



Project:	Conceptual Framework for Financial Reporting	Meeting:	AASB February 2019 M169
Topic:	Legislation Research	Agenda Item:	5.1
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		Decision-Making:	High
		Project Status:	Deciding which for-profit entities should be captured by amendments under phase 2

Objective of this paper

- 1 This paper
 - (a) considers the findings from the *Legislation Research Report* (Research Report; Agenda Paper 5.2) in relation to for-profit entities, and
 - (b) discusses how these findings might affect the drafting of the application paragraphs for Australian Accounting Standards.

Reasons for the Board to consider this paper at this meeting

- 2 If the Board decides to proceed with Phase 2 of the proposals to adopt the IASB's revised Conceptual Framework for all for-profit entities in Australia¹ in this meeting, staff will need to develop an Exposure draft in the next few months to incorporate proposals of the financial reporting framework that would apply to for-profit entities affected in Phase 2. In order to do this, it will be necessary to obtain the Board's decision on the proposed wording of the application paragraphs of the Australian Accounting Standards (AAS) to ensure the proposed amendments would only apply to those for-profit entities that the Board determines need to comply with AAS.

¹ See Agenda Item 4.0

Staff recommendation and Questions for the Board

- 3 Based on the analysis undertaken in this paper, staff recommend that:
- (a) the application paragraphs should not specifically exclude any particular entities that are required by legislation to prepare financial statements that comply with AAS, subject to the Board's discussions in relation to possible transitional relief for trusts and similar entities in agenda item 4 (see paragraphs 14 to 19 below); and
 - (b) the application paragraphs in the AAS should be drafted to apply whenever legislation or another document requires that financial statements comply with AAS, but without reference to:
 - (i) 'true and fair view' or any similar wording (see paragraphs 20 to 28 below); or
 - (ii) partial financial information (see paragraphs 29 to 37 below).

Questions for Board members

1. Does the Board agree that the application paragraphs should not be drafted to specifically exclude any particular types of entities that are required by legislation or otherwise to prepare financial statements in compliance with AAS?
2. Does the Board agree that the application paragraphs in the AAS should not have a reference to 'true and fair view' or similar wording, for the reasons set out in paragraphs 20 to 28 below, and that staff should continue liaising with the relevant regulators to discuss their specific circumstances?
3. Does the Board agree that the application paragraphs of the standards should not be drafted to encompass financial information that is not a complete set of financial statements where the legislative requirements refer to compliance with AAS?
4. Does the Board agree that the proposed wording as set out Appendix B of ITC 39 (see paragraph 4 below) remains to be appropriate?

4 Proposed wording:

“Unless specified otherwise in paragraphs 6-21, Australian Accounting Standards apply to:

- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act; and
- (b) financial statements that are required to comply with Australian Accounting Standards.”

Attachments

Agenda Paper 5.2 Legislation Research Report

Structure of paper

5 The paper is set out as follows

- (a) Background
- (b) Questions considered and staff recommendations
 - (i) Are there any entities that should be exempted from compliance with AAS? (see paragraphs 14 to 19 below)
 - (ii) Does ‘true and fair view’ require compliance with AAS? (see paragraphs 20 to 28 below)
 - (iii) How should AAS be applied to financial information? (see paragraphs 29 to 37 below)
- (c) Other observations from the legislative review (see paragraph 38 below); and
- (d) Appendix: Further information on ‘true and fair view’.

Background

- 6 At present, the majority of the AAS only apply to ‘reporting entities’ – being entities that are likely to have users dependent on general purpose financial reports². This means that while legislation or other legal documents such as constitutions may require the preparation of financial statements or financial information that comply with AAS, an entity is not necessarily required to comply with all of the requirements in AAS if the entity can demonstrate that it is not a reporting entity.

² [SAC 1 Definition of the Reporting Entity](#), paragraph 40

- 7 Subject to the Board’s decisions made in agenda item 4 of this meeting, SAC 1 and the reporting entity concept is expected to be removed when the RCF is adopted for all entities in Australia that are required to prepare financial statements that comply with AAS.
- 8 The extent to which entities will need to comply with the Australian Accounting Standards (AAS) going forward will depend on the interplay between:
- (a) the requirements of the relevant legislation, and
 - (b) the wording used for the application paragraphs of the AAS.
- 9 ITC 39³ proposed using the following general application paragraph in AASB 1057 after Phase 2 is implemented:
- “Unless specified otherwise in paragraphs 6-21, Australian Accounting Standards apply to:
- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act; and
 - (b) financial statements that are required to comply with Australian Accounting Standards.”
- 10 Staff have undertaken a comprehensive review of legislation in Australia that refers to the preparation of financial statement or financial information. The results of this analysis are set out in the Research Report that is attached as agenda item 5.2.
- 11 As can be seen from this analysis, there is a broad spectrum of legislative requirements which refer either explicitly or implicitly to compliance with accounting standards (AAS or other/unspecified standards), and which require either the preparation of a complete set of financial statements or financial information⁴.
- 12 If the wording of the application paragraph is retained as suggested in ITC 39:
- (a) the entities in categories (1) and (2) on pages 2-3 of Agenda Paper 5.2 would be required to prepare financial statements that comply with all AAS; and
 - (b) entities in the other categories would not necessarily be required to comply with all of the AAS.

Questions considered

- 13 The following questions have been considered:
- (a) Are there any entities in categories (1) and (2) that would be captured and which are likely to be significantly affected by the proposals, other than those already considered in

³ [ITC 39 Applying the IASB’s Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems \(ITC 39\)](#) – see Appendix B, Amendments to AASB 1057 *Application of Australian Accounting Standards*, paragraph 5.

⁴ Financial information refers to information that is not a complete set of financial statements as defined in AASB 101 paragraph 10 or a financial report, but is required to be provided to regulators and other third parties, including members of the entity.

previous deliberations by the Board? And if yes, is this something the AASB need to address? See paragraphs 14 to 19 below.

- (b) Can financial statements give a ‘true and fair view’ without compliance with accounting standards, or should compliance with accounting standards be mandatory where legislation requires the preparation of financial statements that give a true and fair view? See paragraphs 20 to 28 below.
- (c) If legislation does not require preparation of a complete set of financial statements, but specifically refers to compliance with AAS, does this need to be addressed in the application paragraphs of the standards? See paragraphs 29 to 36 below.
- (d) Should the application paragraphs also address financial information that is required to give a true and fair view or a fair view without referring to AAS? See paragraph 37 below.

Are there any entities that should be exempted from compliance with AAS?

- 14 Categories (1) and (2) in the table on pages 2-3 of the Research Report list entities that are required by legislation to prepare financial statements in accordance with AAS. For all of the for-profit entities, except casino licensees in South Australia, the legislation further clarifies that these are AAS as issued by the AASB (ie category (1)).
- 15 While the majority of the entities listed in category (1) are those covered under the *Corporations Act 2001* (Corporations Act), staff note that the list also includes entities such as large and certain small and medium indigenous corporations, medium and large incorporated associations, large co-operatives, small co-operatives (where directed), potentially franchisors (before entering a franchise agreement), non-government approved providers of residential care services, higher education providers and certain funeral funds. It is possible that some of these entities are currently preparing SPFS and hence will be affected by the Phase 2 proposals.
- 16 It is noted that in considering the financial reporting framework including a revised Tier 2 framework for for-profit entities (agenda item 4 of the February 2019 AASB meeting), the AASB would consider the types of entities required to comply with AAS and the suitability of its suite of accounting standards for the different types of entities to ensure that there are appropriate accounting standards for each type of entity that must comply with AAS.
- 17 However, as set out in the *AASB’s For-Profit Entity Standard-Setting Framework*⁵, it is legislators and other regulators that determine which entities should be required to prepare financial statements in accordance with accounting standards and not the AASB.
- 18 Entities may also be required to prepare financial statements that comply with AAS under trust deeds, constitutions or other legal documents. Staff note that stakeholders have suggested the Board considers grandfathering existing requirements such that preparation of GPFS would only be required for trust deeds, contracts etc set up, amended or entered into after the effective date of the Phase 2 amendments. This is being discussed by the Board as a separate issue in agenda item 4 and would not affect the general application paragraph of the Phase 2 amendments.

⁵ See paragraphs 6-8 of the AASB’s [For-Profit Entity Standard-Setting Framework](#)

- 19 On that basis, staff recommend that the application paragraphs in AAS should not specifically exclude any particular entities that are required by legislation or otherwise to prepare financial statements that comply with AAS.

Question to the Board

Q1: Does the Board agree that the application paragraphs should not be drafted to specifically exclude any particular types of entities that are required by legislation or otherwise to prepare financial statements in compliance with AAS?

Does 'true and fair view' require compliance with AAS?

- 20 The following discussion refers to the entities noted in items (3) and (4) of the table on page 3 of the Research Report, being
- (a) small co-operatives in various states and territories – required to prepare ‘true and fair financial statements’; and
 - (b) various entities under state and territory gaming legislation – required to prepare financial statements that provide a true and fair view of the financial operations.
- 21 While there is a perception that financial statements must comply with accounting standards in order to give a true and fair view, staff note that:
- (a) Both, accounting standards and the *Corporations Act 2001* (Corporations Act) envisage that compliance with the accountings standards may not necessarily result in financial statements that provide a true and fair view.
 - (b) The UK FRC confirmed the continuing ‘primacy’ of the true and fair requirement above compliance with accounting standards.
- 22 Further details on each of these points is provided in the Appendix to this paper. The analysis confirms that it cannot be presumed that compliance with the accounting standards always ensures that the financial statements provide a true and fair view.
- 23 If the application paragraphs for AAS were drafted to require compliance with AAS whenever it is necessary to give a true and fair view, this could possibly even create a conflict with the true and fair override provided in AASB 101 *Presentation of Financial Statements* (AASB 101).
- 24 Staff further note that the only entities that are required to prepare ‘true and fair’ financial statements without reference to compliance with AAS at the same time are small co-operatives and entities reporting under state and territory gaming legislation. In all other cases, the legislation refers to both, providing a true and fair view and complying with AAS.
- 25 Where legislation refers to financial statements providing a true and fair view of the financial operations only (category (4) in the table on page 3 of the Research Report), there could be arguments that this may only extend to the statement of profit or loss and comprehensive

income. An alternative view may be that it is not possible to provide a true and fair view of the operations only without also ensuring the financial position of the entity is fairly reflected.

Conceptual Framework Panel views – 24 January 2019

- 26 Staff also asked members of the Conceptual Framework Panel (the Panel) at a conference call held on 24 January 2019 for their views. One panel member mentioned that the AASB had considered, when deliberating differential reporting in 2009, whether a reference to ‘true and fair’ would require mandatory compliance with AAS. However, this did not proceed due to a political desire not to increase red tape. Others made the point that the true and fair view in Australia has been interpreted to accommodate SPFS and that it is likely legal agreements have also been drafted on that background. Linking true and fair view to compliance with AAS could therefore have significant unforeseen consequences.

Staff recommendation

- 27 Having considered these points, on balance, staff are of the view that it should be a matter for each regulator to decide as to how to interpret the relevant legislation in relation to ‘true and fair view’. Staff are in the process of making contact with regulators/legislators of some of the affected entities to obtain their views on the matter.
- 28 On that basis, subject to strong contrary views from regulators/legislators of affected entities, staff recommend that the application paragraphs of the standards should not require compliance with AAS where legislation only refers to ‘true and fair view’, but does not specifically require compliance with AAS.

Question to the Board

Q2 Does the Board agree that a reference to ‘true and fair’ should not imply mandatory application of accounting standards, for the reasons set out in paragraphs 20 to 28 above, subject to strong contrary views from legislators/regulators of the affected entities?

How should AAS be applied to financial information?

- 29 Some legislation requires the preparation of specified financial information and specifically refers to, or has the effect of, or been interpreted as requiring compliance with AAS in this context (category (5) on page 4 of the Research Report). For example:
- (a) A prospectus prepared under section 710 of the Corporations Act must explain the entity’s financial position, performance and prospects and must include certain financial statements and other information, which is prepared in compliance with Chapter 2M.3 of the Corporations Act, but does not need to include the complete financial statements that are lodged with ASIC.
 - (b) Friendly societies, life insurance companies and superannuation must provide specified financial information to APRA in prescribed forms. The information provided must be consistent with AAS unless otherwise specified; and

- (c) Landlords in retail leases must prepare a statement of operating expenses, and possibly also annual sinking fund statements; the legislation in NSW, WA and Vic specifically refers to compliance with AAS made by the AASB.
- 30 In the examples listed above, the relevant legislation refers to, or has the effect of, or been interpreted as requiring compliance with AAS. In these cases, it would prima facie appear that the financial information should be compiled by applying the recognition and measurement requirements of the relevant AAS but without all of the disclosures.
- 31 However, some of the legislation may have been drafted with the reporting entity concept in mind, and entities may currently report the financial information required under that legislation without complying with all of the recognition and measurement requirements of the relevant AAS, on the basis that they consider themselves to be non-reporting entities.
- 32 Staff further note that the AASB sets standards only for general purpose financial statements.⁶ In this context, financial statements are interpreted to refer to a complete set of financial statements including notes as defined in paragraph 10 of AASB 101 *Presentation of Financial Statements*.⁷
- 33 While it may be desirable that financial information other than a complete set of financial statements should also be prepared on a consistent and comparable basis, using clearly defined recognition and measurement rules, it could be ambiguous whether or to what extent the specified financial information may need to be accompanied by note disclosure to satisfy the requirements of the AAS. Staff consider that it should be a matter for the individual regulators that administer the relevant legislation to provide interpretation that clarifies the extent to which AAS should be applied in the specific circumstances.

Conceptual Framework Panel views – 24 January 2019

- 34 Panel members similarly cautioned against widening the application paragraphs to specifically cover financial information. This is primarily on the basis that financial information is not a defined term and that it may be interpreted too broadly and thus create unintended consequences.

Staff recommendation

- 35 Based on the above, staff recommend liaising with the relevant regulators to encourage a review of the relevant requirements. Staff would also encourage regulators to provide guidance to explain the extent of expected compliance with AAS, including any disclosures that may need to be included.
- 36 At the same time, staff recommend that the application paragraphs are not drafted to address circumstances where financial information, that does not comprise a complete set of financial information per AASB 101 paragraph 10, is nevertheless required to comply with AAS to the extent that the standards apply to the specified financial information.

⁶ [The AASB's For-Profit Entity Standard-Setting Framework](#), paragraph 9 and [AASB Policies and Processes](#) paragraph 20

⁷ A complete set of financial statements is defined in [AASB 101](#) paragraph 10 as comprising a statement of financial position, a statement of profit or loss and other comprehensive income, a statement of changes in equity, a statement of cash flows, notes (comprising significant accounting policies and other explanatory information) and comparative information in respect of the preceding period

- 37 For the same reason as set out in paragraphs 21 to 28 above, staff do not consider that a reference to ‘true and fair’ or ‘fair’ in relation to financial information should require compliance with AAS if the legislation does not specifically refer to AAS.

Question to the Board

Q3: Does the Board agree that the application paragraphs of the standards should not be drafted to encompass financial information that is not a complete set of financial statements where the legislative requirements refer to compliance with AAS?

Other observations from the legislation review

- 38 Staff further noted in the review that some legislation or associated regulations specifically refer to the preparation of special purpose financial reports as an option to satisfy the relevant reporting requirements. Should the Board approve Phase 2 and proceed removing the ability to prepare SPFS from AAS, staff will contact the relevant regulators to discuss whether the legislation or regulations may need to be amended.

Appendix

Further information on ‘true and fair view’

Additional disclosures and true and fair override

- 39 The Corporations Act specifically requires both, compliance with accounting standards and regulations (section 296) and for the financial statements and notes to give a true and fair view of the financial position and performance of the entity (section 297). Section 297 further states that if the financial statements and notes prepared in compliance with AAS would not give a true and fair view, additional information must be disclosed in the notes per section 295(3). This confirms that the legislator has envisaged situations where compliance with AAS may not give a true and fair view.
- 40 AASB 101 goes further and notes that while the application of AAS with additional disclosures, where necessary, is presumed to result in financial statements that achieve a fair presentation, there may be circumstances – albeit extremely rare – where it may be necessary to depart from a requirement in a particular standard in order to achieve a fair presentation⁸.
- 41 While this ‘true and fair override’ is not available to entities that are required to prepare financial reports under Part 2M.3 of the Corporations Act, private and public sector not-for-profit entities, and entities applying AAS – Reduced Disclosure Requirements⁹ it is technically currently available to any other for-profit entities that are required to prepare financial reports under legislation other than the Corporations Act.

UK FRC perspective on ‘true and fair view’

- 42 Staff have also referred to the UK FRC paper *True and Fair* from June 2014¹⁰ which discusses the status of the true and fair requirement in the UK context, in particular in light of the introduction of IFRS and the removal of the term ‘prudence’ from the conceptual framework in 2010. The paper confirms that while there has been a gradual shift to more detailed accounting standards, the preparation of financial statements cannot be reduced to mechanically applying the standards without using objective professional judgement at the same time, to ensure the financial statements still give a true and fair view.
- 43 The FRC also notes that the essence of the accounting standards is to provide for recognition, measurement, presentation and disclosure for specific aspects of financial reporting in a way that reflects economic reality and hence provides a true and fair view. However, this does not release directors from their legal obligation to only approve particular accounts if they are satisfied that they give a true and fair view, and directors should not rely on compliance with accounting standards to avoid making appropriate judgements.

⁸ See AASB 101 paragraphs 15 and 19

⁹ See AASB 101 paragraph Aus19.1

¹⁰ [UK Financial Reporting Council \(FRC\) *True and Fair*](#), June 2014