entities, especially subsidiaries).

72. Despite the absence of an assessment in this Report of costs to preparers (as acknowledged in paragraph 17 above), the following table is an attempt to condense the possible 'gaps' between user needs (particularly those of investors/analysts) and current requirements (when accounting standards and other regulations are considered together) that can be deduced from the above discussion in respect of specific scenarios (in particular, where there is a cross guarantee and/or NCI). Given the nature of the table, some of the detail is lost, and therefore it should be treated with caution as a broad-brush, highly judgemental depiction highlighting the apparent differences, including where information shortfalls and overload might be.

Summary Table: Gaps between User Needs and Current Requirements

	User Needs			Current Requirements/Guidance					Cost to Preparer
Type of financial statements/information	Relative usefulness, based on review of relevant material reported in (Appendix D)	Empirical evidence of user needs undertaken for the purpose of this Report		Australia				NZ (Appendix G)	
		Banks as lenders (Appendix E)	Investors/analysts (Appendix F)	AAS requirements (Appendix B)	Financial regulations (Appendix C)				
					APRA	ASIC Reporting entity	ASIC Non-reporting entity (RG85)		
GROUP									
Cross guarantee									
Consolidated	✓✓✓✓	✓✓✓✓	✓✓✓✓	Yes, with some exemptions/ exceptions	Yes, if AASB 10	Yes, if AASB 10	No	Yes	?
No cross guarantee									
Consolidated	✓✓✓	✓✓✓✓	✓✓✓✓	Yes, with some exemptions/ exceptions	Yes, if AASB 10	Yes, if AASB 10	No	Yes	?
PARENT									
Cross guarantee			Q4						
Complete set unconsolidated	✓✓	✓✓ (Q7)	X (Q1)	No, unless choose AASB 127	Yes	No	Yes	No	?
Summary information	✓	✓ (Q7)	✓✓✓ (Q1)	No	No	Yes	No, NA	No	?
Other information	?	✓ (Q7)	✓ (Q1)	No	No	No	No, NA	No	?
No cross guarantee			Q4						
Complete set unconsolidated	✓✓	✓✓ (Q7)	X (Q1)	No, unless choose AASB 127	Yes	No	Yes	No	?

Summary information	✓	✓✓ (Q7)	✓✓✓ (Q1)	No	No	Yes	No, NA	No	?
Other information	?	✓ (Q7)	✓ (Q1)	No	No	No	No, NA	No	?
SUBSIDIARY (BOTTOM)									
Wholly owned									
Cross guarantee		Q5							?
Complete set	✓✓	✓✓ (Q1)	✓ (Q5)	Yes	Yes	No	No	No	?
Summary information	✓	✓ (Q1)	✓✓ (Q5)	No, NA	No, NA	No, NA	No, NA	No	?
Other information	?	✓✓ (Q2)	✓ (Q5,10,11)	Yes, AASB 12	Yes, AASB 12	Yes, AASB 12	No	No	
No cross guarantee		Q5							
Complete set	✓✓	✓✓✓(Q1)	✓ (Q5)	Yes	Yes	Yes	Yes	No	?
Summary information	✓	✓✓ (Q1)	✓✓ (Q5)	No, NA	No, NA	No, NA	No, NA	No	?
Other information	?	✓✓ (Q2)	✓ (Q5,10,11)	Yes, AASB 12	Yes, AASB 12	No	No	No	?
Partly owned									
Cross guarantee		Q5	Q4						?
Complete set	✓✓	✓✓ (Q1)	✓ (Q5)	Yes	Yes	Yes	Yes	No	?
Summary information	✓	✓ (Q1)	✓✓ (Q5)	No, NA	No, NA	No, NA	No, NA	No	?
Other information	?	✓✓ (Q2)	✓✓ (Q5,10,11)	Yes, AASB 12	Yes, AASB 12	No	No	No	?
No cross guarantee		Q5	Q4						?
Complete set	✓✓	✓✓✓ (Q1)	✓ (Q5)	Yes	Yes	Yes	Yes	No	?
Summary information	✓	✓✓ (Q1)	✓✓ (Q5)	No	No	No, NA	No, NA	No	?
Other information	?	✓✓ (Q2)	✓✓ (Q5,10,11)	Yes, AASB 12	Yes, AASB 12	No	No	No	?

This table summarises the gap between user information needs in relation to each of group, parent and subsidiary financial information and the information required to be disclosed by current standards and legislation (NZ requirements are shown for completeness, to provide another point of comparison). The information that users need is summarised based on a review of material that throws light on user needs (Appendix D), and outreach feedback from banks (Appendix E) and investors/analysts (Appendix F).

- Explanation of colour coding (only depicted in the first and ASIC columns because that regulator is the main focus of this Report and ASIC regulations effectively encapsulate accounting standards to the extent they require them to be applied):
    - Yellow = circumstances where it appears that the needs of at least some investors/analysts are greater than current requirements.
    - Blue = circumstances where it appears that current requirements could result in information overload for at least some investors/analysts.
- Explanation of symbols
    - ✓ = our assessment of the level of usefulness of such information to decision making, whereby the number of ticks indicates a rough indication only of how our review of relevant material and responses from banks and investors/analysts indicates the relative usefulness of the respective financial statements/information under different circumstances. It is very rough because:
        - the review of relevant material did not particularly focus on the effect of the existence of cross-guarantees, summary information vs complete sets of financial statements or the existence of NCI, but we have inferred their effect from some of the comments made in the material reviewed; and
        - of the limitations of the research methodology in consulting with banks and investors/analysts (as acknowledged in paragraphs E3-E11 and F2-F5, respectively). Furthermore, the survey of banks did not distinguish between the effect of NCI on their information needs, and despite some questions being asked about parents, no useful responses were received. Accordingly, given the nature of some of the responses, a high level of judgement has been used in making inferences.
    - X = no users (analysts/investors) indicated they would require or find such information useful for their decision making.

- ? = we were uncomfortable inferring anything from our research. It could be an area for further research.
- (Q) = the question number in the survey instruments sent to banks or investors/analysts (see Appendices E and F for details of the instruments).
- NA = not applicable, for example where a complete set of financial statements are prepared, disclosure of summary financial information extracted from such financial statements would not be applicable.

- In relation to the column reflecting the effect of accounting standards requirements on the information produced, not all nuances are reflected, for example, foreign entities.
- In relation to the column reflecting the effect of ASIC requirements, it omits details re foreign controlled companies (paragraphs C20-C24) and omits some nuances, for example a parent being able to choose between producing a complete set of parent financial statements or summary financial information (paragraphs C13 and C14).

73. With that background, the following section analyses each of the three issues that are the subject of this Report in turn, and includes preliminary recommendations for future action that could be taken.

Analysis of key issues

For-profit private sector

Issue 1: Parent (unconsolidated) financial reporting

74. The discussion above (supported by details in the Appendices) suggests that unconsolidated financial information about a parent is not needed by a significant cohort of users (investors/analysts). However, in contrast to the approach in NZ, we found no support for relieving a parent from at least providing summary financial information. There is a clear differentiation in need between lenders and investors/analysts: whilst some lenders prefer complete sets of parent financial statements they are often able to request the information they need as part of their lending arrangements; whereas investors/analysts, who are typically not in a position to demand information they need, generally indicated the current Corporations Act requirements are providing sufficient information.

75. Therefore, in relation to lenders, this Report provides some preliminary support for the findings of AASB Staff Paper *Relevance of parent entity financial reports* 2003, which states:

"Retain the requirement for full audited parent entity general purpose financial reports to be lodged with ASIC except for parent entities that:

(a) do not conduct substantive operations, including treasury operations;
(b) are not borrowing entities;
(c) are not single guarantors for the debt of one or more subsidiaries."
(paragraph 2 of section 7, 'Recommendations' of the AASB Staff Paper.)

76. However, based on the findings in relation to investors/analysts, there does not appear to be any compelling reason at this time to fundamentally review the current Corporations Act requirements.

77. In weighing up the relative needs of lenders and investors/analysts, as noted in paragraph 70, lenders can often obtain the information they need directly (as evident from their responses to question 3 [paragraph E24 re their ability to obtain GPFS rather than SPFS] and question 5 [paragraph E31 re their ability to obtain cross-guarantees] of the survey instrument). Accordingly, for the purposes of this Report, the needs of investors/analysts are considered to be more representative of the needs of general purpose users.

Issue 2: Subsidiary financial reporting

78. The importance of subsidiary financial statements is circumstance driven and dependent on the individual needs of different types of users. The presence or otherwise of cross guarantees or NCI is not necessarily a determining factor. However, it is apparent that if a subsidiary is an operating subsidiary i.e. carrying on business operations and not merely a pass through and/or is a borrowing entity, the subsidiary financial statements assume more importance.

79. The discussion above (supported by details in the Appendices) provides some support for the view that, in Australia, users need more financial information about subsidiaries disclosed in consolidated financial statements than is currently required to be provided, including financial information about: material subsidiaries with material NCI and/or significant going concern issues; international operations or where the financial characteristics of a subsidiary are different from the group; and significant intra-group transactions and dividend traps and other factors that might impact dividend paying capacity. Some also need to know whether other financial statements pertaining to group entities (including the group itself) exist and, where they do, those users need to see cross-references to them.

80. This indicates there is a need to review the current requirements in AASB 12 in relation to subsidiary financial information. If AASB 12 or the Corporations Act is amended to provide

the extra disclosures required by users in consolidated financial statements, it is recommended the relevant regulators reconsider the need for lodging subsidiary financial statements with the ASIC. Until then, in light of the current disclosure requirements, users continue to need complete sets of subsidiary financial statements. However, it is also possible there could be a benefit in Australia monitoring the NZ approach, with a view to considering whether there is any evidence of its suitability in the Australian context.

Issue 3: Disclosures to facilitate assessment of risks

81. A proper analysis of Issue 3 would require a detailed post-implementation review of the requirements of AASB 12 – which is outside the scope of this Report.

82. That being said, the following observations should be provided by the AASB to the IASB to assist in determining the scope of the post-implementation review of IFRS 12 (and consequently AASB 12):

    (a) IFRS 12/AASB 12 are expressed as a high-level principle, which might be too high to be effective in practice and therefore perhaps more application guidance is warranted;

    (b) IFRS 12/AASB 12 do not explicitly require consolidated financial statements to provide a cross-reference to parent and/or subsidiary financial statements, where they are presented physically separately; or a note to say they do not exist. Similarly, IAS 27/AASB 127 does not explicitly require, in all cases, a parent's unconsolidated financial statements to provide a cross-reference to consolidated and/or subsidiary financial statements, where they are presented physically separately; or a note to say they do not exist. (However, paragraph 16(a) of IAS 27/AASB 127 require a cross reference to a parent's own higher-level parent's consolidated financial statements when the lower-level parent is exempt under paragraph 4(a) of IAS 27/AASB 127 (and paragraphs Aus4.1 and Aus4.2 of AASB 10) from preparing consolidated financial statements and its unconsolidated financial statements (prepared in accordance with IAS 27/AASB 127) are the only financial statements prepared by it);

    (c) IFRS 12/AASB 12 require disclosure of summary financial information only about subsidiaries that have material NCI. Consideration could be given to expanding that to subsidiaries for which there is significant uncertainty regarding their ability to continue as a going concern or that would constitute dividend traps for group profits, or that are material to the operations of the group, have international operations (particularly because of any tax implications or profit repatriation constraints) or have financial characteristics different from the group; and

(d) there is a relationship between IFRS 12/AASB 12 and IAS 24/AASB 124 that could be further acknowledged and give rise to additional disclosure requirements. For example, currently intra-company (related party) transactions are eliminated on consolidation and therefore there is a lack of disclosure in consolidated financial statements of intra-group transactions that could pose significant risk to the group.[32]

Not-for-profit and public sector entities

83. The analysis above has focused on for-profit private sector corporate entities. The question arises as to whether there are any not-for-profit or public sector specific issues that also need to be addressed. As noted in paragraph 21, this Report does not consider that question in detail because it is the subject of other AASB documents.[33] However, for completeness, the following comments are made.

84. Accounting standards are developed by the AASB in a transaction neutral way, with sector specific issues addressed through 'Au's' paragraphs. In contrast, sector specific regulators do not necessarily take a transaction neutral approach. Indeed, as noted in AASB Research Report No.5, different regulators within the not-for-profit private sector (ACNC and the Office of the Registrar of Indigenous Corporations (ORIC)) adopt different approaches to group reporting and reporting thresholds.

85. The focus of the brief discussion in paragraphs 86-87 below is to broadly consider the extent to which the analysis of the issues throughout this Report could be relevant for the not-for-profit private and public sectors.

Not-for-profit private sector

86. In the context of parent/subsidiary relationships and their consequences for financial reporting by private sector not-for-profit entities, AASB Research Report No.5 identifies a number of issues that are pertinent in the context of this Report, including:

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32 This is a comment made in an article by Graham Holt in the July 2016 edition of the continuing professional development (CPD) technical update of the Association of Chartered Certified Accountants (ACCA) – https://www.accaglobal.com/an/en/member/discover/cpd-articles/corporate-reporting/holt-jul16.html.

33 As noted in paragraph 8 the financial reporting requirements applicable to charities and public sector entities are contained in AASB Research Report No.5 *Financial Reporting Requirements Applicable to Charities* and AASB Research Report No.6 *Financial Reporting Requirements Applicable to Public Sector Entities*, respectively. Further, as also noted in paragraph 8, AASB Discussion Paper: *Improving Financial Reporting for Australian Charities* and AASB Discussion Paper: *Improving Financial Reporting for Australian Public Sector* suggest possible options for improving the current framework applicable to charities and public sector entities, respectively, in light of criticisms regarding unnecessary complexity, inconsistent and uncertain requirements and financial reports not focused on the needs of their stakeholders.

(a) ACNC has discretion as to whether to allow joint or collective reporting by charities registered with it, which does not necessarily align with AASB 10's principle of control being used as the basis for circumscribing a group (see paragraph A1.14 of AASB Research Report No.5). Research Report No.5 notes that the effect of section 60.25 of *Australian Charities and Not-for-profits Commission Regulation 2013* is that group reporting as described by ACNC could usurp accounting standards (in particular AASB 10) (see the first footnote to paragraph A1.14 of that Report).[34]

(b) ACNC thresholds for triggering the level of reporting requirements are determined on an individual (registered) entity basis rather than on a consolidation (group) basis (see paragraph A1.18 of AASB Research Report No.5). This approach is more consistent with a legal entity view than an economic entity view and could result in reasonable public accountability expectations and obligations not being met. Furthermore, currently, as noted in Research Report No.5, different regulators adopt different criteria for determining the boundaries of entities for the purposes of applying financial reporting thresholds.

87. Based on the above, when the AASB and other regulators come to consider the financial reporting framework for not-for-profit private sector entities in the light of AASB Research Report No.5, further research is required to consider whether there is a need to align financial reporting requirements (both standards and regulations) arising from parent/subsidiary structures with the for-profit private sector and whether the differences can be justified on sector-specific grounds.

Public sector

88. Consistent with transaction neutrality, the discussion throughout this Report is pertinent to parent/subsidiary relationships in the public sector where the entities are separate legal entities. However, where public sector parent/subsidiary relationships arise from administrative structures (such as departments within a whole of government), they are in the nature of branches rather than 'subsidiaries' as that term is used in relation to the for-profit private corporate sector throughout this Report. Financial reporting issues that arise from the existence of branches (and how they relate to segment reporting or reporting by function or along accountability lines – including the reporting of 'administered items'

34 Despite this, to date ACNC has not approved a group report that excludes another registered charity that AASB 10 would require to be consolidated.

separately from 'controlled items') should be addressed in the context of AASB Research Report No.6 and is not considered further in this Report.[35]

Related observations

89. Whilst undertaking the research for this Report, the following related observations (including in relation to possible areas for further consideration) were made. Although some have been identified earlier in this Report, they are repeated here for completeness.

Suitability of current financial reporting requirements for parents, subsidiaries and groups

Issue	Consideration could be given to the following questions
Parent (unconsolidated) financial reporting	1. Should the nature and characteristics of a parent or the group influence whether or not a parent should be required to prepare a complete set of financial statements or summary financial information or nothing, and if so which characteristics should have an influence? (See paragraphs C2-C9) 2. If a decision is made to broadly retain the current requirements: a. should the summary financial information about the parent currently required to be disclosed in consolidated financial statements be broadened or narrowed? If so, how? (See paragraphs E18-E23 and F7) b. to remove doubt, should accounting standards/legislation be amended to explicitly clarify that the accounting policies reflected in the summary financial information about the parent are required to be consistent with the policies adopted in the consolidated financial statements? (See paragraph C7)

35 Paragraph 25 of Research Report No.6 states "The departments however, have a similar construct to branches used by private sector entities – rather than separate stand-alone entities – since they perform functions as instructed by the relevant government." Paragraphs 60-62 of that Report go on to state that:
(a) the requirement to distinguish administered (i.e. transactions managed on behalf of another entity of government, such as the Australian Taxation Office collecting tax on behalf of Treasury) versus controlled transaction items for departments is a unique financial reporting disclosure to Australia;
(b) there are no IFRS Standards or IPSASB Standards dealing specifically with administered items; and
(c) there is no academic research to support that users of government department financial reporting require a distinction between administered and controlled items.

	c. should the detailed list of summary financial information about a parent required to be disclosed in consolidated financial statements, currently specified in Regulation 2M.3.01 of the Corporations Regulations, be relocated from the regulations into accounting standards? (See paragraph C6)
Subsidiary financial reporting	1. To what extent should the existence of a deed of cross guarantee that encompasses a subsidiary and its own subsidiaries (if any) and parent, or the presence of NCI, influence the nature of subsidiary financial reporting requirements? (See for example paragraphs F11 and F21) 2. If summary financial information about a subsidiary in the consolidated financial statements would suffice and therefore replace the current requirement for the preparation of complete sets of subsidiary financial statements: a. what information should be required? Should it be similar to that currently specified in Regulation 2M.3.01 for parents? (See paragraphs E18-E23 and F14) b. on what basis should the amounts be determined i.e. based on amounts that would be included in the subsidiary’s own financial statements or amounts included in the consolidated financial statements of the ultimate (Australian) or any intermediate parent in which the summary note is included? (See paragraphs E28-E30) c. should it be required to be disclosed only in the ultimate (Australian) or any intermediate parent’s consolidated financial statements or both or elsewhere? d. should the detailed list of summary financial information be specified in accounting standards or in regulations? (See paragraph C6, albeit discussed in the context of summary financial information about the parent) 3. Should the list of specific disclosures currently required by *ASIC Corporations (Wholly-owned Companies) Instrument 2016/785* relating to a subsidiary in consolidated financial statements be relocated from the regulations into accounting standards? (See

	paragraph C6, albeit discussed in the context of summary information about the parent)
Group financial reporting	1. To remove doubt, should accounting standards be amended to explicitly clarify that a parent that is exempt from consolidation under AASB 10 but elects to produce consolidated financial statements must do so in a manner that is consistent with the principles in accounting standards and regulations? (See paragraph C9) 2. Are current requirements for the determination of the amount to be recognised for NCI in consolidated financial statements clear and applied consistently in practice; and is the resulting information useful to users? (See paragraphs B30-B33)
Disclosures in consolidated financial statements	1. Are the disclosure requirements in AASB 12 expressed at too high a principle level to be effective in practice and therefore is additional application guidance warranted? (See paragraphs 82(a) and B45-B51) 2. Should AASB 12 be amended to require cross-references between consolidated, parent and subsidiary financial statements – where they exist (and, if not, a statement to that effect) – to help users determine what financial information about entities within a group is available? (See paragraphs 65(d) and 82(b), and F25) 3. Should AASB 12 be amended to require disclosure of summary financial information about not only partially-owned subsidiaries that have material NCI but also about any subsidiaries that are material to the group, have significant going concern issues, that represent dividend traps for group profits or have financial characteristics different from the group? (See paragraph 82(c)) 4. Given the relationship between AASB 12 and AASB 124, (e.g. intra-group (related-party) transactions are eliminated on consolidation), does the lack of disclosure of intra-group transactions in consolidated financial statements mean that users are not adequately informed of significant risks to the group from the current corporate structure? (See paragraph 82(d))

Other sectors

90. Consistent with the AASB's transaction neutrality policy, despite this Report's focus on reporting entities in the for-profit private corporate sector, the recommendations and related observations in this Report might also be relevant to the not-for-profit and public sectors. Accordingly, these sectors should be considered as part of any work being undertaken to review the financial reporting framework applicable to them, as listed in the following table.

Sector	AASB research to date
Not-for-profit private	AASB Research Report No 5 *Financial Reporting Requirements Applicable to Charities* (October 2017) and AASB Discussion Paper *Improving Financial Reporting for Australian Charities* (November 2017)
Public	AASB Research Report No 6 *Financial Reporting Requirements Applicable to Public Sector Entities* (May 2018) and AASB Discussion Paper *Improving Financial Reporting for Australian Public Sector* (June 2018), including questions surrounding reporting by government departments and whether they are in the nature of subsidiaries or branches.

Further research

91. Because this Report presents recommendations in relation to the three issues noted above based on limited feedback from lenders and investors/analysts and consideration of the regulatory approach in NZ, further research could be undertaken into:

- the views of a wider range of users;
- the views of preparers, including explicitly asking whether they think current financial reporting requirements unduly influence business structuring (e.g. branch vs subsidiary) decisions;
- the extent to which entities have elected to prepare parent financial statements in addition to consolidated financial statements as an alternative to summary parent information in accordance with ASIC Class Order 10/654 re Parent entity financial statements (see paragraphs C13 and C14);
- the entity vs proprietary perspectives of financial reporting (see paragraphs B20-B29); and
- approaches adopted in other comparable international jurisdictions, to identify if they may be suitable in an Australian context. In particular, consideration could be given to:

- as noted in the recommendations above, monitoring the effectiveness of the NZ financial reporting regulatory approach. (Appendix G notes that the NZ approach is significantly less onerous than the Australian approach, apparently giving greater weight to reducing the financial reporting burden on preparers or perceived information overload for users);[36] and
- whether the approach in the NZ *Companies Act* allowing directors to act in the best interest of the holding company where NCI are present would be appropriate in an Australian context.

36 There are no current plans in NZ to undertake a post-implementation review of its regulations.

Appendix A

Factors affecting business structures and their consequences for financial reporting

A1. The manner in which an entity is structured has implications for its financial reporting requirements. This is particularly so from a regulatory perspective rather than from an accounting standards perspective because, consistent with user needs, accounting standards typically look through the legal form of an entity to its economic substance.

A2. In the context of this Report, a question arises as to whether regulatory requirements and accounting standards have an undue (and therefore economically inefficient) influence on the choice of business structure. It is reasonable to conclude that regulations and accounting standards should be reviewed if they are unduly influencing business structures and therefore distorting economic behaviour.

A3. On that basis, this Appendix briefly considers the common types of business structures and the typical factors that lead to their adoption in practice, and whether there is any evidence to suggest that behaviour is being distorted.

A4. In Australia, at a broad level, the four most common types of for-profit business structures are sole trader, partnership, trust and company[37]. Each of these structures has different legal attributes. The key considerations that drive their adoption in practice include[38]:

(a) Decision making authority and degree of control

(b) Limited liability or otherwise

(c) Cost and complexity of formation and compliance

(d) Sharing of profits

(e) Tax considerations.

A5. Of further relevance to this Report is how activities might be structured within a business – for example whether as branches within a single legal structure or parent/subsidiaries as separate legal entities within an economic group. From the literature it is apparent such choices are primarily driven by market circumstances and the strategic objectives of the business. For example, foreign companies establishing a business presence in Australia

37 https://www.business.gov.au/info/plan-and-start/start-your-business/business-structure.
38 http://www.entrepreneurshipinabox.com/11271/7-factors-legal-structure-business/
https://www.bmgaccountants.com.au/business-structure/.

may establish or acquire an Australian subsidiary company and carry on business in the name of that Australian company or establish a branch office of a foreign company and carry on business in the name of that foreign company.

A6. Accounting standards make it clear that whether business activities are carried on through different branches, subsidiaries or various other structures does not absolve the group or management from its financial reporting obligations to provide useful information to users. For example, the international accounting standards (and consequently the corresponding AAS) on consolidation IAS 27 *Consolidated and Separate Financial Statements* and SIC 12 *Consolidation – Special Purpose Entities* were superseded by IFRS 10 *Consolidated Financial Statements* (effective from 1 January 2013) to overcome inconsistent application of the concept of control and thus entities not consolidating their interests in special purpose vehicles (as per paragraph BC3 of the Basis for Conclusions on IFRS 10).

A7. From the list in paragraph A4 above, the reference to 'compliance' in the third dot point suggests that financial reporting requirements could have some influence on the choice of legal structure and the structuring of business activities (e.g. branches versus subsidiaries, if the financial reporting regulations on parent/subsidiary relationships are more onerous and complex than those imposed on businesses operated only through branches). The more onerous reporting requirements reflect the fact that the benefits of certain structures such as companies, which have access to public fund raising avenues and limited liability, comes with associated proportionate obligations such as enhanced financial reporting requirements. However, the review of relevant material undertaken for the purpose of this Appendix did not provide any evidence that suggests that financial reporting requirements unduly influence the structures that businesses might choose.

A8. Despite that, parent-subsidiary structures raise the question of whether financial reporting should be required to be on a consolidated or individual entity basis or whether both bases should be required to best meet user needs, whilst balancing the financial reporting costs. As noted in Appendix D, there are different perspectives and levels of usefulness that each of the different types of financial statements (i.e. consolidated financial statements, parent financial statements and subsidiary financial statements) – or at least financial information if not complete sets of financial statements – bring to their respective users.

Appendix B

Current accounting requirements

B1. This Appendix outlines the current accounting requirements relating to consolidated, parent and subsidiary financial reporting that are pertinent to this Report. As noted in paragraph 15 above, although this Report does not address the suitability of current accounting requirements relating to consolidated financial statements except some issues relating to disclosures and information about NCI. Current accounting requirements are outlined in this Appendix to a provide a context for addressing whether the current requirements relating to parent and subsidiary financial information are suitable.

General Purpose Financial Statements (GPFS)

B2. Consistent with paragraph 40 of SAC 1, Appendix A of AASB 1053 *Application of Tiers of Australian Accounting Standards* defines a reporting entity 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."[39] Paragraph 32 of SAC 1 explains further and states, "The focus on user needs as the basis for determining the existence of a reporting entity implies that the fact that an economic entity (for example, a corporate group or a government) may be a reporting entity does not affect whether the controlling entity or any of the controlled entities are reporting entities in their own right". Paragraph 27 of SAC 1 notes there will exist some entities that will not be regarded as reporting entities, but form part of an economic entity that is a reporting entity (for example in the case of wholly owned subsidiaries of such a size or with economic characteristics that mean users are not interested in the subsidiary financial statements – but they may be interested in the collective information about the group. AASB 1053 defines GPFS as "those 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."[40]

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39 Paragraph Aus7.2 of AASB 101 *Presentation of Financial Statements* states that, in respect of public sector entities, local governments, governments and most, if not all, government departments are reporting entities.

40 Paragraph 3.10 of the IASB's revised Conceptual Framework creates a new definition of reporting entity: "…an entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity." In other words, according to the IASB's revised Conceptual Framework, an entity that is required by legislation or otherwise to prepare financial statements is a reporting entity and the financial statements of such reporting entities could differ based on the 'boundary' of economic activities included in their financial statements (i.e. a reporting entity's financial statements could be consolidated financial statements, single entity financial

B3. AASB 1057 *Application of Australian Accounting Standards* specifies the types of entities and financial statements to which AAS apply. Its main requirement is that reporting entities prepare GPFS in accordance with AAS.

B4. AASB 1053 introduces two tiers of reporting requirements for GPFS:

(a) Tier 1 covers AAS incorporating International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) and includes requirements that are specific to Australian entities; and

(b) Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1[41] but substantially reduced disclosure requirements.

B5. AASB 1053 also introduces the concept of 'public accountability'[42] and requires all for-profit private sector entities that have 'public accountability' to comply with Tier 1 reporting requirements.[43] Other 'reporting entities' are required to comply with Tier 2 reporting requirements. (However, these entities may elect to apply Tier 1 instead of Tier 2 reporting requirements in preparing GPFS).

B6. Although the focus of accounting standards is on GPFS and reporting entities (as is this Report), a handful of standards explicitly apply beyond reporting entities, and therefore to

statements or part of an entity's financial statements). This is fundamentally different from the current definition of reporting entity in Australia, where a reporting entity (as per SAC 1) is an entity that is required to prepare GPFS and an entity that is not a reporting entity (i.e. non-reporting entity) can choose to prepare SPFS. Refer to AASB ED 297 *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (issued 15 August 2019 and open for comment until 30 November 2019 for details.

41 Except for the presentation of a third statement of financial position as per AASB 101 (paragraph 10(f)), which is applicable for Tier 1 only. AASB ED 295 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (issued 1 August 2019 and open for comments until 30 November 2019 is seeking comments on the proposed new framework.

42 Appendix A of AASB 1053 defines 'public accountability' as accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs. It goes on to state that a for-profit private sector entity has public accountability if:

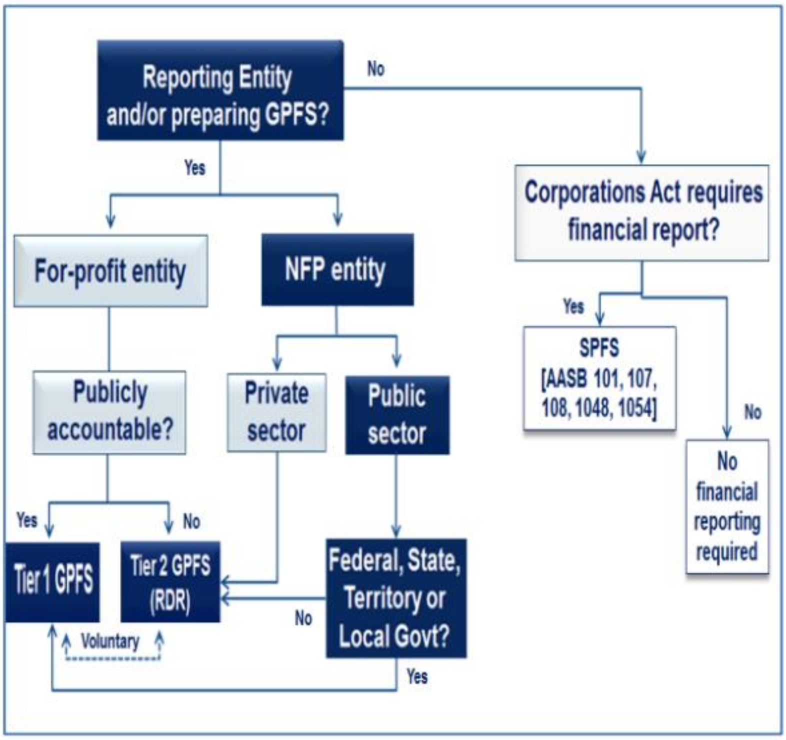
(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

43 Paragraph 11 of AASB 1053 further requires Tier 1 reporting requirements be applied by the Australian Government and State, Territory and Local Governments.

SPFS (i.e. they also apply to non-reporting entities that are required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act) .[44]

B7. The above requirements are summarised in the following diagram:



Souce: AASB's Invitation to Comment (ITC) 39, Consultation Paper *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems*

Preparation of consolidated financial statements

B8. As noted in paragraph B2 above, AASB 1053 and SAC 1 define 'reporting entity'. Both AASB 1053 and SAC 1 circumscribe the boundaries of a reporting entity using the concept of control, which, in relation to groups of entities, is given effect through AASB 10 *Consolidated Financial Statements*. Paragraph 6 of AASB 10 states that "an investor controls an investee, when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its

44 As per Paragraph 7(a) of AASB 1057: AASB 101 *Presentation of Financial Statements*, AASB 107 *Statement of Cash Flows*, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, AASB 1048 *Interpretation of Standards* and AASB 1054 *Australian Additional Disclosures* apply to each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act, irrespective of whether it is a reporting entity.

power over the investee".[45] Further, Appendix A of AASB 10 defines 'consolidated financial statements' as "the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity." (Also see footnote at the end of paragraph B2 above).

B9. Except as explained in paragraphs B10-B18 below, AASB10 requires a Tier 1 or Tier 2 reporting entity that is a parent (an entity that controls one or more entities (subsidiaries)) to present consolidated financial statements.

Exception from preparing consolidated financial statements

B10. AASB 10 does not permit consolidation of subsidiaries by some parents. In particular, paragraphs 31-33 of AASB 10 require a parent that is an 'investment entity'[46] to measure its investment in a subsidiary at fair value through profit or loss as per AASB 9 *Financial Instruments* rather than account for it on a consolidation (ie line-by-line) basis. The rationale for this exception is provided in paragraphs BCZ15 to BCZ17 of the Basis for Conclusions on IFRS 10. It is evident from that Basis for Conclusions the IASB concluded that, since an investment entity holds investments for the sole purpose of capital appreciation, investment income or both, the information regarding the fair value of the investments (and an understanding of how the investment entity measures the fair value of its investments) is more useful than consolidated information to its users.

Exemptions from preparing consolidated financial statements

B11. Paragraph 4(a) of AASB 10 exempts a parent that is a reporting entity from the preparation of consolidated financial statements provided all the following conditions are met:

(a) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

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45 The notion of control is formally defined in Appendix A of AASB 10.

46 Appendix A of AASB 10 defines 'investment entity' as "An entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis."

(b) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(c) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(d) its ultimate or any intermediate parent produces financial statements that are available for public use and comply with IFRSs,[47] in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with AASB 10.

B12. In addition, in relation to not-for-profit and Tier 2 reporting entities, paragraph Aus4.1 of AASB 10 specifies:

> "Notwithstanding paragraph 4(a)(iv), a parent that meets the criteria in paragraphs 4(a)(i), 4(a)(ii) and 4(a)(iii) need not present consolidated financial statements if its ultimate or any intermediate parent produces financial statements that are available for public use in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Standard and:
>
> (a) the parent and its ultimate or intermediate parent are:
> (i) both not-for-profit entities complying with Australian Accounting Standards; or
> (ii) both entities complying with Australian Accounting Standards – Reduced Disclosure Requirements; or
>
> (b) the parent is an entity complying with Australian Accounting Standards – Reduced Disclosure Requirements and its ultimate or intermediate parent is a not-for-profit entity complying with Australian Accounting Standards."

B13. However, in relation to circumstances where there is an ultimate foreign entity, paragraph Aus4.2 of AASB 10 specifies:

> "Notwithstanding paragraphs 4(a) and Aus4.1, the ultimate Australian parent shall present consolidated financial statements that consolidate its investments in subsidiaries in accordance with this Standard when either the parent or the group is a

47 It is notable that compliance with IFRSs does not necessarily imply full compliance with the AAS e.g. even with full compliance with IFRSs it is conceivable that an entity may not have complied with AASB 1054 *Australian Additional Disclosures*. However, the exemption provided through paragraph 4(a)(iv) of AASB 10 is consistent with a view that maintaining international comparability through IFRS compliance is the most important.

reporting entity or both the parent and the group are reporting entities, except if the ultimate Australian parent is required, in accordance with paragraph 31 of this Standard, to measure all of its subsidiaries at fair value through profit or loss."

B14. Private sector for-profit Tier 1 entities that meet the definition of public accountability are unlikely to satisfy the criteria of paragraph 4(a) of AASB 10 exemption because their debt or equity instruments are traded in a public market. In contrast, many Tier 2 private sector for-profit entities would be expected to qualify for the exemption.

B15. The rationale for the exemptions in paragraph 4(a) of AASB 10 is provided in paragraphs BCZ12-BCZ18 of the IASB's Basis for Conclusions on IFRS 10. In summary, while amending IAS 27 Consolidated Financial Statements and Accounting for Investments in Subsidiaries in 2003, the IASB retained the consolidation exemption that was in the superseded 2000 version of the then IAS 27 for a parent that is itself a wholly owned subsidiary. The IASB decided to retain that exemption, with conditions, so that entities within a group that are required by law to produce financial statements available for public use in accordance with IFRSs, in addition to consolidated financial statements, would not be unduly burdened (paragraph BCZ13[48]). The IASB also noted in paragraph BCZ14 that "in some circumstances users can find sufficient information for their purposes about a subsidiary from either its separate financial statements or the consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can get access to, more information". Further, the IASB granted the exemption to partially owned subsidiaries while restricting the exemption to such subsidiaries when the NCI have been informed about, and do not object to, consolidated financial statements not being presented (this condition protects NCI, who otherwise lack the power to determine the accounting policies adopted in the preparation of the entity's financial statements).

B16. Regarding the exemption specified in paragraph 4(a)(ii) and (iii) of AASB 10, the IASB believed that the information needs of users of financial statements of entities whose debt or equity instruments are traded in a public market were best served when investments in subsidiaries[49] were accounted for on a consolidated basis – although, the IASB did not provide an explicit basis for its belief. Therefore, the IASB decided that the

48 "The Board decided to retain an exemption, so that entities in a group that are required by law to produce financial statements available for public use in accordance with International Financial Reporting Standards, in addition to consolidated financial statements, would not be unduly burdened."

49 Similarly, for investments in joint ventures and associates respectively, the IASB believed that the information needs of users of financial statements of entities whose debt or equity instruments are traded in a public market were best served when such investments are accounted for as per IAS 28 *Investments in Associates and Joint Ventures*.

exemption from preparing consolidated financial statements should not be available to such entities or to entities in the process of issuing instruments in a public market.

B17. The rationale for the exemptions in paragraph Aus4.1 relating to not-for-profit entities and entities complying with Tier 2 AAS – Reduced Disclosure Requirements is effectively an extension of the rationale for the similar exemptions contained in paragraph 4(a) of AASB 10 (described in paragraph B14 above). Paragraph Aus4.1 was considered necessary by the AASB because the addition of Aus paragraphs for not-for-profit entities in IFRSs as adopted in AAS, and the adoption of Tier 2, may, and would, respectively, cause the financial statements of some entities applying AAS to be non-IFRS-compliant. The AASB concluded that financial statement users would be able to satisfy their information needs through the consolidated financial statements prepared by the parent higher up in the group, and therefore being non-IFRS-compliant should not preclude a not-for-profit entity or Tier 2 complier from the exemption in paragraph 4(a) of AASB 10 from having to prepare consolidated financial statements (paragraphs BC3, BC11, BC14, BC15 and BC20 of the AASB's Basis for Conclusions on AASB 10[50]).

B18. Paragraph Aus4.2 limits the exemption in paragraph 4.2(a) of AASB 10 and states that in cases where the ultimate parent is a foreign entity, even if all other criteria (as listed in paragraphs 4(a)(i)-(iv) and Aus4.1) are met, the ultimate Australian parent is required to present consolidated financial statements. This is presumably in the context of maintaining the Australian public interest.

B19. From the discussion in paragraphs B8-B17, it is apparent that accounting standards emphasise an economic entity view whilst acknowledging some aspects of a legal entity view of a corporate structure. Within that context, it might also be informative to explore more deeply what the nature of that economic entity view is. From the literature it is apparent that consolidated financial statements could be prepared from an entity perspective, the owners' (proprietary) perspective or an amalgam of the two perspectives. The difference in perspectives is particularly pertinent where there are NCI in subsidiaries. The perspective taken affects the type of information provided to users and is therefore relevant to a determination of the extent to which user needs are currently being met. Paragraphs B20-B28 explore the extent to which accounting standards explicitly or implicitly take an entity or proprietary perspective.

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50 Published as the AASB's Basis for Conclusions on Amending Standards AASB 2011-5 *Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation* and AASB 2011-6 Amendments to Australian Accounting Standards – *Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation – Reduced Disclosure Requirement*.

The financial reporting perspective: entity vs proprietary

B20. A review of the literature suggests there is a spectrum of perspectives that could be taken, from a pure adoption of the entity perspective to a pure adoption of the proprietary perspective. In descending order, for illustrative purposes, the spectrum could be represented by the following six points:

(a) **PURE ENTITY PERSPECTIVE:** Full consolidation, with no distinction between liabilities and equities because, from the entity's perspective all claims on the assets of the entity are liabilities. Under this treatment, even if a parent has only an 80% controlling stake in a subsidiary, the group financial statements would reflect 100% of the assets because they are effectively controlled by the entity, with 100% of the owners' interest reflected as a liability because the entity 'owes' those owners;

(b) Full consolidation, with liabilities and equities classified as separate elements of financial statements but no distinction made (even at a disclosure level) between controlling and non-controlling ownership interests, which are all classified as equity. Under this treatment, even if a parent has only an 80% controlling stake in a subsidiary, the group financial statements would reflect 100% of the assets because they are effectively controlled by the entity, with 100% of the owners' interest reflected as a single equity item;

(c) **PRESCRIBED BY ACCOUNTING STANDARDS:** Full consolidation, with liabilities and equities classified as separate elements of financial statements, and separate presentation and disclosure of controlling and non-controlling ownership interests (both categories of which are included in equity) [the current treatment in AASB 10 and AASB 101]. Under this treatment, even if a parent has only an 80% controlling stake in a subsidiary, the group financial statements would reflect 100% of the assets because they are effectively controlled by the entity, with equity comprising 80% of the controlling (parent's) interest presented separately from the 20% non-controlling interest;

(d) Full consolidation, with liabilities and equities classified as separate elements of financial statements, controlling ownership interests classified as equity and non-controlling ownership interests presented separately from equity and liabilities [the treatment in IAS 1 before the Improvements Project amendments issued by the IASB in December 2003, which were incorporated in Australia's initial full adoption of IFRSs from 2005 onward (in AASB 101 and then AASB 127)]. Under this treatment, even if a parent has only an 80% controlling stake in a subsidiary, the group financial statements would reflect 100% of the assets because they are effectively controlled by the entity, with equity comprising only 80% of the controlling (parent's) interest.

The 20% non-controlling interest would be presented as a mezzanine item, between liabilities and equity;

(e) Full consolidation, with liabilities and equities identified as separate elements of financial statements, controlling ownership interests classified as equity interests and non-controlling ownership interests classified as liabilities. Under this treatment, even if a parent has only an 80% controlling stake in a subsidiary, the financial statements of the subsidiary would reflect 100% of the assets because they are effectively controlled by the entity, with equity comprising only 80% of the controlling (parent's) interest (reflecting the parent only has an 80% interest in the assets). The 20% non-controlling interest would be presented as a liability because, from the parent's perspective it 'owes' the non-controlling interest 20% share of the assets effectively controlled by the parent; and

(f) **PURE PROPRIETARY PERSPECTIVE:** Partial (also referred to as proportionate) consolidation, with liabilities and equities identified as separate elements of financial statements and non-controlling ownership interests excluded altogether from the credit side of the consolidated statement of financial position. Under this treatment, if a parent has only an 80% controlling stake in a subsidiary, the financial statements of the 'group' would reflect only 80% of the assets and liabilities, even though 100% of the assets are controlled. Equity would also comprise only 80%, being the parent's interest. The 20% non-controlling interest would be ignored because, from the parent's perspective the non-controlling interest in 20% of the assets and liabilities have been excluded. This is akin to the accounting under AASB 127, although under that Standard the parent's interest in the subsidiary is reflected in a single line asset item 'investment in subsidiary'.

B21. The IASB recently stated that it adopts the 'entity' perspective in its revised Conceptual Framework. In particular, it states in paragraph 3.8 that "Financial statements provide information about transactions and other events viewed from the perspective of the reporting entity as a whole, not from the perspective of any particular group of the entity's existing or potential investors, lenders or other creditors." In this regard, paragraph BC3.9 of the IASB's Basis for Conclusions on its revised Conceptual Framework states "… This reflects the Board's view that the reporting entity is separate from its investors, lenders and other creditors…" Similarly, as per paragraph 1.12 of the IASB's revised Conceptual Framework, "General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's economic resources and the claims against the reporting entity." Thus such information is not limited to economic resources and claims attributable to the reporting entity's parent.

B22. Paragraph BC3.10 of the IASB's Basis for Conclusions on its revised Conceptual Framework goes on to state:

> "The Board adopted the entity perspective because it is consistent with the objective of general purpose financial reporting … This objective is to provide useful information to existing and potential investors, lenders and other creditors rather than to provide information to a particular subset of those capital providers. If information were to be directed towards the needs of a particular subset of primary users, it might be necessary to provide different sets of financial statements for each subset. That could cause confusion and undermine confidence in financial reporting…"

B23. In addition, paragraph BC1.8 of the IASB's Basis for Conclusions on its revised Conceptual Framework explains that "Some respondents to the 2008 Exposure Draft said that the reporting entity is not separate from its equity investors or a subset of those equity investors. This view has its roots in the days when most businesses were sole proprietorships and partnerships that were managed by their owners who had unlimited liability for the debts incurred in the course of the business. Over time, the separation between businesses and their owners has grown. The vast majority of today's businesses have legal substance separate from their owners by virtue of their legal form of organization, numerous investors with limited legal liability and professional managers separate from the owners. Consequently, the Board concluded that financial reports should reflect that separation by accounting for the entity (and its economic resources and claims) rather than its primary users and their interests in the reporting entity."

B24. The IASB's adoption of the entity perspective over a proprietary perspective is also apparent from the amendments to IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* incorporated in IAS 27 *Consolidated and Separate Financial Statements* in 2003 when the IASB required NCI (ie non-controlling ownership interests) to be presented in the consolidated statement of financial position within equity. The previous version of IAS 27 (issued by the International Accounting Standards Committee) precluded presentation of NCI within liabilities, but did not require presentation of NCI within equity.[51] In effect, NCI had been permitted to be presented as, effectively, a 'mezzanine' element between liabilities and equity. Similarly, the January 2008 amendment of IAS 27 *Consolidated and Separate Financial Statements*, to require

51 Paragraph IN12 of the Introduction to the 2004 version of IAS 27 "This Standard requires an entity to present minority interests in the consolidated balance sheet within equity, separately from the parent shareholders' equity. Though the previous version of IAS 27 precluded presentation of minority interests within liabilities, it did not require presentation within equity."

attributing the minority interest’s share of a subsidiary’s losses to the NCI even if doing so results in those interests having a deficit balance (instead of the preceding version’s requirement to attribute the NCI share of losses to the majority interest to the extent that this share of losses exceeds the minority interest) is another example of the IASB preferring the entity perspective to the proprietary perspective.

B25. Similarly, as explained in paragraph BCZ168 of the IASB’s Basis for Conclusions on those amendments (included now in the IASB’s Basis for Conclusions on IFRS 10): “The Board decided that after control of an entity is obtained, changes in a parent’s ownership interest that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners). This means that no gain or loss from these changes should be recognized in profit or loss. …”. In substance, the IASB adopted an entity perspective in this decision. Pertinent features of an entity perspective are that changes in an entity’s capital are not part of the entity’s operations, and an entity cannot gain or lose in transactions with owners acting in their capacity as owners.

B26. However, there are some requirements in current accounting standards that appear to acknowledge and accommodate aspects of a proprietary perspective. For example, AASB 101 *Presentation of Financial Statements* requires:

(a) separate presentation of the amounts of profit or loss and comprehensive income for the period attributable to a) owners of the parent and b) non-controlling interests (paragraphs 81B(a) and (b) of AASB 101 and paragraph B94 of AASB 10);

(b) separate presentation of NCI within equity (paragraph 54(q) of AASB 101 and paragraph 22 of AASB 10)); and

(c) presentation of earnings per share attributable to the ordinary equity holders of the parent entity (paragraph 66 of AASB 133 *Earnings per Share*).

B27. Furthermore, arguably, aspects of a proprietary perspective was adopted in IFRS 7 *Financial Instruments: Disclosures* through that Standard’s retention (in Appendix A) of the definition of ‘financial liability’ set out in IAS 32 *Financial Instruments: Presentation*. Paragraph 11 of IAS 32 defines a ‘financial liability’ to include some contracts that will or may be settled in the entity’s own equity instruments, even though there is no obligation to transfer an economic resource of the entity to another party. From the entity’s perspective, only obligations to transfer its economic resources to another party are liabilities (and this is reflected in the definition of a ‘liability’ in paragraph 4.26 of the IASB’s Conceptual Framework for Financial Reporting, March 2018)—obligations to transfer an entity’s own equity instruments affect the entity’s proprietors but not the entity.

B28. Consistent with this, paragraph 6.89 of the revised IASB Conceptual Framework states that:

> "Although total equity is not measured directly, it may be appropriate to measure directly the carrying amount of some individual classes of equity … and some components of equity. …"

However the IASB argues that such a measurement does not compromise the entity perspective. In particular, paragraph BC6.55 of the revised IASB Conceptual Framework states:

> "the direct measurement of some individual classes of equity or components of equity would not contradict the entity perspective adopted in financial statements. Those direct measures might provide users of financial statements with information useful in making decisions relating to providing resources to the entity. This information would be provided from the perspective of the entity and reflect the equity claims held against the entity. Such information would not be provided from the perspective of a particular claimholder."

However, although the measurement of total equity as the residual interest in the entity's assets after deducting its liabilities is consistent with an entity perspective, measuring any classes or components of equity on a different basis from total equity (ie directly) is arguably a departure from an entity perspective.[52]

B29. By primarily adopting the entity perspective in consolidated financial statements, NCI of subsidiaries are not necessarily provided with the information they need, even though the requirements in paragraphs 54(q) and 81B (a) and (b) of AASB 101 are consistent with some acknowledgement of the information needs of NCI (albeit not at an individual subsidiary level). This could mean that, consistent with the comments in paragraphs D11 of Appendix D of this Report, certain users of subsidiary financial statements and their information needs are not well catered for in the consolidated financial statements. The extent to which the consolidated financial statements prepared in accordance with accounting standards are sufficient to meet user needs is considered later in this Report (see paragraphs D2-D9 of Appendix D) and Appendices E and F.

52 In addition, paragraph 12 of AASB 12 requires disclosure of separate information about NCI, which is also arguably a departure from a strict entity perspective.

Implications of the existence of non-controlling interests

B30. As is evident from paragraphs B14-B19 the existence of NCI has an impact on financial statements. Paragraphs B31-B35 below briefly outline another implication of NCI for consolidated financial statements.

B31. AASB 10 specifies requirements for the recognition and measurement of NCI. Although not specifically raised as a concern during the outreach to users undertaken for the purpose of this Report (see Appendices E and F), arguably there is a lack of clarity in AASB 10 (and IFRS 10) in measuring NCI, particularly the interaction between paragraphs B86(c) and 94 of AASB 10, which might affect the usefulness of consolidated financial statements for users.[53] The relevant paragraphs include:

(a) Paragraph 22 of AASB 10: "A parent shall present NCI in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent."

(b) Paragraph B86(c) of AASB 10: "Consolidated financial statements: … **eliminate in full** intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full)." … (emphasis added)

(c) Paragraph B94 of AASB 10: "An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. …"

B32. These paragraphs are potentially unclear on how consolidation adjustments impact the measurement of a subsidiary's profit or loss for the purposes of determining the attribution referred to in paragraph B94 of AASB 10, given the following two possible interpretations:

(a) measurement of NCI 'looks through to the subsidiary' by eliminating **all** intra-group transactions (per paragraph B86(c) of AASB 10) at the subsidiary level. For example, suppose a subsidiary sold $500 of intra-group management services to its parent, and made a net profit on the sale of $50. Under this interpretation, the effect of this transaction on the subsidiary's contribution to consolidated profit would be

53 Although users did not raise this matter as a concern, preparers might have the concern or practice might be diverse. As noted in paragraph 17 above, outreach to preparers was not undertaken as part of the research for this Report and nor was the consistency in the interpretation of the requirements of AASB 10 in relation to NCI assessed in practice.

determined to be a loss of $450, as the sale transaction is eliminated against the parent's purchase, but the costs of providing the service remain with the subsidiary (at the consolidated level, the group recognises nil income and $450 expenses). Therefore, the NCI's share of consolidated profit or loss would include its portion of that loss, even though the net effect of the consolidation adjustment does not affect group net assets, nor indeed net profit; or

(b) consistent with paragraph 94 of AASB 10 – which arguably results in a more sensible outcome – a subsidiary's reported profit or loss is only adjusted for consolidation adjustments that affect the consolidated net asset position. That is, while all intra-group transactions and balances continue to be eliminated in full as required by paragraph B86(c) of AASB 10, only consolidation adjustments that affect the consolidated net profit/net asset position are taken into consideration in determining the subsidiary's contribution to the consolidated profit or loss. Under this interpretation, consolidation adjustments that do not change the consolidated net asset position (group equity) should not be allowed to affect the determination of the non-controlling interest's contribution to the consolidated profit or loss. Instead, they are treated as though they were earned/incurred ('realised') by the subsidiary, as would be the case in the subsidiary's own financial statements. Applying this interpretation to the simple example in A) above, the subsidiary's contribution to consolidated profit would be determined to include the profit of $50 (even though at the consolidated level the group recognises nil income and $450 expenses in relation to the transaction) rather than decreased by a loss of $450.

B33. Resolution of this issue is beyond the scope of this Report. Further research would be needed to confirm which of the above two interpretations is adopted in practice in Australia (and internationally), together with an assessment of which interpretation provides the most useful information to users of consolidated financial statements where any of the subsidiaries in the group have NCI. Depending on the outcome of the research, recommendations could be made to the IASB to consider at least clarifying the requirements.

The nature of consolidation

B34. Another issue that arises in the context of AASB 10 is whether consolidation should be regarded as relating to recognition, measurement, presentation and/or disclosure.[54] This has emerged as an issue in practice due to RG85 guidance that all recognition and measurement requirements in accounting standards should be adopted in SPFS. The

54 The issue has also been discussed in AASB Agenda Paper 4.1 of the April 2019 AASB meeting.

question has arisen as to whether that includes consolidation. As noted in paragraphs C11 below, the issue is particularly pertinent in the context of paragraph 5.5 of RG85, which says, "The sole determining factor as to whether consolidated financial statements are required is whether the group is a reporting entity" whilst otherwise requiring compliance with all recognition and measurement requirements of AAS by non-reporting entities.

B35. However, this matter is expected to become less significant if the Board finalises the proposals in ED 297 to remove the ability to prepare SPFS. This is because parents currently lodging SPFS, that would now be required to lodge GPFS, would be required to consolidate (and equity account) and comply with full recognition and measurement requirements.[55] Furthermore, irrespective of whether consolidation is recognition, measurement, presentation and/or disclosure, internationally it is clear that a parent must consolidate unless it qualifies for one of the exemptions or exceptions in IFRS 10 *Consolidated Financial Statements* (AASB 10). Accordingly, this matter is not considered further in this Report.

Preparation of parent financial statements

B36. AASB 127 *Separate Financial Statements* anticipates circumstances where financial statements are prepared by a parent on a non-consolidation basis. Paragraph 2 of AASB 127 states "This Standard shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by local regulations, to present separate financial statements." Paragraph 4 defines 'separate financial statements' as "those presented by an entity in which the entity could elect, subject to the requirements in this Standards, to account for its investments in subsidiaries, joint ventures and associates either at cost or in accordance with AASB 9 *Financial Instruments*, or using the equity method as described in AASB 128 *Investments in Associates and Joint Ventures*." Paragraph 6 of AASB 127 goes on to explain that separate financial statements are those presented in addition to consolidated financial statements.[56] However paragraph 8 of AASB 127 says that if an entity is exempt from preparing consolidated financial statements based on the requirements of AASB 10 (as summarised in paragraphs B11-B12 above), it may present separate financial statements as its only financial statements.

55 Refer to ED 297 for detail.

56 Or in addition to the financial statements of an investor that does not have investments in subsidiaries but has investments in associates or joint ventures that are accounted for using the equity method as required by AASB 128.

B37. Paragraph 7 of AASB 127 clarifies that the financial statements of an entity that does not have a subsidiary, associate or joint venture's interest in a joint venture are not separate financial statements – such an entity might be the bottom subsidiary in a group.

B38. It is notable that AASB 127 does not mandate which parent entities should produce separate (unconsolidated) financial statements. It only applies when a parent entity elects or is required by local regulations to present separate financial statements. Consistent with the IASB views expressed in paragraphs BCZ216 and BCZ218 of the Basis for Conclusions on IFRS10, the rationale for this is apparently that AASB 10 specifically requires a parent to prepare consolidated financial statements in accordance with AASB 10, which best meets users' information needs by revealing the extent of the operations controlled by the parent.

B39. It is apparent that AASB 127 takes a legal view over an economic view, but only to supplement rather than replace consolidated financial statements. It thereby acknowledges current legislative requirements without necessarily endorsing them.

Preparation of subsidiary financial statements

B40. Financial statements of subsidiaries with no further investments in subsidiaries (i.e. a bottom subsidiary in a group) are referred to in this Report as 'subsidiary financial statements' and are required to be prepared in accordance with applicable accounting standards.[57]

Overview of requirements

B41. The requirements in accounting standards for preparation of consolidated, parent and subsidiary financial statements are summarised in the following high-level diagram, created for the purpose of this Report. It shows the implications for the financial statements prescribed by accounting standards of there being or not being an entity having investments in subsidiaries, associates or joint ventures:[58]

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57 Financial statements of subsidiaries with no further investments in subsidiaries but having investments in associates and/or joint ventures are usually referred to in practice as individual financial statements. These are prepared using the principles of AASB 128 *Investments in Associates and Joint Ventures* using the equity method of accounting. Paragraph 3 of AASB 128 defines equity method as "a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income." Individual financial statements are outside of the scope of this Report.

58 Some of the details and nuances of the AAS are excluded from the diagram for the sake of simplicity. In particular, financial reporting by investment entities is excluded, as are the intricacies of the exemptions from

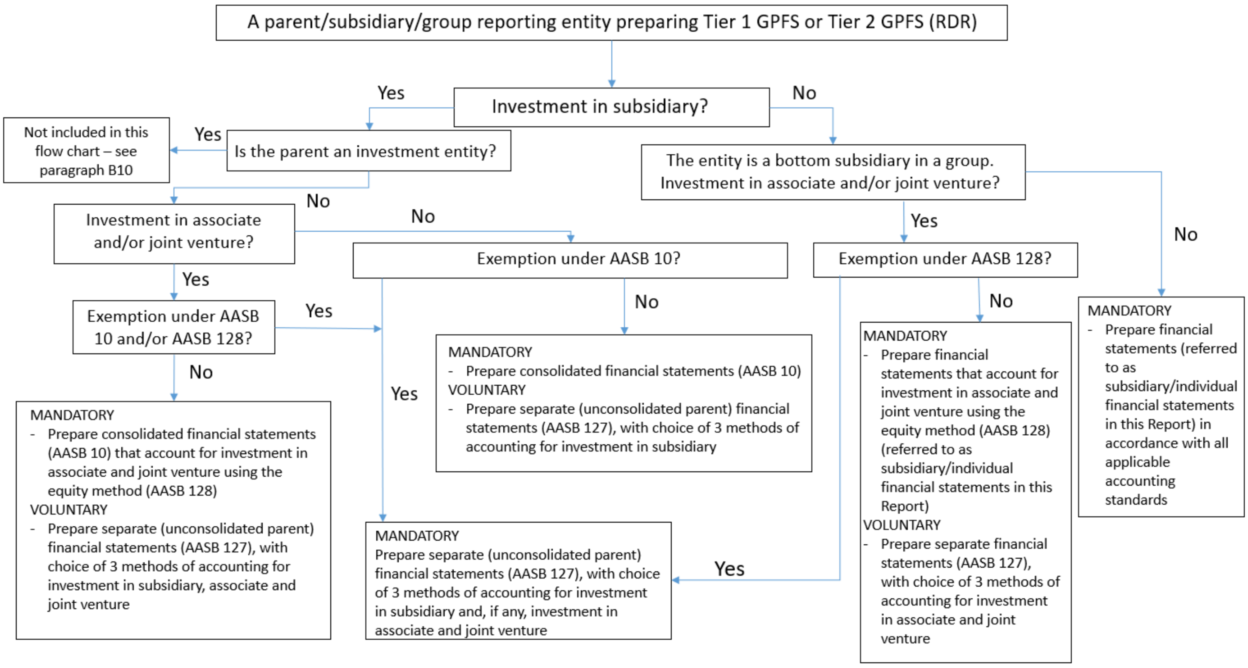

Figure 1 Summary of AAS requirements for the preparation of consolidated, parent and subsidiary financial statements

Pertinent disclosure requirements

B42. Whilst the above paragraphs contain a summary of key financial reporting requirements applicable to the preparation of consolidated, parent and subsidiary financial statements, it is also relevant to consider the role disclosure requirements play in meeting users' needs for information about parent/subsidiary relationships.

B43. Paragraphs 7.1 and 7.2 of the IASB revised Conceptual Framework states that "A reporting entity communicates information about its assets, liabilities, equity, income and expenses by presenting and disclosing information in its financial statements. Effective communication of information in financial statements makes that information more relevant and contributes to a faithful representation of an entity's assets, liabilities, equity, income and expenses. It also enhances the understandability and comparability of information in financial statements."

B44. AASB 10 does not contain disclosure requirements. While the disclosure requirements in each accounting standard enhance the usefulness of information contained in financial

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consolidation in AASB 10. Furthermore, disclosure requirements are not addressed in the diagram (but are discussed in paragraphs B36 -B54 below) and the relationship of financial reporting legislative requirements with the accounting standards is not demonstrated. They are demonstrated in a diagram in paragraph C26 (Diagram 2), after they are discussed in that Appendix.

statements, AASB 12 *Disclosure of Interests in Other Entities*[59] and AASB 124 *Related Party Disclosures* are particularly relevant in a parent/subsidiary relationship context. These two standards help users to gain a better understanding about the group structure and inter-relationships between entities to assess the performance of an entity and the group as a whole and evaluate risks associated with the group structure and are therefore particularly pertinent to consideration of Issue 3 addressed in this Report.

AASB 12

B45. The objective of AASB 12

> "is to require an entity to disclose information that enables users of its financial statements to evaluate:
>
> (a) the nature of, and risks associated with, its interests in other entities; and
>
> (b) the effects of those interests on its financial position, financial performance and cash flows." [Paragraph 1 of AASB 12]

B46. Particularly pertinent to this Report are circumstances in which 'interests in other entities' are interests in subsidiaries.

B47. In meeting the objective of the standard, AASB 12 broadly requires (as per paragraph 2 of AASB 12) disclosure by an entity about its interests in subsidiaries. The key items of information that paragraph 10 of AASB 12 requires an entity to disclose regarding its interests in subsidiaries are:

> "Information that enables users of its consolidated financial statements
>
> (a) to understand:
>   (i) the composition of the group; and
>   (ii) the interest that non-controlling interests have in the group's activities and cash flows…; and
>
> (b) to evaluate:

59 Appendix A of AASB 12 states, "For the purpose of this Standard, an interest in another entity refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship."

(i) the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group…;
(ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities …;
(iii) the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control…; and
(iv) the consequences of losing control of a subsidiary during the reporting period…"

B48. Further, paragraph B10 of AASB 12 states:

"For each subsidiary that has non-controlling interests that are material to the reporting entity, an entity shall disclose:

(a) dividends paid to non-controlling interests.
(b) summarised financial information about the assets, liabilities, profit or loss and cash flows of the subsidiary that enables users to understand the interest that non-controlling interests have in the group's activities and cash flows. That information might include but is not limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss and total comprehensive income." The list of requirements cited in paragraphs B28-B31 above are not exhaustive. Paragraph 3 of AASB 12 states "If the disclosures required by this Standard, together with disclosures required by other Standards, do not meet the objective…, an entity shall disclose whatever additional information is necessary to meet that objective."

B49. Paragraph BC28 of the Basis for Conclusions on IFRS 12 states:

"In reaching its decision, the Board noted that users have consistently requested additional financial information about consolidated entities for many years. Although users have requested financial information about all subsidiaries that are material to the group, the Board decided to require financial information only for those subsidiaries with material non-controlling interests. A requirement to disclose information about subsidiaries with immaterial or no non-controlling interests might prove to be onerous to prepare without any significant benefit for users, who are expected to benefit most from having financial information about subsidiaries with material non-controlling interests. Summarised financial information about subsidiaries with material non-controlling interests helps users predict how future cash flows will be distributed among those with claims against the entity including the non-controlling interests."

B50. Whilst appreciating the concerns of the IASB that a requirement to provide summary financial information for all material subsidiaries may prove onerous, based on the views expressed by users (see Appendices E and F of this Report) consideration could be given to extending the requirement to subsidiaries that are material to the group, have significant going concern issues or that represent dividend traps for group profits.

B51. AASB 12 effectively incorporates information that is consistent with a legal entity view into consolidated financial statements. This is because consolidated financial statements present the financial position, comprehensive income and cash flows of the group as a single entity while AASB 12 acknowledges that legal boundaries could affect the parent's access to and use of assets and other resources of its subsidiaries and, therefore, requires disclosures covering those aspects [paragraph BC 22 of the IASB's Basis for Conclusions on IFRS 12 *Disclosure of Interests in Other Entities*].

AASB 124

B52. The objective of AASB 124 is to "ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties." [Paragraph 1 of AASB 124].

B53. Specifically, in relation to parent/subsidiary relationships, at a minimum AASB 124 requires such relationships to be disclosed irrespective of whether there have been transactions between them (paragraph 13 of AASB 124). Additionally, where there are transactions, paragraph 18 requires an entity to:

> "… disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements … At a minimum, disclosures shall include:
>
> (a) the amount of the transactions;
> (b) the amount of outstanding balances, including commitments, and:
>   (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
>   (ii) details of any guarantees given or received;
> (c) provisions for doubtful debts related to the amount of outstanding balances; and
> (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties."

B54. Paragraph 4 of AASB 124 states:

> "Related party transactions and outstanding balances with other entities in a group are disclosed in an entity's financial statements. Intragroup related party transactions and outstanding balances are eliminated, except for those between an investment entity and its subsidiaries measured at fair value through profit or loss, in the preparation of consolidated financial statements of the group."

Thus, parents and subsidiaries disclose related party transactions and balances, including commitments, in any separate financial statements of the parent and the financial statements of the subsidiary. This means that intra-group transactions and balances are disclosed in parent and subsidiary financial statements. Furthermore, in consolidated financial statements, under AASB 10, an investment entity will not consolidate its subsidiaries, instead measuring them at fair value through profit and loss. Intra-group transactions and outstanding balances with non-consolidated subsidiaries are required to be disclosed in the investment entity's consolidated financial statements, because they are not eliminated on consolidation. It seems from these requirements that, since the intra-group transactions with consolidated subsidiaries are eliminated in consolidated financial statements and not required to be disclosed, AASB 124 effectively is adopting the economic entity view.

The relationship of accounting requirements with legislative requirements

B55. In addition to the accounting requirements outlined above, the requirement for an entity to publish financial statements is also governed by legislation. Legislative requirements are outlined in Appendix C.

Appendix C

Legislative requirements – for-profit private sector

Regulations directly related to the preparation of consolidated, parent and subsidiary financial statements/information in Australia

C1. Typically, regulators require reporting entities to comply with accounting standards. To the extent accounting standards do not address non-reporting entities, regulators specify requirements or otherwise provide guidance, typically by also referencing some or all accounting standards (see, for example, RG85, referred to in paragraph C11 below). Although accounting standards do not require preparation of both consolidated and parent financial statements, legislation (see paragraph C25) or an entity's governing constitution may require preparation of both sets of financial statements, or entities might prepare both by choice.

Corporations Act

C2. Section 292(1) of the Corporations Act states:

> " A financial report and a directors' report must be prepared for each financial year by:
> (a) all disclosing entities; and
> (b) all public companies; and
> (c) all large proprietary companies; and
> (d) all registered schemes."

C3. Section 295(2) of the Corporations Act states:

> "The financial statements for the year are:
> (a) unless paragraph (b) applies—the financial statements in relation to the company, registered scheme or disclosing entity required by the accounting standards; or
> (b) if the accounting standards require the company, registered scheme or disclosing entity to prepare financial statements in relation to a consolidated entity—the financial statements in relation to the consolidated entity required by the accounting standards."

C4. The interpretation of section 295(2)(a) in practice results in:

(a) a subsidiary that is at the bottom of a group (although see paragraph C11 below in relation to non-reporting entities);

(b) an intermediate or parent company that is exempt from preparing consolidated financial statements under AASB 10; and

(c) a company that is not part of a group

lodging (unconsolidated) financial statements (unless relief is otherwise provided through, for example, an ASIC Instrument). However, section 295(2)(b) relieves a parent from preparing unconsolidated financial statements when it prepares consolidated financial statements.[60] This relief from the requirement to prepare parent (unconsolidated) financial statements in addition to the consolidated financial statements was introduced through the Corporations Amendment (Corporate Reporting Reform) Act 2010.[61]

C5. However, as a substitute for parent entity financial statements, the following additional disclosures (summary information) in relation to the parent entity are required by Regulation 2M.3.01 to be included in the consolidated financial statements:[62]

- current assets of the parent entity;
- total assets of the parent entity;
- current liabilities of the parent entity;
- total liabilities of the parent entity;
- shareholders' equity in the parent entity separately showing issued capital and each reserve;
- profit or loss of the parent entity;
- total comprehensive income of the parent company;
- details of any guarantees entered into by the parent entity in relation to the debts of its subsidiaries;
- details of any contingent liabilities of the parent entity; and
- details of any contractual commitments by the parent entity for the acquisition of property, plant or equipment; comparative information for the previous period for each of the above.

C6. A question arises as to whether these requirements, together with the disclosure requirements of AASB 12 and AASB 124, provide adequate information about a parent and whether the regulations or AAS are the most appropriate vehicle for housing them. Given the requirement for financial statements is specified in legislation it is arguably

60 Similar to section 295, section 303(2) of the Corporations Act requires a disclosing entity to prepare only consolidated half-yearly financial statements, if required by the accounting standards.

61 The explanatory memorandum, Corporations Amendment (Corporate Reporting Reform) Bill, 2010 explains the rationale for the amendments – see https://www.legislation.gov.au/Details/C2010B00109/Explanatory%20Memorandum/Text, and the discussion in paragraph C10 below).

62 http://www5.austlii.edu.au/au/legis/cth/consol_reg/cr2001281/s2m.3.01.html

appropriate for the requirement for the provision of summary financial information as an alternative to a complete set of financial statements to remain in the regulations. However, specification of the particular information that is required to be disclosed in summary form could be more suitably relocated to AAS.

C7. Regulation 2M.3.01 also specifies that the summary information must be calculated in accordance with AAS in force in the financial year to which the disclosure relates. The Regulation does not explicitly state that the accounting policies adopted in the notes must be consistent with the accounting policies adopted in the consolidated financial statements. However, different accounting policies between parent and the group is not expected to arise in practice. This is because paragraph B87 of AASB 10 requires that appropriate adjustments are made to group members' financial statements (this includes the parent) in preparing the consolidated financial statements to ensure conformity with the group's accounting policies. Therefore, it is reasonable to conclude that the same principle would apply in disclosing the summary financial information of the parent in the consolidated financial statements. However, the same conclusion would not necessarily be reached in relation to the legislation and therefore, for the removal of doubt, consideration should be given to clarifying the legislation, and possibly AAS, on this matter.

C8. AFS licensees continue to be required to present both consolidated and parent entity financial statements under Chapter 7 of the Corporation Act 2001. This is because the amendments arising from Corporations Amendment (Corporate Reporting Reform) Act 2010 (see paragraphs C4 and C5 above) do not apply to financial reports lodged by AFS licensees under section 989B of Chapter 7 of the Act, where complete parent entity financial statements including notes must still be presented.

C9. Practice suggests that where parents that are exempt from AASB 10 choose to prepare consolidated financial statements in meeting financial reporting obligations (under the Corporations Act), they tend to comply with all the requirements of AAS and those of the Corporations Act (including disclosure of the summary financial information about its separate financial statements as required under Regulation 2M.3.01 – see paragraph C5 above), even though current requirements could be seen as insufficiently explicit on that point.[63]

63 Although arguably it is reasonable to expect that, consistent with paragraph 5(c) of AASB 1057 *Application of Australian Accounting Standards*, financial statements that are or are held out to be GPFS would be prepared as if the exemption from consolidation were not applied.

Basis for providing relief from preparation of parent financial statements

C10. The explanatory memorandum to the Corporations Amendment (Corporate Reporting Reform) Bill 2010 observes that the usefulness of separate parent entity financial statements was debated in Australia for a number of years. In developing the Bill, the government took account of AASB Discussion Report *The Relevance of Parent Entity Financial Reports* (2003)[64] and submissions from the Group of 100, an organisation representing Chief Financial Officers of Australia's largest entities, in determining what summary financial information should replace complete parent entity financial statements. The explanatory memorandum further explains that this regime (para. 10.49):

> "strikes an effective balance between the needs of users of parent entity financial information and the cost of preparing such information. Users of parent entity financial statements continue to retain access to relevant financial information relating to the parent entity through the summary report. While some information on the parent entity would no longer be reported, consultation with stakeholders has indicated that this information is not widely used and adds to the complexity of the financial statements. The costs of preparing and auditing summary financial information would be significantly lower than for separate parent entity financial statements — the extent of these costs savings would depend on the size and complexity of the entity and the relativities around the size of the parent as opposed to the consolidated entity."

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64 AASB Research Report *Relevance of Parent Entity Financial Reports* (2003), however, recommended a more limited exemption:
"Remove the requirement for parent entity financial reports to be published in the annual report;
Retain the requirement for full audited parent entity general purpose financial reports to be lodged with ASIC except for parent entities that:
(a) do not conduct substantive operations, including treasury operations;
(b) are not borrowing entities;
(c) are not single guarantors for the debt of one or more subsidiaries.
Require disclosure of the following to be published in the annual report:
(a) whether a full audited parent entity report has been lodged with ASIC, and, if not, a statement indicating that each of the exception criteria contained in (2) above are satisfied;
(b) parent entity shareholders' funds, including dividends and franking credits, if different from the consolidated accounts;
(c) the manner in which the group is structured, including which entity(s) within the group conduct the major trading and treasury operations;
(d) in which entities the group's borrowings and contingent liabilities reside;
(e) class orders, guarantees and indemnities in place, including which entities are party to the guarantee(s)…."

Australian Securities & Investments Commission (ASIC)

ASIC Regulatory Guide RG85 Reporting requirements for non-reporting entities

C11. In relation to non-reporting entities, RG85 states that "the recognition and measurement requirements of accounting standards must … be applied in order to determine the financial position and profit or loss of any entity preparing financial reports in accordance with the Act" (para. 2.5). Further, paragraph 5.5 of RG85 states, "The sole determining factor as to whether consolidated financial statements are required is whether the group is a reporting entity." There is some difference in opinion in the way paragraph 5.5 of RG85 is interpreted. Some argue that since RG85 states that all recognition and measurement principles should be applied by non-reporting entities required to report and that consolidated financial statements need only be prepared by reporting entities, preparation of consolidated financial statements is not a recognition and measurement issue, it is a presentation issue. On the other hand, others argue that RG85 does not express a view on whether consolidation is a recognition and measurement issue or a presentation issue – paragraph 5.5 of RG85 is merely expressing an exception to the more general requirement in paragraph 2.5.[65] As noted in paragraph B20 above, there are differences in views of whether consolidation is a recognition, measurement, presentation and/or disclosure requirement and a search undertaken for the purpose of this Report was unable to find evidence that this matter had previously been explicitly considered or addressed either by the IASB or by the AASB.

C12. However, as noted in paragraph B34, this matter is expected to become less significant if the Board finalises the proposals in ED 297 to remove the ability to prepare SPFS. This is because parents currently lodging SPFS, that would now be required to lodge GPFS, would be required to consolidate (and equity account) and comply with full recognition and measurement requirements.[66]

ASIC Class Order 10/654 re Parent entity financial statements

C13. ASIC's Class Order 10/654 allows parent entity financial statements to be presented in addition to consolidated financial statements, as an alternative to summary parent information that would be otherwise required by Regulation 2M.3.01. ASIC states that the

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65 However, the AASB's project that is reviewing the IASB's revised Conceptual Framework for adoption in Australia is contemplating superseding SAC 1 (see the first footnote to paragraph B2 above). A consequence of that would be for parent entities currently preparing special purpose (unconsolidated) financial statements having to prepare consolidated financial statements (unless exempted under AASB 10) and disclose summary financial information about the parent in those statements per Regulation 2M.3.01. Refer to AASB ED 297 *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (currently open for comment until 30 November 2019).

66 Refer to ED 297 for detail.

rationale for allowing entities to present a complete set of parent entity financial statements, despite the relief provided by the Corporations Act (see paragraphs C4 and C5 above), is that:

"some entities want to present parent entity financial statements:

- to avoid the cost of changing their reporting formats, particularly for 30 June 2010 year ends; or
- because they believe that the parent entity financial statements provide useful information to users of their financial reports."[67]

C14. As mentioned in paragraph C8 above, since the AFS licensees are required to prepare a complete set of consolidated and separate financial statements under the Corporations Act, ASIC Class Order 10/654 is not applicable to them.

ASIC Instrument 2016/785 re Wholly-owned subsidiaries[68]

C15. ASIC's 'Relief for wholly-owned entities under ASIC Corporations (Wholly-owned Companies) Instrument 2016/785 (Instrument)'[69] states that certain wholly-owned companies[70] may be relieved from the requirement to prepare and lodge audited financial statements under Chapter 2M of the Corporations Act, where they enter into deeds of cross guarantee with their holding entity[71] and meet certain other conditions. ASIC[72]

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67 https://www.legislation.gov.au/Details/F2017C00172; https://asic.gov.au/about-asic/media-centre/find-a-media-release/2010-releases/10-165ad-asic-provides-relief-for-parent-entity-financial-statements/.

68 ASIC's 'Relief for wholly-owned entities under ASIC Corporations (Wholly-owned Companies) Instrument 2016/785 can be found at https://www.legislation.gov.au/Details/F2016C01085.

69 http://asic.gov.au/regulatory-resources/financial-reporting-and-audit/preparers-of-financial-reports/relief-from-corporate-finance-provisions/relief-for-wholly-owned-entities-under-asic-corporations-wholly-owned-companies-instrument-2016785/.

70 Paragraph 4 of ASIC Instrument 2016/785 defines wholly-owned entities in relation to a holding entity as collectively meaning "companies and foreign companies:
(a) all of which are controlled by the holding entity; and
(b) all of which are closely-held subsidiaries of the holding entity; and
(c) all of which are parties to the deed of cross guarantee;
but does not include an entity which:
(d) holds office as trustee or alternative trustee under the deed of cross guarantee; and
(e) is not a Group Entity (within the meaning of that deed)."
ASIC defines control in the same way as AASB 10. AASB 10 uses the term wholly owned but does not define it.

71 Paragraph 4 of ASIC Instrument 2016/785 defines holding entity in relation to a company that is party to a deed of cross guarantee as "a company, a disclosing entity which is a body incorporated in Australia, or a registered foreign company:
(a) of which the company is a closely-held subsidiary; and
(b) which is a party to the deed; and
(c) which is not controlled by another of its closely-held subsidiaries which is also a party to the deed."

72 http://asic.gov.au/regulatory-resources/financial-reporting-and-audit/preparers-of-financial-reports/relief-from-corporate-finance-provisions/deeds-of-cross-guarantee/.

explains that "The deed of cross guarantee makes the group of companies that are parties to that deed akin to a single legal entity in many respects. Creditors and potential creditors can then focus on the consolidated position for those entities rather than the individual financial statements of the wholly-owned subsidiaries that are parties to the deed".[73] The effect of the relief is that many wholly owned companies within a group that are subject to a deed of cross guarantee would be exempt from preparing financial statements.[74] The relief reduces the reporting requirements for such wholly owned subsidiaries forming part of closed groups,[75] who have chosen to 'severally, unconditionally and irrevocably' guarantee each other's debts, i.e., in addition to the parent guaranteeing the debts of wholly owned subsidiaries; each subsidiary would now guarantee the debts of the parent and each other subsidiary within the closed group.[76]

C16. The ASIC Instrument clarifies that, to be eligible for the exemption, the wholly owned subsidiary may be a public company, large proprietary company or small foreign controlled proprietary company (section 292(2)(b) of the Corporations Act). However, if such a wholly owned company is a disclosing entity, borrower in relation to debentures, a guarantor of such a borrower or a financial services licensee, then this exemption does not apply, presumably for similar reasons underlying APRA's approach (see paragraph C25 below). Further, to qualify for exemption, no party to the deed of cross guarantee should be a body regulated by APRA and that the parent entity financial year must end on the same date as the financial year of the exempted entity.

73 Also refer to Appendix E, which provides the results of outreach undertaken for the purpose of this Report seeking banks' views on the relevance of financial statements in the case of wholly owned subsidiaries where deeds of cross guarantee are entered into. The outreach indicated that the extent of reliance on consolidated financial statements in those circumstances primarily depends on the lending policies of each individual bank and on the risk associated with each case. Sole reliance on consolidated financial statements where there are deeds of cross guarantee might not be appropriate in some cases, given that the banks included in the outreach stated that they emphasise the debt servicing capacity of legal borrowers over security in making lending decisions. It would seem to depend on whether the borrower is regarded as being 'the group' or an individual entity within the group. Accordingly, it depends on specific circumstances whether a bank feels it is appropriate for it to place reliance on a cross guarantee as part of the bank's assessment of servicing capacity, in contrast to its assessment of debt security. Appendix F of this Report provides the results of outreach undertaken for the purpose of this Report seeking the views of a different group of users (investors/analysts) on the relevance of different types of financial statements. That outreach indicated that, in apparent contrast with banks as lenders, investors/analysts place a greater reliance on consolidated financial statements of the group in all cases.

74 As well as from the requirement of preparing a directors' report, audit of the financial report, requirements to send these reports to members, and to lodge the reports with ASIC.

75 Closed group means the holding entity and the wholly-owned entities as per ASIC Corporations (Wholly-owned Companies) Instrument 2016/785.

76 Dean, G., Luckett, P. & Houghton, E. 1993, 'Notional calculations in liquidations revisited: The case of ASC (now called ASIC) Class Order Cross Guarantees', Companies and Securities Law Journal; page 207.

C17. The Instrument further requires that where the exemption is adopted, the notes to the consolidated financial statements must include the following additional disclosures (see paragraph 6(1)(v) of the Instrument):

(a) a short statement of the nature of the deed of cross guarantee;

(b) details regarding the parties to the deed of cross guarantee separately identifying members of the closed group, other members of the extended closed group;

(c) details of parties to the deed of cross guarantee that have been added, removed or subject to a notice of disposals;

(d) details of any entities that were eligible for relief (under this instrument or ASIC Class Order [CO 98/1418][77]) in the immediately preceding financial year but are no longer eligible for relief; and

(e) if the consolidated financial statements cover entities that are not members of the closed group or not parties to the deed of cross guarantee), include additional consolidation information (including a statement of financial position, statement of comprehensive income, opening and closing retained earnings, dividends provided for or paid and transfers to and from reserves), for those entities that are members of the closed group or parties to the deed of cross guarantee.

C18. Like the question noted in paragraph C6 above, a question arises as to whether these requirements provide adequate information and whether the regulations or accounting standards are the most appropriate vehicle for housing them.

C19. Additionally, the Instrument notes that consolidated financial statements should include adequate provision in relation to the liabilities of any parties to the deed of cross guarantee that are not consolidated where it is probable that those liabilities will not be fully met by those parties.

77 This Instrument [2016/705] superseded CO 98/1418

ASIC Instrument 2017/204 re Foreign controlled companies[78]

C20. As explained in section 1 of the explanatory statement for ASIC Corporations (Foreign-Controlled Company Reports) Instrument 2017/204,[79] section 292(2)(b) of the Corporations Act requires a small proprietary company that was controlled by a foreign company for all or part of a financial year to comply with the financial reporting obligations under Part 2M.3 of the Corporations Act unless it was consolidated for that period in financial statements lodged with ASIC by a registered foreign company, a company, a disclosing entity or a registered scheme.

C21. Section 292(2)(b) results in more onerous financial reporting requirements for small foreign-controlled proprietary companies compared with their Australian counterparts that are not foreign controlled. This particularly applies to those small foreign-controlled proprietary companies that are not required by the law in their place of origin to prepare financial statements.

C22. However, ASIC Corporations (Foreign-Controlled Company Reports) Instrument 2017/204 puts the reporting requirements of small foreign-controlled proprietary companies on a par with other Australian small proprietary companies.

C23. To qualify for the relief (apart from the procedural requirements), the Instrument 2017/204 states that such exemption is available to a small proprietary company provided:

(a) its parent foreign company is registered with ASIC and lodges consolidated financial statements of the group including the activities of such small proprietary company; and

(b) the small proprietary company is not part of a large group.[80]

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78 The ASIC Corporations (Foreign-Controlled Company Reports) Instrument 2017/204 can be found at https://www.legislation.gov.au/Details/F2017L00307.

79 https://www.legislation.gov.au/Details/F2017L00307/Explanatory%20Statement/Text.

80 Paragraph 4 of Instrument 2017/204 defines a large group as a group which, for a financial year, satisfies at least 2 of the following paragraphs:

(a) the combined revenue of the group for the financial year is $25 million, or any other amount prescribed for the purposes of paragraph 45A(2)(a) of the Act, or more;

(b) the combined value of gross assets of the group at the end of the financial year is $12.5 million, or any other amount prescribed for the purposes of paragraph 45A(2)(b) of the Act, or more;

(c) the group has 50, or any other number prescribed for the purposes of paragraph 45A(2)(c) of the Act, or more employees (part-time employees being counted as an appropriate fraction of a full-time equivalent) at the end of the financial year.

C24. The purpose of the second condition is to discourage foreign-controlled companies from structuring into smaller companies to avoid financial reporting obligations as explained in section 3 of the explanatory statement for ASIC Corporations (Foreign-Controlled Company Reports) Instrument 2017/204.

Australian Prudential Regulation Authority (APRA)

C25. As noted in paragraph 46-47 above, APRA requires entities that are AFS licensees regulated by it to provide both consolidated financial statements and parent financial statements. The rationale as given by APRA states, "APRA needs to understand the ability of the parent entity to meet its obligations and support depositors and policyholders, on a standalone as well as a consolidated basis. We wish to fully understand the financial position and risks of the parent. APRA presently accesses parent entity financial statements, including the relevant notes, principally through the group annual financial report. We wish to continue this practice as it is a reliable and efficient means for APRA to obtain this information." "In those isolated cases where a parent entity is not an AFS licensee but APRA regulated, APRA would prefer that these groups voluntarily continue to include full parent entity financial statements, including notes, in their group annual financial reports."[81]

C26. The requirements outlined in paragraphs C2 to C25 are depicted in the following diagram at a high level, developed for the purpose of this Report. The diagram effectively expands on the diagram in paragraph B36 by showing how the relationship between accounting standards and legislative requirements affect the type of financial information that is required to be prepared and lodged.[82]

81 https://www.apra.gov.au/sites/default/files/Letter-for-Website_Parent-Entity-Financial-Statements-September-2010.pdf

82 The diagram also effectively expands on the diagram in paragraph B7, although that diagram addresses both reporting entities and non-reporting entities. The current diagram only focuses on the effect of the relationship between accounting standards and legislative requirements for reporting entities. For the sake of simplicity it excludes some nuances. For example, it excludes lodgement requirements of small proprietary companies, other than in relation to small foreign controlled proprietary companies, and investment entities.

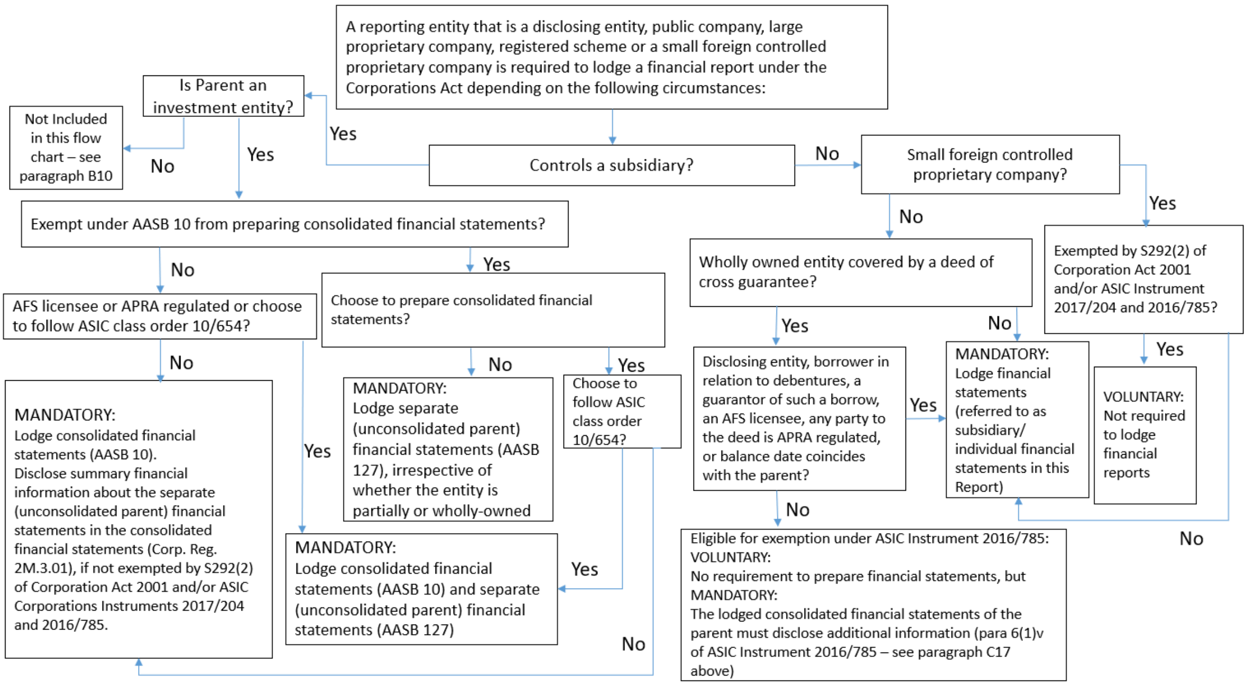

Figure 2 Summary of the relationship between accounting standards and legislative requirements affecting the type of financial information

Regulations indirectly related to the preparation of consolidated, parent and subsidiary financial statements/information in Australia

C27. Regulators of companies aim to play an important role in the economy by facilitating and maintaining a robust and sustainable commercial system. They do so by striving to balance the costs and benefits of regulation. Regulations focus on a range of matters, only some of which are directly related to financial reporting (outlined above in this Appendix) and therefore of greatest relevance to this Report. However, some regulations that are not directly related to financial reporting are indirectly related and therefore may be of some relevance to this Report to the extent they throw light on or have implications for financial reporting matters.

C28. Regulations have evolved to especially address factors pertinent to businesses that are structured as groups with parent/subsidiary relationships. Paragraphs C33 to C53 below describe regulations that do not directly address financial reporting matters but which may be indirectly related.

C29. An understanding of the way these regulations treat corporate groups might inform a review of financial reporting regulations for corporate groups – for example, to the extent regulations that are not directly related to financial reporting treat a corporate group as a single economic entity rather than as separate legal entities might be seen as providing a level of justification for taking a consistent approach to the regulation of financial reporting (and, for example, supporting a view that consolidated financial statements with merely note disclosure of some subsidiary financial information is sufficient). It might also throw light on the needs of regulators for financial information about group structures.

C30. Accordingly, having a broad understanding of:

(a) how corporate groups are regulated generally;

(b) how regulators view different entities within a group; and

(c) the possible impact of these regulations on the financial reporting requirements that currently exist will help address the Issues that are the subject of this Report.

C31. The Corporations Act contains various provisions that are not directly related to financial reporting and take an economic view (and thereby effectively override an otherwise strict application of the separate legal entity approach). Similarly, the courts, in applying the law to corporate groups have taken an economic entity view in some cases.[83] Key regulated activities in this regard include:

(a) Director's responsibilities, and rights of the minority to obtain a remedy for unfair treatment;

(b) Related party transactions (including intra-group transactions);

(c) Insolvent trading by a subsidiary;

(d) Pooling arrangements in the event of liquidation; and

(e) Dividend distribution.

C32. Each of these regulatory matters are addressed in turn below and include an assessment of whether they are consistent with a 'legal' view and/or an 'economic' view.

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83 As indicated by:

- Section V(E) of the Research Report "Corporate Groups in Australia" by Ian Ramsay and Geof Stapledon (Centre for Corporate Law and Securities Regulation, University of Melbourne, 1998); and
- Paragraph 2.14 and 2.16 of the Final report of the Companies & Securities Advisory Committee on 'Corporate Groups' (May 2000).

See paragraphs C39 to C43 Below.

Director's responsibilities, and rights of the minority to remedy unfair treatment

C33. This issue relates to the question of whether directors are legally obliged to act in the interest of a legal entity or the economic entity (i.e. the group).

Legislation

C34. Even if a company is part of a group, the Corporations Act requires the directors to act in good faith for that company, as a separate legal entity. Section 181(1) of the Act states, "A director or other officer of a corporation must exercise their powers and discharge their duties: (a) in good faith in the best interests of the corporation; and (b) for a proper purpose." Further, section 184(1) of the Act states, "A director or other officer of a corporation commits an offence if they:

(a) are reckless; or
(b) are intentionally dishonest;

and fail to exercise their powers and discharge their duties:

(c) in good faith in the best interests of the corporation; or
(d) for a proper purpose."

C35. However, from a group perspective, section 187 of the Act, which specifically deals with 'Directors of wholly-owned subsidiaries', states:

> "A director of a corporation that is a wholly-owned subsidiary of a body corporate is taken to act in good faith in the best interests of the subsidiary if:
>
> (a) the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and
> (b) the director acts in good faith in the best interests of the holding company; and
> (c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act."

C36. Unlike in NZ,[84] there is no provision in the Australian Corporations Act relating to minority shareholders that explicitly allows directors to act in the best interests of the holding company. Minority shareholders have a recourse under sections 232 and 233 of the

84 Section 131(3) of the NZ Companies Act 1993 allows a director to act in the best interests of the holding company (which may not be in the best interest of the subsidiary) even where the subsidiary is not wholly owned, provided the director is expressly permitted to do so by the constitution of the subsidiary company and with the prior agreement of the shareholders (other than its holding company).

Australian Corporations Act when the affairs of the company are being conducted in a way that is:

(a) unfair to that shareholder or to other shareholders of the company; or

(b) against the interests of the company as a whole.

A court may, for example, order the winding up of a company or the appointment of a receiver.

Case law

C37. There have been cases brought before the courts where minority shareholders of a subsidiary have made claims of unfair treatment where directors of a parent have made decisions in the interests of the parent and the group. The courts have found in favour of the directors in some of these cases on the basis that the directors had taken the least worst course of action that was in the interest of the subsidiary (and the parent and the group).

C38. For example, the final report of the Companies & Securities Advisory Committee on 'Corporate Groups' (May 2000) states: "In Nicholas v Soundcraft Electronics Ltd [1993] BCLC 360, the minority shareholders of a subsidiary company alleged that by withholding payment of debts due to the subsidiary, the parent company had acted in the affairs of the subsidiary in an unfairly prejudicial manner. …." However, while the Court had jurisdiction to entertain an oppression action, it held that the withholding of debts by the parent company, which deprived the subsidiary company of much-needed funds, did not constitute unfair prejudice, because if the parent company failed to hold off its creditors, the subsidiary company would also suffer. The Court stated (at 366):

> "It was in the interests of the [subsidiary] company that the parent should not go into liquidation. The [subsidiary] company had to pay a price to help secure that. It is the fact that the price - the withholding of debts - left the [subsidiary] company critically short of money. But the attempt to keep the group afloat by recourse to the assets of both companies was a reasonable commercial judgment in the circumstances which existed and was not unfair. It no doubt harmed the [subsidiary] company but worse harm [to the subsidiary company] would probably have followed from the liquidation of [the parent]."

C39. Similarly, section V(E) of the Research Report "Corporate Groups in Australia" by Ian Ramsay and Geof Stapledon (Centre for Corporate Law and Securities Regulation, University of Melbourne, 1998) states that:

> "although each company in a corporate group must be treated as having its own interests, the courts have acknowledged that to some extent directors, when performing their functions, may properly consider the interests of other companies within the corporate group."

C40. Consistent with this, although giving supremacy to focusing on the separate legal entity, the final report of the Companies & Securities Advisory Committee on 'Corporate Groups' (May 2000) in paragraph 2.14 mentions a UK case law principle (known as the Charterbridge principle) in which the judge employed the following test for whether directors have breached their duties:

> "whether an intelligent and honest man in the position of a director of the company concerned, could in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company."

C41. The May 2000 report further states at paragraph 2.16 that:

> "The Charterbridge principle has been applied in Australian case law. Directors must exercise their powers for the benefit of the company they direct. Nevertheless, in determining whether to enter into an upstream or lateral intra-group loan or security transaction, directors of group companies may have regard to any direct or derivative commercial benefits to be derived by their company, and the extent to which their company's prosperity or continued existence depends on the well-being of the group as a whole. To that limited extent, directors may consider the wider interests of the group. Therefore, "…actions carried out for the benefit of the group as a whole may, in particular circumstances, be regarded as benefiting as well one or more companies in a group. (Case of Equiticorp Financial Services Ltd v Bank of New Zealand (1993) 11 ACSR 642"

Are regulations relating to directors' responsibilities (and minority shareholders rights) consistent with a 'legal entity' view or an 'economic entity' view?

C42. Regulations relating to directors' responsibilities (and minority shareholders' rights) appear to be consistent with a mixed view of a group – 'legal entity' or 'economic entity', depending on circumstances; although it seems the legal entity view is the more dominant. An economic entity view is only adopted when it is not inconsistent with a legal entity view.

C43. Thus, from the way regulators and the courts have viewed directors' responsibilities (and minority shareholders' rights), directors must balance the interests of the group and the legal entity of which they are the directors, and understand the financial implications of their decisions at both the legal entity and group level.

C44. As Jeffrey W. Rubin put it in his article in the November 2006 edition of the *New York Law Journal*:

> "In each situation where a public company controls a public subsidiary, there exists a need for the board and management of each company to understand the roles and responsibilities of the board and management of the other … Because matters affecting one entity may also affect the other, it would be prudent for the entities to agree to a protocol for the disclosure to the audit committee of the parent of matters brought to the attention of the subsidiary, and for the disclosure to the audit committee of the subsidiary of matters brought to the attention of the parent that may involve or relate to the subsidiary."

Related party transactions (including intra-group transactions)

C45. Section 208 of the Corporations Act requires a public company (or an entity controlled by a public company) giving a financial benefit to a related party (including a company within the group) to obtain approval from a majority of shareholders of that public company[85] who are not party to the transaction, subject to certain exceptions such as where the financial benefit given is at arm's length or where the benefit is given to a closely-held subsidiary.[86]

C46. This legislative requirement to obtain approval seems consistent with giving primacy to a 'legal entity' view as it focuses on transactions between related but separate legal entities.

Insolvent trading by a subsidiary

C47. Under sections 588V and 588W of the Corporations Act a holding company may be held liable if the subsidiary company was insolvent when the subsidiary incurred a debt and there were reasonable grounds for the holding company or any of its directors to believe the subsidiary was insolvent. The liquidator may recover from the holding company the loss incurred by a person to whom the debt was owed, even if the debt was wholly or partially unsecured (also refer to 'pooling arrangements' discussed in paragraphs C49 and C50 below).

C48. This requirement seems to be broadly consistent with an 'economic entity' view as it effectively looks through the legal structure and requires directors of the parent entity to

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85 If the minority (non-controlling interests) feels disadvantaged they have certain rights – see for example paragraphs C37 and C38. For procedures for obtaining member approval refer to sections 217 to 227 of the Corporations Act.

86 For details of such exceptions refer sections 210 to 216 of the Corporations Act. For definition of closely-held refer section 214 of the Corporations Act.

be aware of the business operations of each and all of its subsidiaries. It is notable that sections 588V and 588W do not distinguish between a wholly or partially owned subsidiary.

Pooling arrangements in the event of liquidation

C49. Section 571 of the Corporations Act requires that, in the case of each company in the group being wound up, the liquidator of one or more companies may (subject to certain conditions) make a 'pooling determination', which is subject to the approval of eligible unsecured creditors (and the court, if an application is made to the courts). If a pooling determination comes into effect, each company in the group is taken to be jointly and severally liable for each debt payable by, and each claim against, each other company in the group.

C50. This requirement is potentially more consistent with taking an 'economic entity' view than a 'legal entity' view. However, its pertinence to this Report is limited, given the going concern assumption (unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so) under paragraph 25 of AASB 101.

Dividend distribution

C51. Section 254T(1) of the Corporations Act states that "A company must not pay a dividend unless:

(a) the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend; and
(b) the payment of the dividend is fair and reasonable to the company's shareholders as a whole; and
(c) the payment of the dividend does not materially prejudice the company's ability to pay its creditors."

C52. Prior to 2010, dividends were based on a 'profits test', which required dividends only to be paid out of profits. Since then, the new test is commonly referred to as a 'solvency test' or 'net assets test'. However, as per PwC's IFRS Spotlight, May 2016, "various legal opinions have concluded that the Net Assets Test has not displaced, but has added to, the historic requirement in Australian case law for the dividend to be paid from profits of the company (commonly referred to as the Profits Test)." [87] It goes on to explain how these tests work in practice and states:

87 EY Corporate Law Update (Oceania), August 2016, also expresses this view and states "As it currently stands, the present regime (perhaps inadvertently from the drafters' perspective) limits the circumstances where it is

> "This means that when paying dividends up to a holding company and then to shareholders, these respective tests are applied to each legal entity that makes a return to its parent. For example, in a group of companies with extensive and complex holding chains, profit generated by a trading subsidiary at the bottom of the chain will need to pass through each intermediate holding company to reach the parent company. Accumulated losses at any of these intermediate holding companies may result in dividend traps; that is, the losses, depending on when they were incurred and accounted for, may absorb any dividends paid up, preventing those profits from passing to the parent to be distributed to shareholders."

C53. Given the interrelationship between a parent and its subsidiaries in relation to dividends, the legislative requirements relating to dividends seem consistent with both a 'legal entity' view and an 'economic entity' view. The economic entity view is pertinent because, for example, the ability to distribute dividends between companies within a group and ultimately outside the group is potentially dependent on the level of profits of each entity within the group. However, the 'legal entity' view seems to take precedence, because inadequate solvency of any intermediate parent company could prevent the passing on of the trading subsidiary's dividend to shareholders of the ultimate parent even if both the trading subsidiary, and the entire group of companies including the ultimate parent and all the companies it controls (as an economic entity), pass the solvency test quoted in paragraph C52.

appropriate to declare and pay a dividend far beyond what one would glean from a "first blush" read of section 254T. The prevailing view, despite the expressed intention of the reforming legislation, is that the profits test lives on in the current regime."

Appendix D

Relative merits of consolidated, parent and subsidiary financial statements

D1. This Appendix summarises the findings of a review of some relevant material undertaken for the purpose of this Report into the relative merits of consolidated, parent and subsidiary financial statements. It provides useful input to an assessment of whether the current financial reporting requirements (outlined in Appendices B and C) are too onerous or result in information overload or shortfalls.

The Usefulness of Consolidated Financial Statements

D2. Although, as described in paragraphs A4-A6, entities might organise their various activities and operations through different legal structures, they typically ultimately operate as a single economic entity. Where an entity is structured through parent/subsidiary relationships, consistent with paragraphs 1.4, 1.13 and 3.15 of the IASB's revised Conceptual Framework, users such as investors and lenders of a parent require information to understand the overall financial health of the business and how efficiently and effectively the entity's management has discharged its responsibilities to use the entity's economic resources provided by them. Such information helps users assess management's stewardship of those resources and to predict how efficiently and effectively management will use the entity's economic resources in future periods. Hence, the information can be useful for assessing the parent entity's prospects for future net cash inflows. This information is provided through consolidated financial statements of the group presenting holistic financial information about the group.

D3. Information about the consolidated entity might also be useful to users such as investors/analysts and lenders of a subsidiary as this facilitates a broader understanding of a group's operations and their implications for the subsidiary. Since the activities of the subsidiary are controlled by the parent, investors/analysts and lenders of the subsidiary might find it useful to understand the nature, structure and financial performance of the group as a whole controlled by the parent. The users might be interested in evaluating the impact of the financial operations of the group on the subsidiary to which they are exposed. For example, in the case where there is a deed of the cross guarantee, investors in the subsidiary would be expected to be interested in the group information.

D4. In addition to the discussion in paragraphs D1- D3 above, paragraphs (a)-(g) below provide a list, although not mutually exclusive, of more specific reasons identified in the literature for why consolidated financial statements are regarded useful:

(a) **Control:** Since the parent entity controls its subsidiaries, it has the power to control the assets and liabilities of the group. By having control, the parent entity has the ability to restructure the group, transfer assets between group entities, push down or pull up resources of the subsidiaries or transfer them between subsidiaries to be utilised to generate benefits for the parent entity or other entities in the group (See paragraphs C37 and C38 on the rights of minority shareholders). Thus, compared with individual financial statements of each subsidiary, consolidated financial statements portray the overall financial position of a group regardless of which entity in the group records these in its accounting transactions;

(b) **Aids decision making by directors of companies within the group:** As discussed in paragraphs C39-C43, from the way regulators and courts have viewed director's responsibilities (and minority shareholders' rights), directors must balance the interests of the group and the legal entity of which they are the directors, and understand the financial implications of their decisions at both the legal entity and group levels.

Thus, it becomes important for directors to understand the group structure (including inter-relationships between various entities of the group) and the group's financial information, which can be served by the consolidated financial statements of the group. The sound understanding of the group's financial information is expected to aid them to understand the rationale behind the transactions, especially intra-group transactions, and how best to safeguard the interests of the specific legal entity in the first place and also the group without being exposed to offences/liabilities under the Corporations Act. The consolidated financial statements become important especially for those directors (for example, of subsidiaries) who are not able to demand group related information from the parent or other subsidiaries;

(c) **Summarises net cash flows available to investors:** Consolidated financial statements provide useful information about the consolidated cash flow position of the group through the consolidated statement of cash flows. It presents overall cash generated by the group from operations, major investments by the group, major disposals (for example divesting businesses) and cash flows from financing activities, thus providing information about the operations and overall cash generating capacity of the group as a whole. Information regarding cash flows is an important input for many decisions, particularly for lending decisions.

Specifically, while identifying the usefulness of consolidated financial statements compared with the separate financial statements of the parent, paragraph 3.15 of the IASB's revised Conceptual Framework states "Consolidated financial statements provide information about the assets, liabilities, equity, income and expenses of both the parent and its subsidiaries as a single reporting entity. That information is useful for existing and potential investors, lenders and other creditors of the parent in their assessment of the prospects for future net cash inflows to the parent. This is because net cash inflows to the parent include distributions to the parent from its subsidiaries, and those distributions depend on net cash inflows to the subsidiaries.";

(d) **Aids in investment/lending decisions by providing information about the overall financial health of the group:** As explained in paragraphs D2-D3 above, the consolidated financial statements are useful for lenders and investors of both the parent and individual subsidiaries. The consolidated financial statements give a comprehensive perspective of the financial health of the group and an indication about the future prospects of the business. Even if the business is diversified, consolidated financial statements provide information about the key segments in the notes to the financial statements (as per AASB 8 *Operating Segments*) to facilitate decision making. Without consolidated financial statements, the process of evaluating a parent and each subsidiary separately and its relationship with the group as a whole would be long and complex.[88]

As also mentioned in paragraphs C51-C53, the regulatory requirements relating to dividend distribution seem to be consistent with both a 'legal entity' view and an 'economic entity' view. Thus, the consolidated financial statements are relevant especially for the shareholders of the parent (including consolidated financial statements of the intermediate parent) since the parent company will be profitable if the whole group it controls is profitable as accumulated losses at any of the 'intermediate parent' level may act as dividend traps;

(e) **Reduction in cost:** There is less work and less effort involved in preparing and analysing consolidated financial statements compared with preparing and analysing a set of unconsolidated financial statements of a parent and each subsidiary as the consolidated statements summarise the individual financial statements of subsidiaries and their parent into one set.[89] The consolidated financial statements would be particularly useful in the case of large groups with multiple subsidiaries as it may get tedious for users to individually go through the financial statements of each subsidiary to gain an understanding about the group;

(f) **Cross guarantees:** Consolidated financial statements provide useful information to users who might otherwise be more interested in separate parent and subsidiary

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88 https://bizfluent.com/about-5685728-importance-consolidated-financial-statements.html
89 http://www.qvinci.com/the-importance-of-consolidated-financial-statements

financial statements where the group entities have entered into a deed of cross guarantee. Since the parties to the deed of cross guarantee are responsible for each other's debts, the deed arguably effectively renders the group a single legal entity (See paragraph C15). Therefore, where the repayment of a debt through security is a focus of an assessment, it is useful for lenders and creditors (either of an individual subsidiary or the parent) to analyse the consolidated financial statements as input to their assessment of the efficacy of the deed. In addition, understanding the nature of the group and cross guarantees for the purposes of assessing the sustainability of future income might also be important; and

(g) **Insolvency:** The relevance of understanding the overall financial health of the group can also be gathered from the fact that a holding company may be held liable if the subsidiary company was insolvent when the subsidiary incurred a debt and there were reasonable grounds for the holding company or any of its directors to believe the insolvency of the subsidiary (refer to paragraphs C49 and C50). Similarly, in the case where each company in the group is wound up, the liquidator of one or more companies may make a 'pooling determination' (under section 571 of the Corporations Act – discussed in greater detail in paragraphs C51 and C52 of this Report). If a pooling determination comes into effect, each company in the group is taken to be jointly and severally liable for each debt payable by, and each claim against, each other company in the group. Thus, the information about the consolidated group is important, which is best reflected in the consolidated financial statements of the group[90]. The consolidated financial statements of the whole group can give important insight into the functioning of the group as a whole and whether there are any red flags that the directors need to be aware of. Similarly, such information would be useful for lenders as the consolidated financial statements would include information about a subsidiary that may be facing financial difficulties and having a material impact on the group.

D5. In contrast to the above benefits of consolidated financial statements, one limitation is that it is difficult to assess the amounts that can be legally claimed against each of the legal entities (for example, by banks) forming part of the consolidated group. Legal separation between various entities forming part of a group can significantly affect the cash flows available to existing and potential investors, lenders and other creditors of each entity within a group. Thus, although consolidated financial statements are useful to understanding the overall financial health of the group, lenders such as banks need to

90 In the case where the going concern assumption is not appropriate, disclosures in the financial statements are required to be made as per paragraph 25 of the AASB 1 *Presentation of Financial Statements.*

ascertain the loan servicing capacity of an individual (legal) borrower within the group for which they seek entity specific information.

D6. Appendices E and F of this Report note that banks and investors/analysts regard the information contained in consolidated financial statements, albeit not necessarily exclusive of parent and subsidiary financial statements (or at least summary financial information), as important input for making their decisions.

The Usefulness of Parent Financial Statements

D7. Parent (unconsolidated) financial statements purport to portray the financial health and profitability of the parent separate from the rest of the group. Such separate financial information about the parent may be relevant to ascertain resources legally controlled by the parent. In this regard, paragraph 3.17 of the IASB's revised Conceptual Framework states:

> "Unconsolidated financial statements are designed to provide information about the parent's assets, liabilities, equity, income and expenses, and not about those of its subsidiaries. That information can be useful to existing and potential investors, lenders and other creditors of the parent because:
>
> (a) a claim against the parent typically does not give the holder of that claim a claim against subsidiaries; and
>
> (b) in some jurisdictions, the amounts that can be legally distributed to holders of equity claims against the parent depend on the distributable reserves of the parent. …"[91]

D8. However, despite those comments, paragraph 3.18 of the IASB's revised Conceptual Framework highlights the importance of consolidated financial statements compared with unconsolidated financial statements of the parent and states:

> "Information provided in unconsolidated financial statements is typically not sufficient to meet the information needs of existing and potential investors, lenders and other creditors of the parent. Accordingly, when consolidated financial statements are required, unconsolidated financial statements cannot serve as a substitute for consolidated financial statements. Nevertheless, a parent may be required, or choose,

91 The IASB paragraph goes on to say "Another way to provide information about some or all assets, liabilities, equity, income and expenses of the parent alone is in consolidated financial statements, in the notes." The suitability of note disclosure in lieu of a complete set of parent financial statements is discussed paragraph 5 of this Report.

to prepare unconsolidated financial statements in addition to consolidated financial statements." (Refer to paragraphs C8, C13 and C14 of this Report)

D9. Another potentially relevant factor in identifying the usefulness of consolidated financial statements relative to parent financial statements is the accounting requirements for a parent's investment in a subsidiary in unconsolidated financial statements. A possible limitation of unconsolidated financial statements is that current accounting standards (AASB 127 Separate Financial Statements) allow optional accounting treatments for investments in subsidiaries. In particular, paragraph 4 of AASB 127 defines 'separate financial statements' as "those presented by an entity in which the entity could elect to account for its investments in subsidiaries, joint ventures and associates either at cost or in accordance with AASB 9 Financial Instruments, or using the equity method as described in AASB 128 Investments in Associates and Joint Ventures." Arguably, the optional accounting treatments could lead to a lack of comparability. This gives rise to a question of whether AASB 127 should be amended to limit the options for accounting for investments in subsidiaries? However, this question is outside the scope of this Report, as noted in the 'Scope' section above.

D10. Appendix E of this Report notes that some banks, in making lending decisions, regard the information contained in a complete set of parent financial statements as important input to those decisions especially when they are lending to the parent entity. In contrast, Appendix F to this Report notes that investors/analysts do not require a complete set of parent financial statements for their decision making, although many require the summary financial information about the parent disclosed in the consolidated financial statements for their decision making.

The Usefulness of Subsidiary Financial Statements

D11. As paragraph 3.16 of the IASB's revised Conceptual Framework states "Consolidated financial statements are not designed to provide separate information about the assets, liabilities, equity, income and expenses of any particular subsidiary. A subsidiary's own financial statements are designed to provide that information." Specific reasons identified in the review of relevant material as to why subsidiary financial statements are useful (in addition to, or even instead of, consolidated financial statements) are summarised in the following:

(a) **Poor performance of subsidiaries:** Individual profitability of subsidiaries is difficult to assess from the consolidated financial statements. While sharing views on consolidated financial statements, Angie Mohr, a finance columnist, states "For example, if a subsidiary lost a substantial amount of money in the year as a result of poor sales, financial statement readers may not see that information if the loss is combined with profits of the parent company." So users such as creditors or lenders to individual subsidiaries may still require relevant information about subsidiary's profitability to carry out their risk assessments about that subsidiary[92].

Similarly, financial ratios based on consolidated numbers may not be representative of each entity's ratios. For example, if one of the subsidiaries has a high level of debt compared to the equity of the owners, that leverage would be hidden in consolidated financial statements;

(b) **Establishment of legal rights:** Subsidiary financial statements provide insight into the amounts that can be legally claimed by banks/creditors in case of default by a particular entity. See paragraph D5; and

(c) **Regulatory requirements:** As discussed above (paragraph 58), since requirements relating to director's responsibilities, interests of minority shareholders and dividend distribution seem to take both the economic entity and legal entity views, the relevance of subsidiary financial information for regulatory purposes should not be underestimated.

D12. Appendix E notes that banks, in making lending decisions, typically regard the information contained in a complete set of subsidiary financial statements as important input to those decisions if they are lending to that subsidiary. Somewhat, although not entirely consistently, Appendix F notes that although investors/analysts place reliance on the consolidated financial statements of the group, some investors do prefer in addition to the consolidated financial statements a complete set of subsidiary financial statements and/or some form of subsidiary financial information for their decision making.

D13. Based on the above analysis, it is evident that consolidated financial statements are relatively more useful than parent and subsidiary financial statements, although parent and subsidiary financial statements (or at least summary financial information about parents and subsidiaries) can provide useful supplementary information for some decision making purposes.

92 https://bizfluent.com/info-8463041-disadvantages-consolidated-financial-statements.html; and https://bizfluent.com/about-5685728-importance-consolidated-financial-statements.html.

Appendix E

Results of outreach to banks as lenders

E1. To obtain empirical evidence of user needs in relation to parent and subsidiary financial statements (or summary financial information thereon) in the context of consolidated financial statements, research undertaken for the purpose of this Report included outreach to individuals within banks as lenders to companies. This Appendix describes the research methodology adopted (including its limitations) prior to listing the questions put and a summary of responses.

E2. The primary purpose of the outreach was to gain an understanding of the views of this type of user of GPFS[93] on the relevance of subsidiary financial statements (whether themselves consolidated or not) and parent financial statements (not consolidated) when the consolidated financial statements of the group are available. The respondents' thoughts were also sought on whether summary financial information about each subsidiary would be a sufficient replacement for the complete set of subsidiary financial statements currently required to be prepared, if that summary information were to be disclosed in the consolidated financial statements.

Research methodology

E3. Five banks were approached and a total of eleven individuals were consulted. (There were four large banks (three Australian and one bank that operates in an Asian country) and one second tier Australian bank). The input received is based on personal interviews conducted and/or written responses. Confidentiality was assured – therefore the results are presented in a way as to not identify the views of individual banks or their officers.

E4. Access to these individuals was gained by contacting senior executives from organisations expected to employ such individuals and in one case by knowledge of their relevant experience in the banking sector. To increase the likelihood of gaining access to the type of individuals included in the target sample, many of the senior executives approached had previous contact with the AASB.

E5. These senior executives (from the five banks) were contacted by telephone and e-mail and were encouraged to respond to the survey questions (shared with them). The survey was in the form of a word document to enable the respondents to provide detailed responses.

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93 It could be argued that the banks consulted are in a position to demand the information they need as input to their lending decisions and therefore are not general purpose users. However, in practice they accept GPFS as satisfying much of their financial information needs and therefore their views on the usefulness of information in GPFS and the manner in which it is presented are worth being understood by regulators/standard setters.

These executives were given an option of either submitting written responses or sharing their feedback via tele/video conference with AASB staff.

E6. The eleven respondents included representatives from wholesale credit, risk management, corporate and institutional banking, commercial credit and group accounting policy. There is considerable variation in the roles performed by the eleven individuals responding to the survey. This degree of variation helped ensure the information needs of banks working in different roles were identified. Two banks submitted written responses. Feedback from other banks was taken by conducting group interviews (with representatives from one bank forming one group) via tele/video conference.

E7. The interviews took a semi-structured form, with the interviewers following a standard set of questions, and then following up with individually tailored questions to clarify answers given or probe reasoning. Despite this, it is difficult to discern from the responses the extent to which they reflect the banks' lending policies compared with the banks' lending practices, and the extent to which lending practices differ from lending policies.

E8. Given the relatively small sample size, care needs to be taken about generalising from the responses to the larger class of users of GPFS that are lenders. However, because the views expressed by different banks were broadly consistent (as will become evident later in this Appendix), cautious generalisations could be justified.

E9. In any event, the extent to which the views expressed in the responses should influence the actions of regulators/standard setters should be carefully considered given that regulators/standard setters have a broader responsibility.

E10. Questions raised as part of the outreach and a summary of responses is provided below. As multiple representatives from one bank formed one group, the feedback is presented in the summary below as received from the five banks and it is not identified as responses received from eleven respondents. However, the term banks/respondents are used interchangeably.

E11. Since the interviews were in a semi-structured form and not all questions were responded to by all banks/individuals, each question is analysed below based on the total number of banks that responded to that question (rather than the total number of banks that undertook the survey questionnaire or were interviewed). Questions were phrased differently in each interview depending on the responses at the time. Questions listed below summarise the key issues that were discussed with the respondents during the interview, rather than the way the questions were expressed in the survey instrument that was used as the basis for the discussions.

Summary of results

E12. ***QUESTION 1: As a lender to a subsidiary, do you think there is a need for a complete set of individual financial statements of the subsidiary or would the summary financial information about the subsidiary in the parent's/group's consolidated financial statements suffice?***

E13. All the banks responded to this question. Four specifically stated their lending policies require a thorough and comprehensive process to evaluate the creditworthiness of a potential borrower. Before granting a loan, their policies require a lending officer to be satisfied primarily about the servicing capacity through operations of the borrower and, secondarily, about the security backing the debt; although servicing capacity and debt security are both important considerations. To make this evaluation, all the banks mentioned that significant reliance is placed on the individual financial statements of the legal borrower.

E14. All the banks mentioned that their need for individual financial statements of the subsidiary depends on to whom they are legally lending within the group, and to whose assets the banks have legal recourse in the case of default. That is, if they have recourse to only the assets of an individual subsidiary to whom they are lending, then the individual financial statements of that subsidiary would be specifically required, and summary financial information would not be an adequate substitute. However, three of the banks specifically said that in addition to the financial statements of the borrowing entity, they need consolidated financial statements of the group to make their lending decisions.

E15. Two of the banks specifically mentioned that whether summary financial information would suffice would depend on the amount of the borrowing application, the nature of the facility (for example short-term working capital facility or long-term loan) and the risk grade of the borrower. For example, comments made included:

(a) if the subsidiary is wholly owned with a deed of cross guarantee or if the subsidiary is only a non-operating finance subsidiary looking after the treasury function of the whole group, then summary financial information about the subsidiary in the consolidated financial statements of the group may be sufficient;

(b) in the case where there are deeds of cross guarantee, consolidated financial statements may suffice;

(c) if the debt is structurally subordinated within the group structure i.e. if there is an effective reduction in the ranking of the claim of the lender resulting from the ownership structure of the borrower in the case of a group of companies, consolidated financial statements are particularly important; and

(d) if lending to a subsidiary is in the form of a credit enhancement to the whole group that requires an assessment of the solvency, gearing and liquidity of the whole group in addition to the subsidiary, consolidated financial statements are particularly important.

However, irrespective of circumstances, as the risk grade of the borrower increases, a complete set of financial statements of the borrowing subsidiary would be required. It is a case-by-case type of consideration.

E16. In summary, based on the above, the banks noted that their answer to the question depends on circumstances. Where a bank is lending to a subsidiary within a group, it is apparent that the answer also depends on the emphasis that bank's lending policies place on servicing capacity relative to debt security. In limited circumstances only the consolidated financial statements of the group are sufficient. More typically consolidated financial statements of the group and a complete set of financial statements of the borrowing subsidiary are warranted.

E17. ***QUESTION 2: If subsidiary financial statements were to be replaced by summary financial information about the subsidiary in consolidated financial statements of the parent, would a similar set of information as required for parent entities (as per Corporation Act 2001 Regulation 2M.3.01) be sufficient or does something need to be added or reduced from that list?***

E18. All banks provided a response to this question and stated that, while the summary financial information about a subsidiary (similar to that required by Regulation 2M.3.01 for parent entities – see paragraph C5 of this Report) gives useful high level information, lending decisions require a comprehensive analysis of a borrowing subsidiary's complete set of financial statements (as mentioned in the responses to question 1).

E19. Four of the banks additionally mentioned that there is no 'one size fits all'. The risk assessment (risk grade – which includes both financial and non-financial factors) of each individual borrower and their respective circumstances provides a guide as to any additional information that may be required beyond the individual financial statements of the borrowing entity. For example, in the case of wholly owned subsidiaries with low risk grade and with a deed of cross guarantee, reliance may be placed only on the consolidated financial statements of the group (including summary financial information about the subsidiary similar to that currently required by Regulation 2M.3.01 for parents) but this is not in all cases.

E20. In addition to the summary financial information of the kind required by Regulation 2M.3.01, key information that the banks said they specifically look at in making lending decisions to a subsidiary (apart from the subsidiary's statement of financial position, statement of profit or loss and other comprehensive income and statement of changes in equity as per AASB 101 *Presentation of Financial Statements*) are listed in paragraphs E21 and E22 (the former listing in the second column of the table in that paragraph those currently required to be included in subsidiary financial statements as per current accounting standards, the latter listing those not currently so required).

E21. As illustrated in the following table, there is a difference between:

(a) Column 1: the financial information currently required in the notes to the consolidated financial statements specified by Regulation 2M.3.01.

(b) Column 2: the financial information mentioned as being used by the banks that is also currently required by the accounting standards to be included in complete sets of subsidiary financial statements (where they are prepared); and

Summary information required by Regulation 2M.3.01	**Information used by Banks that is also required by accounting standards in complete sets of financial statements**
Asset	
current assets of the parent entity; total assets of the parent entity;	information on working capital, including detailed disclosures for current assets such as inventory and debtors ageing (AASB 101 *Presentation of Financial Statements*)
	detailed disclosures for property, plant and equipment (AASB 116 *Property, Plant and Equipment*)
	detailed disclosures for impairment (AASB 136 *Impairment of Assets*)
	off balance sheet items (for example, information on operating and finance leases as per AASB 116 *Leases*)
Liability	
current liabilities of the parent entity; total liabilities of the parent entity;	information on working capital, including detailed disclosures for current liabilities such as contractual maturities creditors and current loan facilities along with repayment schedule (AASB 101; AASB 7 *Financial Instruments: Disclosures*)
details of any contingent liabilities of the parent entity; details of any contractual commitments by the parent entity for	commitments and contingent liabilities (AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*)

the acquisition of property, plant or equipment;	
details of any guarantees entered into by the parent entity in relation to the debts of its subsidiaries;	cross guarantees (AASB 124 *Related Party Disclosures*; AASB 137)
Equity	
shareholders' equity in the parent entity separately showing issued capital and each reserve;	
Income	
profit or loss of the parent entity; total comprehensive income of the parent company;	detailed disclosures for revenue (AASB 15 *Revenue from Contracts with Customers*; and AASB 118 *Revenue*)
Structure	
	details of the group structure (AASB 12 *Disclosure of Interests in other Entities*)
	detailed disclosures for business combinations (for example acquisition of subsidiaries) during the year (AASB 3 *Business Combinations*)
	related party disclosures (AASB 124)
Cash Flow	
	cash flow statement (AASB 107 *Statement of Cash Flows*)
Income Tax	
	detailed disclosures for income taxes (AASB 112 *Income Taxes*)
Other	
comparative information for the previous period for each of the items listed above	comparative information for the previous period for each of the items listed above

E22. Apart from the information mentioned in column 2 of the table immediately above that is available from the financial statements of a borrowing subsidiary, four banks stated that additional information such as the following is also required, which may be derived from the borrowing subsidiary's financial statements or additionally required (and some might argue are outside the scope of GPFS):

- Nature of the borrower: for example, if it is a subsidiary to which the banks are lending, whether it is an operating subsidiary or a financing vehicle (i.e. handling treasury operations of the entire group);
- Directors' report;
- Auditor's reports;
- Project reports or due diligence reports, especially in relation to new ventures;
- Cash flow projections;
- Legal recourse to which entity in case of default;
- Information to calculate various ratios of the borrowing subsidiary such as debt gearing, liquidity and debt service ratios;
- Structural subordination of the debt; and
- Expenditure on property, plant and equipment, distinguishing between expenditure incurred for growth compared with maintenance.

E23. In summary, the common response to this question indicates that the banks are of a view that if summary financial information about a subsidiary were to replace a complete set of financial statements of the subsidiary, the current summary of financial information listed in Regulation 2M.3.01 would not be sufficient for lending decisions. Indeed, given the long list of additional information required by banks, a complete set of subsidiary financial statements might continue to be the most efficient way to provide the information.

E24. ***QUESTION 3: Do you ask for GPFS or do you accept SPFS? What additional information do you ask for (e.g. an independent audit)? If you do accept SPFS, is there a financial consequence (i.e. penalty due to additional risk)?***

E25. All the banks provided a response to the first two parts of this question:

(a) Four mentioned that they require audited GPFS where their clients are required to prepare GPFS as per accounting standards. However, where their clients are not required to prepare GPFS and prepare only SPFS, the banks do accept SPFS, but only if they are prepared in a manner consistent with all the recognition and measurement requirements in accounting standards (and, presumably, not consolidated – see paragraph C11 above re RG85). However, since SPFS do not require all disclosures as per accounting standards, additional information is sought along the lines of some or all of those listed in the bullet points in paragraphs E21 and E22. Depending on the risk grade of the borrower and information available, security and guarantees for the debt would also be required; and

(b) The remaining one bank mentioned it does not ask for GPFS as the majority of their client base do not prepare GPFS. However, it requires financial statements to be prepared in accordance with AAS.

E26. No useful responses were received on the third part of this question. It is not germane to this Report and therefore has not detracted from the usefulness of the feedback from the outreach.

E27. ***QUESTION 4: If summary financial information about a subsidiary were to be provided instead of a complete set of subsidiary financial statements, in your view, should the amounts disclosed be based on what the subsidiary's individual financial statements would have been or should they be based on consolidated amounts (for example, after adjusting for the impact of different accounting policies adopted by the parent)?***

E28. Despite the banks' responses to question 2 (in which they essentially rejected the use of summary financial information as a substitute for complete sets of subsidiary financial statements), they indulged us by responding to this question. One of the issues pertinent to this question is, for example, how should assets be measured for disclosure purposes: at amounts based on their cost when originally acquired by the subsidiary or based on their fair value when the subsidiary was acquired by the group?

E29. Four banks provided views:

(a) Two banks expressed a view that the accounting policies should ideally be the same, unless the parent company is merely a shell/holding company and the subsidiary company carries the main operation. They also stated that in any event they would not expect there to be major areas of different accounting policies between subsidiaries and their parent in practice. Having said that, these two banks also stated that any summary financial information about the subsidiary that might be required to be disclosed in consolidated financial statements should be based on the group's accounting policies – for consistency and to avoid users being confused;

(b) In contrast, one of the banks mentioned that it is essential to keep the summary financial information about the subsidiary based on subsidiary accounting policies as this may become especially relevant in cases where parent and subsidiaries belong to different industries and it is a diversified group; and

(c) One bank specifically mentioned that it does not have a preference but noted that it would depend on materiality of the difference in accounting policies between parent and subsidiary.

E30. In summary, the views were somewhat mixed, and might, although not explicitly raised with the respondents, also throw some light on the views of banks on the extent to which the accounting policies adopted by a subsidiary in its separate financial statements should be allowed to differ from the accounting policies adopted in the consolidated financial statements (a question that is outside the scope of this Report).

Lending demographics:

E31. ***QUESTION 5: Do you usually lend to subsidiaries – if so do you require cross guarantees from parents or other group entities*****?**

E32. This question about cross guarantees was asked to get an understanding regarding the extent to which the banks rely on security from the parent entity compared with relying on an assessment of the independent service capacity of the borrowing legal entity. For example, reliance on security may suggest that consolidated financial statements of the group along with summary information about the borrowing (subsidiary) entity may serve the lending decisions of the banks, however reliance on independent servicing capacity would suggest that a complete set of subsidiary financial statements would be required.

E33. All banks provided a response to this question: after mentioning that they have diversified portfolios of clients i.e. they lend to parents as well as at subsidiary levels:

(a) Two of the banks noted that they specifically request deeds of cross guarantee; and

(b) The other three banks mentioned that requesting deeds of cross guarantee depends on the risk grade of the borrowers or whether the subsidiary is an operating subsidiary. One of these banks specifically mentioned that some large public companies may not agree to give deeds of cross guarantee and in those case the financial statements of the borrowing subsidiary are required. Similarly, cross guarantees are not common in cases of offshore lending, thus in such cases financial statements of the borrowing subsidiary are required.

E34. Having said that, the banks mentioned that deeds of cross guarantee act as an additional comfort in that they enable a greater reliance to be placed on the consolidated financial statements. But, on a case by case basis, this does not completely rule out the relevance of financial statements of the borrowing subsidiary after having regard to a combination of multiple factors including risk grade, amount of the borrowing and nature of the loan facility, group structure, existing lending arrangements, cash flow projections, project reports, and due diligence reports especially in the case of a new venture.

E35. Further, it depends on whether the subsidiary to which the loan facility is being granted is a purely treasury company (i.e. handling the treasury operations of the group) or whether that subsidiary is an operating subsidiary having its own operations, assets and stream of income. This is additionally a deciding factor of whether deeds of cross guarantee would be sought. For example, where the subsidiary is an operating subsidiary, reliance generally is placed on the cash flow generation capacity of the subsidiary rather than the deed of cross guarantee.

E36. In summary, the banks' responses to this question are consistent with the comments made in paragraph E10 above where their lending policies emphasise debt servicing capacity of the individual borrowing entity but also give significant weight to security, with the different emphasis being circumstance specific.

E37. ***QUESTION 6: What type of information do you require if a group gets into financial difficulties? If the subsidiary gets into financial difficulties, does the group take over the subsidiary's financial obligation or 'walk away'?***

E38. The reason for asking this question in the context of this Report is similar to the reason for question 5 i.e. if the group stands behind the subsidiary in financial difficulties, then consolidated financial statements of the group, with summary financial information about the borrowing subsidiary instead of a complete set of individual financial statements of the borrowing subsidiary, may suffice.

E39. All banks provided a response to this question. In response to the first part of the question. One bank indicated that if a group gets into financial difficulties, the first step is to investigate to determine whether it is temporary or permanent phase. Generally, the companies' management will be asked to provide a brief report to describe the problem and explain the reason for such difficulties. Details for recovery plans, up-to-date details of bank obligations, fixed assets schedule with lenders hypothecation[94] table, realistic debtors' realisation schedules and inventory valuation as on date are sought.

In response to the second part of the question:

(a) Three banks mentioned they have knowledge of cases where a holding company does not support a subsidiary when the latter becomes insolvent. These banks mentioned that in these cases the financial statements of the subsidiary become more important, especially where the banks do not have access to the group cash flows, unless the debts are guaranteed by the parent. Two of these banks additionally mentioned that if the subsidiary is of a significant scale and size, its insolvency will have an overwhelming impact on the group as a whole and that the whole group becomes insolvent;

(b) One bank mentioned that where the subsidiary becomes insolvent, the parent as a guarantor has an obligation to fulfil the subsidiary's liability; and

94 Hypothecation occurs when an asset is pledged as collateral to secure a loan, without giving up title, possession or ownership rights, for example income generated by asset.

(c) One bank mentioned that in its experience holding companies do not generally walk away from their subsidiaries.

E40. The responses from the banks go some way towards explaining why banks place reliance on the individual financial statements of the borrowing entity (in addition to consolidated financial statements) and use guarantees as a secondary source of comfort for repayment of their debts.

E41. ***QUESTION 7: Do you lend to parent entities? Is summary financial information as per Corporation Act 2001 Regulation 2M.3.01 generally sufficient for making lending decisions to parents?***

E42. All banks provided a response to this question noting that, in relation to the first part of the question, consistent with their diversified portfolios of clients, they lend at a parent level as well as at a subsidiary level:

(a) Two of the banks mentioned they are very selective in lending to parents, especially overseas parents, unless they are backed by high external rating/investment grade and credit worthiness; and

(b) Three of the banks mentioned they would require an understanding of how the debt is structurally subordinated in making lending decisions to parents.

E43. In relation to the second part of the question, three banks indicated that summary financial information as per Regulation 2M.3.01 cannot be solely relied upon when making lending decisions. The companies would need to provide more information that is useful for the bank in making lending decisions. One respondent indicated that other than summary information, they need the parent's complete set of unconsolidated financial statements to understand more about the parent. Similarly, one bank prefers a complete set of financial statements for the parent, including a Statement of Financial Position, Statement of Profit and Loss, Statement of Cash Flows and detailed notes.

Appendix F

Results of outreach to investors/analysts

F1. Similar to the outreach conducted with banks as outlined in Appendix E, research undertaken for the purposes of this Report also included outreach with investors/analysts to gain their feedback on the relevance of consolidated, parent and subsidiary financial statements to their decisions. The primary purpose was to gather feedback on whether parent and/or subsidiary financial statements (or summary financial information thereon) are needed if consolidated financial statements, including relevant disclosures, are available.

Research methodology

F2. Twelve investors/analysts were approached. Access was gained by contacting individuals in the AASB's Investors and Analysts Database, the AASB User Advisory Committee[95] and further connections that these individuals had.

F3. Feedback was sought by sending a brief survey questionnaire, asking for a response within two weeks. Twelve written responses were received. Three respondents identified themselves as equity investors, two as analysts, and one as an equity and debt investor. The remaining six respondents did not specifically identify as investor or analyst. The feedback provided was expressed as their individual views, and therefore not necessarily the views of their employers. Confidentiality was assured. The results are therefore presented in a way as to not identify the views of any individual or their employer.

F4. Similar to the limitations relating to banks' feedback, the relatively small sample size of investors/analysts means that care needs to be taken about generalising from the responses to the larger class of users of GPFS that are investors/analysts. However, broadly consistent views by the respondents could justify generalisations being made. Further, the extent to which the views expressed in the responses should influence the actions of regulators/standard setters should be carefully considered given that regulators/standard setters have a broader responsibility.

F5. The questions raised and a summary of their responses is provided below. As respondents were able to skip questions, the responses to each question are analysed based on the total number of respondents to that question (rather than the total number of participants who undertook the survey questionnaire). The questions as put to

95 An independent committee providing the AASB with regular input from the perspective of users of financial statements.

respondents are presented verbatim as, unlike the banks' survey, all responses were received in written form responding to a written survey.

Summary of results by question

F6. ***QUESTION 1: As an investor/analyst of a parent entity (choose only one of the following options that would typically best reflect your information needs)****:*

	Number of responses
a) I only need CFS and I do not need any parent entity information as a stand-alone entity for my analysis	3
b) I only need CFS and the summary financial information as per Regulation 2M.3.01 of the Corporations Regulations 2001 (Regulation 2M.3.01)	8
c) I need CFS and some parent entity information for my analysis but the summary information as per Regulation 2M.3.01 is not sufficient for my analysis (Please explain what additional information would you typically require)	1
d) I need CFS and a complete set of unconsolidated financial statements of the parent for my analysis	0
e) I only need a full set of unconsolidated financial statements of the parent and I do not need CFS for my analysis (Please explain why)	0
TOTAL	**12**

F7. ***QUESTION 2: If you have chosen option c) to question 1 (i.e. summary financial information listed in Q1 above is not sufficient), what additional information in relation to a parent entity would you typically require?***

F8. The one respondent that chose option c) in Q1 indicated that consolidated financial statements and summary information as per Regulation 2M.3.01, in particular current assets of the entity and comparative information for the previous period, would be useful to assess financial health. In addition, a summary of the operating cash flow movements during the period would be useful.

F9. ***QUESTION 3: If you have chosen option e) to Question1 (i.e. you do not need CFS for your analysis), please explain why***.

F10. No responses were received on this question as none of the respondents chose option e) in Question 1.

F11. ***QUESTION 4: Is your answer to question 1 influenced by whether or not the parent is included within cross guarantees with other group entities? Please explain reason for your choice***.

F12. Eleven respondents provided feedback to this question (the other one did not provide an answer):

a. five stated their need for any particular type of financial statements is not influenced by whether or not the parent is part of any cross-guarantee arrangements with other group entities. Some of their particular comments included:

   (i) one indicated that they are only interested in the consolidated group position;

   (ii) one suggested that the key use for financial statements is valuation of listed entities, for which they need consolidated financial statements. The consolidated debt position of the parent and subsidiaries combined is a relevant measure. Whether or not the parent is included in cross guarantees with other group entities does not usually impact the valuation based on the consolidated financial statements;

   (iii) one indicated that they do not look at parent/subsidiary information for wholly owned subsidiaries of Australian corporates. A parent's financial statements are only looked at when the subsidiary is a separately listed entity that produces its own financial statements. The parent financial statements are then useful in assessing whether cash flow, for instance, is being directed to the parent at the expense of the minority Australian Securities Exchange (ASX) listed entity shareholders; and

   (iv) one indicated that debt security issuance documents issued at the parent level normally contain sufficient information;

b. six stated that the type of financial statements they need is influenced by the existence of a cross guarantee. Some of their particular comments included:

   (i) one suggested that certain listed infrastructure vehicles use a combination of stapled structures and cross guarantees, which can be somewhat opaque; and

(ii) one indicated that a cross-guarantee could in some cases influence valuation or capacity to meet obligations.

F13. ***QUESTION 5: As an investor/analyst of a subsidiary, which type/s of financial statements do you need for your analysis (choose only one of the following options that would typically best reflect your information needs):***

	Number of responses
a) I only need CFS and do not need any subsidiary information as a stand-alone entity for my analysis	2
b) I only need CFS and summary financial information about a subsidiary (equivalent to summary information required for parent entities as per Regulation 2M.3.01) for my analysis,	2
c) I need CFS and some subsidiary information for my analysis, but summary information about a subsidiary equivalent to Regulation 2M.3.01 would not be sufficient for my analysis (Please explain what additional information would you typically require)	5
d) I need CFS and a complete set of subsidiary financial statements for my analysis	3
e) I only need a full set of subsidiary financial statements for my analysis and I do not need CFS for my analysis (Please explain reasons for your answer)	0
TOTAL	**12**

F14. ***QUESTION 6: If you have chosen option c) to question 5 above (i.e. summary financial information about a subsidiary equivalent to that listed [in paragraph C5] above would not be sufficient), What additional information would you typically require in relation to a subsidiary?*** [96]

F15. Among the five respondents who chose option c) in Q5:

a. one suggested that there are occasions where detailed financial information about a subsidiary, especially a partially owned subsidiary, is valuable to

96 The survey included the 'summary financial information' required by Regulation 2M.3.01 about a parent, and is reproduced in paragraph C5 above.

analysis in order to better understand liabilities and the relationship of the parent and subsidiary;

b. one indicated that summary information as per Regulation 2M.3.01, in particular current assets of the entity and comparative information for the previous period, would be useful to assess the financial health of subsidiaries;

c. one explained that material subsidiaries with material NCI should provide a detailed statement of financial position and statement of profit or loss. Similarly, material subsidiaries that have different financial characteristics to the consolidated entity (i.e. substantial non-recourse leverage/ unencumbered assets/ higher return on equity etc.) should provide detailed balance sheet and profit and loss information. Further information regarding retained earnings and profit reserves of subsidiaries would be important information as it may impact dividend paying capacity;

d. one suggested that a full balance sheet would ideally be provided. If not, at a minimum, they indicated that they need disclosures about cash and gross debt because there could be a big distinction between tax asset and cash, and deferred income and debt; and

e. one suggested that they need enough information to estimate the market value of any NCI as a reduction in the value of the main listed entity. An example of relevant information they need from the subsidiary accounts, not required by Regulation 2M.3.01, is the underlying earnings measures (e.g. excluding asset impairments, one-off gains/losses etc.) and debt of the subsidiary (not just liabilities).

F16. One respondent who did not choose option c) in Q5 suggested that it would be helpful to have consistent disclosure relating to contribution from acquisitions in a period.

F17. ***Question 7: If you have chosen options b) or c) to questions 5 above (i.e. some financial information about a subsidiary to be disclosed in CFS would be an adequate substitute for a complete set of subsidiary financial statements) should such financial information be based on***:

	Number of responses
a) The subsidiary's own accounting policies irrespective of the group's accounting policies	22
b) The group's accounting policies irrespective of the subsidiary's accounting policies	4
Reason for choosing a) or b) (please specify):	
TOTAL	**6**

F18. Six respondents out of the seven whose response to question 5 was that they need summary financial information about subsidiaries for their analysis (options b) or c) in Q5) answered this question:

F19. ***QUESTION 8: if you have chosen option e) to question 5 (i.e. you do not need CFS for your analysis), please explain why***:

F20. There were no responses to this question as none of the respondents chose option e) in Question 5.

F21. ***QUSETION 9: Is your answer to question 5 influenced by whether or not the subsidiary is included within cross guarantees with other group entities? Please explain reason for your choice***.

F22. All twelve respondents provided feedback to this question:

a. five indicated that the type of financial statements needed for analysis is influenced by whether or not the subsidiary is part of any cross-guarantee arrangements (option a). One of these respondents suggested that for complex group structures and contracting/engineering businesses, more detail about cross guarantee arrangements would be beneficial. Another of these respondents indicated that the existence of a cross guarantee reduces the need for subsidiary statements to a certain extent, but companies are able to move entities in and out of the cross-guarantee structure relatively easily with little penalty or notice. As such there is an ongoing need for subsidiary financial statements. Yet another of these respondents said that cross guarantees may influence a valuation or capacity to meet obligations of the ultimate parent entity; and

b. seven respondents stated that their choice for type of financial statements is not influenced by whether the subsidiary is included within cross guarantee arrangements with other group entities (option b). One of these respondents suggested that they are only interested in the consolidated group position. Another highlighted the need for more disclosure irrespective of cross guarantees – but in the presence of a cross guarantee, the disclosures would be more closely scrutinised. Another one of these seven respondents suggested that the key use for financial statements is the valuation of listed entities, for which they need consolidated financial statements. The consolidated debt position of the parent and subsidiaries combined is a relevant measure. Whether or not the parent is included in cross guarantees with other group entities does not usually impact the valuation based on the consolidated financial statements. Yet another commented that consolidated financial statements and a complete set of subsidiary financial statements improve transparency and enable a more thorough analysis. Another said that irrespective of the existence of cross guarantees, they still want to know 'first pass' exposure. The other two of these seven respondents did not provide explanations for their choices.

   Having said that, one of these respondents indicated that as an investor in a subsidiary (usually via debt), even though it may be subject to a cross guarantee elsewhere in the group, they would generally undertake analysis on the entity as a stand-alone ('first pass') and then consider the value of any credit enhancement. This comment is similar to the feedback received from the banks in their capacity as lenders noted in Appendix E.

F23. ***QUESTION 10: Do CFS currently, including disclosures, provide sufficient information to enable you to make an adequate assessment of the risks arising from a group's structure (e.g. dividends, restrictions on assets, tax implications) for your key investing decisions. Please provide your answers as an investor/analyst of a parent entity and as an investor/analyst of a subsidiary entity***.

F24. All twelve respondents answered this question in their capacity as an investor/analyst in a parent and subsidiary entity:

a. as an investor/analyst of a **parent** entity:

   (i) eight stated that consolidate financial statements provide sufficient information for their decision making; and

(ii) four expressed a view that consolidated financial statements do not provide sufficient information for their decision making. Some particular comments indicating the type of other information required include:

- disclosures about complex structures, for example international operations, are quite opaque and there is a heavy reliance on management disclosure. More information in this regard would be useful, but need to be mindful for the cost of potential information overload;
- companies often provide extremely limited information on subsidiaries. Location of subsidiaries for example is extremely useful to assess the potential for tax risk or risks to the ability to repatriate funds; and
- material subsidiaries with material NCI should provide a detailed statement of financial position and statement of profit or loss; and

b. as an investor/analyst of a subsidiary entity:

(i) six stated that consolidated financial statements provide sufficient information for their decision making. Despite the fact that consolidated financial statements are sufficient, one respondent pointed out that more complete disclosure around leverage in subsidiaries would be better; and

(ii) six respondents expressed a view that consolidated financial statements do not provide sufficient information for their decision making. Additional information required by these respondents includes:

- material information about the subsidiaries, in particular cash flow, and information on tax status of the relevant jurisdictions;
- ‘economic’ impact, because equity investors tend to focus on ‘economic’ impact rather than a strict legal entity reporting; and
- separate financial statements of the subsidiary itself, to facilitate assessments of the subsidiary separately from the parent.

F25. ***QUESTION 11 Do you think the following improvements could make CFS more helpful?***

a) Disclosure of summary financial information about subsidiaries
   - that have significant going concern issues
   - that represent dividend traps for group profits
   - that are material to the group
   - subsidiaries with material NCI (i.e. non-controlling interests/shareholders)
   - all subsidiaries

   (please indicate in (d) below any additional information you need)
b) Significant intra-company transactions that are eliminated on consolidation, which might inform users about significant risks to the group
c) There should be cross-references between consolidated, parent and subsidiary financial statements (where they exist) and, if they do not exist, a statement to that effect, to help users better understand and assess the financial implications of a corporate structure.
d) Any other information that you may require that is currently not addressed in the CFS (please specify):

F26. Six respondents who expressed a view that consolidated financial statements do not provide sufficient information for their decision making answered this question.

a. All six suggested improvements to the disclosures in consolidated financial statements are required and would like disclosure of summary financial information about subsidiaries that have significant going concern issues and that are material to the group. Five out of the six respondents particularly want information about subsidiaries that represent dividend traps for group profit and subsidiaries with material NCI. One respondent indicated they want information about all subsidiaries;

b. Three of the six respondents also suggested that Information about significant intra-company transactions that are eliminated on consolidation would be useful; and

c. Two of the six respondents stated there should be cross-references between consolidated, parent and subsidiary financial statements (where they exist). In cases where financial statements do not exist, a statement to that effect to help users better understand and assess the financial implications of a corporate structure would be preferred.

F27. Overall, the investors/analysts surveyed indicated a significant reliance on consolidated financial statements irrespective of whether they are an investor/analyst of a parent or subsidiary. In relation to their financial information needs pertaining to parents, investors/analysts were generally satisfied with the summary financial information currently required to be disclosed by Regulation 2M.3.01. Their need for financial information about subsidiaries, whether as complete sets of financial statements or as summary financial information (and the type of that information) is more circumstance specific. For example, the information needs of a significant proportion of respondents is affected by whether they are an investor in a parent or a subsidiary or whether there are cross guarantee arrangements between the group entities. The greatest need for information was particularly identified in relation to:

(a) material subsidiaries with material NCI and/or significant going concern issues;

(b) groups with international operations (because of any tax implications or profit repatriation constraints) or where the subsidiaries have financial characteristics different from the group;

(c) significant intra-group transactions, and dividend traps or other information pertinent to dividend paying capacity such as retained earnings and profit reserves of subsidiaries; and

(d) whether other financial statements pertaining to group entities (including the group itself) exist and, where they do, cross-references to them.

Appendix G

International comparison - New Zealand (NZ)

G1. The NZ and Australian requirements to prepare financial statements of, or other financial information about, ultimate parents, intermediate parents and bottom subsidiaries in groups are fundamentally different in the following ways[97]:

(a) Under both section 200(2) of the NZ Companies Act 1993 and section 295(2) of the Australian Corporations Act 2001 separate parent (unconsolidated) financial statements are not required where consolidated financial statements are required to be prepared. However, unlike in NZ, parents in Australia are required to disclose summary financial information about themselves in the consolidated financial statements, as per Regulation 2M.3.01.

(b) In NZ, prior to May 2017, the bottom subsidiary in a group was required to prepare subsidiary (individual) financial statements, which was similar to the current requirement under section 295(2) of the Australian Corporations Act. However, the NZ Act was amended in May 2017 to provide an exemption to the bottom subsidiary in a group from preparing financial statements if consolidated financial statements of the parent are prepared (see section 200(3)). In the context of the issues that are the focus of this Report, it is notable that the previous NZ requirement was not replaced with a requirement for summary financial information about the subsidiary to be disclosed in the consolidated financial statements.

(c) Also, in NZ in May 2017 the exemption relating to preparing group financial statements by an intermediate parent was broadened to exempt intermediate parents from preparing group financial statements where the holding company is a large overseas company that carries on business in NZ[98] and has prepared consolidated financial statements. Prior to May 2017, such an exemption to intermediate parents from preparing group financial statements was available only when the parent entity

97 The following is only a broad summary of the requirements for companies under the NZ Companies Act 1993. Different types of entities are governed by separate pieces of governing legislation. For example, exemptions for crown entities are set out in the Crown Entities Act 2004. The exemption for FMC reporting entities is set out in the Financial Markets Conduct Act 2013.

98 The NZ Companies Act 1993 makes reference to an 'overseas company carrying on business' in NZ includes a reference to the overseas company—
(i) establishing or using a share transfer office or a share registration office in New Zealand; or
(ii) administering, managing or dealing with property in New Zealand as an agent, or personal representative, or trustee, and whether through its employees or an agent or in any other manner:

was incorporated in NZ[99]. In Australia, entities that are large foreign-owned subsidiaries with subsidiaries of their own need to prepare AASB 10 consolidated financial statements and disclose summary financial information about the separate financial statements of the parent in the consolidated financial statements as per Corporations Act Regulation 2M.3.01 (see paragraph C5 above).

G2. From the Regulatory Systems (Commercial Matters) Amendment Bill (which was the precursor to the 2017 Act of the same name) it seems that the rationale for the May 2017 NZ amendments was to reduce the compliance burden. In particular, the first page of the Commentary to the Bill states that the policy objective of the Bill is to maintain the effectiveness and efficiency of the regulatory system and so reduce the chance of regulatory failure. It goes on to say, "The amendments would achieve this objective by: … removing unnecessary compliance costs and costs of doing business."[100]

G3. The above summary of NZ requirements was deduced from the relevant sections of the NZ Companies Act 1993, which are reproduced below:

200 Application of preparation provisions

(1) Sections 201 and 202 apply to—

(a) every large company; and

(b) every company that is a public entity; and

(c) every large overseas company; and

(d) every other company with 10 or more shareholders unless the company has opted out of compliance with the provision in accordance with section 207I; and

(e) every other company with fewer than 10 shareholders if the company has opted into compliance with the provision in accordance with section 207K.

(2) However, section 201 does not apply to a company or an overseas company in relation to a balance date if the company or overseas company has, on that date, 1 or more subsidiaries (*see* section 202).

(3) Further, section 201 does not apply to a company or an overseas company (A) in relation to a balance date if,—

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99 Prior to the revision in May 2017, section 202(2) of the NZ Companies Act 1993 stated:
"Group financial statements are not required under subsection (1) in relation to a balance date if,—
(a) on the balance date, A is a subsidiary of a body corporate that is incorporated in New Zealand (B); and
(b) group financial statements in relation to a group comprising B, A, and all other subsidiaries of B that comply with generally accepted accounting practice are completed in relation to that balance date under this Act or any other enactment."

100 See http://www.legislation.govt.nz/bill/government/2016/0183/latest/096be8ed814f6eb0.pdf

(a) on the balance date, A has no subsidiaries but is a subsidiary of a body corporate (B) that is—

(i) incorporated in New Zealand; or

(ii) registered or deemed to be registered under Part 18; and

(b) group financial statements in relation to a group comprising B, A, and all other subsidiaries of B that comply with generally accepted accounting practice are completed in relation to the balance date under this Act or any other enactment; and

(c) A has not opted into compliance with section 201 as referred to in subsection (1)(e).

201 Financial statements must be prepared

Every company or overseas company to which this section applies (**A**) must ensure that, within 5 months after the balance date of A, financial statements that comply with generally accepted accounting practice are—

(a) completed in relation to A and that balance date; and

(b) dated and signed on behalf of A by 2 directors of A, or, if A has only 1 director, by that director.

202 Group financial statements must be prepared

(1) Every company or overseas company to which this section applies (**A**) that has, on the balance date of A, 1 or more subsidiaries must ensure that, within 5 months after that balance date, group financial statements that comply with generally accepted accounting practice are—

(a) completed in relation to that group and that balance date; and

(b) dated and signed on behalf of A by 2 directors of A, or, if A has only 1 director, by that director.

(2) Group financial statements are not required under subsection (1) in relation to a balance date if,—

(a) on the balance date, A is a subsidiary of a body corporate (B) that is—

(i) incorporated in New Zealand; or

(ii) registered or deemed to be registered under Part 18; and

(b) group financial statements in relation to a group comprising B, A, and all other subsidiaries of B that comply with generally accepted accounting practice are completed in relation to that balance date under this Act or any other enactment; and

(c) A has not opted into compliance with this section as referred to in section 200(1)(e).

203 Recognition of financial reporting requirements of overseas countries

(1) Subsection (2) applies if the Registrar notifies an overseas company (**A**) that the Registrar is satisfied that—

(a) the financial statements of A comply with the requirements of the law in force in the country where A is incorporated or constituted; and

(b) those requirements are—

(i) substantially the same as those of this Act; or

(ii) sufficiently equivalent, in relation to the quality of financial reporting they achieve, to the requirements of this Act.

(2) The financial statements must be treated as complying with generally accepted accounting practice.

(3) Subsection (4) applies if the Registrar notifies an overseas company (**A**) that the Registrar is satisfied that—

(a) the group financial statements of the group that comprises A and its subsidiaries comply with the law in force in the country where A is incorporated or constituted; and

(b) those requirements are—

(i) substantially the same as those of this Act; or

(ii) sufficiently equivalent, in relation to the quality of financial reporting they achieve, to the requirements of this Act.

(4) The group financial statements must be treated as complying with generally accepted accounting practice.

204 Financial statements for overseas company must include financial statements for large New Zealand business

(1) If an overseas company is required to prepare financial statements under section 201 and its New Zealand business is large, the financial statements that are prepared must include, in addition to the financial statements of the overseas company, financial statements for its New Zealand business prepared as if that business were conducted by a company formed and registered in New Zealand.

(2) If an overseas company is required to prepare group financial statements under section 202 and the group's New Zealand business is large, the group financial statements that are prepared must include, in addition to the financial statements of

the group, financial statements for the group's New Zealand business prepared as if the members of the group were companies formed and registered in New Zealand.

(3) In this section, the New Zealand business or the group's New Zealand business is **large** in respect of an accounting period if at least 1 of the following paragraphs applies (calculated as if that business were an entity):

(a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the business exceed $20 million:

(b) in each of the 2 preceding accounting periods, the total revenue of the business exceeds $10 million.

(4) A financial reporting standard (or a part of a standard) issued by the External Reporting Board that is expressed as applying for the purposes of subsection (3) must be applied in determining whether that provision applies.

(5) If an overseas company has been granted an exemption under section 207L from a requirement to prepare financial statements under section 201 or group financial statements under section 202, subsection (1) or (2) (as the case may be) still applies (except that the financial statements for the New Zealand business are not in addition to the financial statements of the overseas company or its group).