



Project:	Australian Financial Reporting Framework	Meeting	AASB June 2018 (M165)
Topic:	Consolidated and Separate/Individual Financial Statements	Agenda Item:	7.0
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		Decision-Making:	Medium
		Project Status:	In progress

Objective

1. The objective of this Cover Memo is to:
 - a. update the Board on the progress of the Working Draft AASB Staff Research Report No. X *Consolidated and Separate/Individual Financial Statements* and obtain input from the Board on some key questions, noted below;
 - b. seek Board approval of the project plan, which includes proposed broadening of the outreach and updated timelines.

Attachments

Agenda Paper 7.1	[WORKING DRAFT] AASB Staff Research Report No. X <i>Consolidated and Separate/Individual Financial Statements</i> Phase 1 (for-profit private sector entities) ¹
Agenda Paper 7.2	Project Plan: <i>Consolidated and Separate/Individual Financial Statements</i> Phase 1 (for-profit private sector entities)

Overview of agenda papers

Agenda Paper 7.1 [WORKING DRAFT] AASB Staff Research Report No. X *Consolidated and Separate/Individual Financial Statements* Phase 1 (for-profit private sector entities)

1. Agenda Paper 7.1 is the first working draft of AASB Staff Research Report No. X *Consolidated and Separate/Individual Financial Statements* for 'for-profit private' sector in its phase 1. This along with the second phase which will address not-for-profit private sector entities and public sector entities will complete the last of the planned Research Reports for the Board's Australian Financial Reporting Framework Project, which aims to play a leading role in reshaping the current financial reporting requirements to make them clearer, more objective and comparable across sectors, balancing costs and benefits. Other Research Reports, Staff paper and Discussion Papers in relation to the Project include the following (see

¹ Phase 2 will address not-for-profit private sector entities and public sector entities.

section ‘The relationship of this Report to other AASB projects’ of the Agenda Paper 7.1 for details):

- a. Research Report No.7 Financial Reporting Requirements Applicable for For-Profit Private Sector Companies - May 2018
 - b. Research Report No.6 Financial Reporting Requirements Applicable to Public Sector Entities - May 2018
 - c. AASB Staff Paper Improving Financial Reporting for Australian Public Sector - June 2018
 - d. Research Report No.5 Financial Reporting Requirements Applicable to Charities – October 2017
 - e. AASB Staff Paper Improving Financial Reporting for Australian Charities - November 2017
 - f. AASB submission to ACNC Legislative Review – February 2018
 - g. AASB Staff Paper Comparison of Standards for Smaller Entities – April 2018
2. The Working Draft AASB Research Report in Agenda Paper 7.1 is focused on entities that are structured as groups with parent-subsidiary relationships and assesses the suitability of the current requirements relating to ‘separate’ and ‘individual’ financial statements of (or financial information about) parent entities and subsidiary entities in light of the fact that consolidated financial statements of the group are typically available. The project rationale is primarily to research whether the financial information about subsidiary entities could be provided in a cost effective way (such as by providing summary financial information in the consolidated financial statements of the parent instead of a complete set of financial statements for the subsidiary entity). The impetus of the discussion is owing to similar exemptions available under the NZ Companies Act 1993 for subsidiary entities and for parent’s separate financial statements under Corporations Act 2001.
3. The Research Report primarily addresses the following fundamental questions:
- (a) *Should subsidiaries continue to be required to prepare and lodge individual financial statements publicly, or would disclosure of certain summary financial information about subsidiaries in the consolidated financial statements of the parent (ultimate or intermediate Australian parent) satisfy user needs in a more cost effective way?*
 - (b) *Where it is currently required, does the summary financial information disclosed in consolidated financial statements of the group about the parent (in lieu of separate financial statements) satisfy user needs in a cost effective way?*
4. Issues relating to these two questions to be addressed in the Research Report will be considered in the context of entities within all three sectors, namely:
- a. For profit private sector (greatest progress has been made on this sector to date) – Phase 1
 - b. Not-for-profit private sector (Phase 2); and
 - c. Public sector (Phase 2).

5. The research to be reported in the Research Report will provide input to the process through which the AASB (and 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. Depending on the findings, suitable suggestions to relevant regulators in Australia will be made.
6. Furthermore, it is intended that the findings in the Research Report (if significant) will be presented at the Accounting Standards Advisory Forum (ASAF) in October 2018, with the possibility of improving financial reporting requirements internationally.
7. ***Progress made so far:*** AASB staff have started researching the key questions (as outlined in paragraph 3 above) for the ‘for-profit’ private sector.

Questions for Board members

1. Do Board members agree with the key issues addressed for the ‘for-profit’ sector (including the related issues for subsidiary entities and parent entities as enumerated under the section ‘Key issues addressed’ in Agenda paper 7.1)? In the opinion of the Board, do some issues we have identified need to be amended/deleted or are there other issues that need to be added?
2. Do Board members have any broad comments on the Research Report as drafted so far (e.g. are there any glaring omissions)? (If Board members have any detailed comments on the Working Draft, staff would welcome receiving them out of session).

Summary of staff recommendations and proposal to broaden outreach

8. When the Research Report was first conceived it was thought that banks in their role as lenders may be a good proxy for users. Therefore, the work to date has focused on getting feedback from major banks in Australia.
9. To summarise bankers’ feedback to date in relation to the question in paragraph 4(a) above (i.e. the relevance of individual financial statements of subsidiaries that are companies), all banks stated they require a full set, if the lending is to the subsidiary. Consolidated financial statements do not suffice, and nor would summary financial information about the subsidiary. Exceptions may be made in limited cases where the subsidiaries are wholly owned, covered by a deed of cross guarantee and not carrying on substantial operations – in which case the banks may rely on the consolidated financial statements, but this decision also depends on the facts and circumstances of each individual borrower. The comments relating to the relevance of separate financial statements of the parent (pertinent to the question in paragraph 4(b) above) are broadly consistent with those made about subsidiary financial statements – suggesting that the currently required disclosure of summary financial information about the parent is not an adequate substitute for a full set of parent financial statements.

Thus, on reflection and based on the consistent limited feedback received from banks from a lender’s perspective (who have placed emphasis on having separate and individual financial statements of parent and subsidiary entities respectively for their lending decisions), we think a broader range of users (e.g. investors, analysts) and preparers should be consulted to have a holistic review of the requirements and need for proposing any legislative amendments, if any. Because we have only been able to undertake limited outreach with banks to date (as detailed in Appendix A of Agenda Paper 7.1) and more outreach is proposed (with more banks, investors, analysts and preparers: see next steps below), the Working Draft is not sufficiently advanced for us to be able to make recommendations.

Questions for Board members

3. Based on the consistent, albeit preliminary, feedback received from the banks to date does the Board agree that staff should complete the Research Report (in light of the additional work envisaged in the ‘pending sections’ below); or does the Board think the research may not add much value and only confirm the status quo (at least in relation to subsidiaries, being the primary impetus for our work to date) and thus no further work should be undertaken?

AASB’s staff views: it is worthwhile continuing the work, on the basis that:

a. in relation to parent separate financial statements banks have informed us that the status quo does not provide sufficient information for lending decisions;

b. in relation to subsidiary individual financial statements comments from banks indicate that such statements are not a cause of information overload. To the extent there are more general concerns about information overload globally, our research (although subject to feedback to be received from a broader range of stakeholders) might confirm that such concerns are not due to additional sets of financial statements. This might indicate that opportunities for reducing overload/clutter need to be found elsewhere;

c. Link to other projects:

(i) The Conceptual Framework (CF) project proposes to remove the reporting entity concept and thus restricting entities’ ability to present special purpose financial statements. Adoption of consolidation and equity accounting is also one of the recommendations of the CF project. As part of the outreach and briefing sessions for the CF project, the relevance of the consolidated financial statements was questioned by the participants with a need to examine whether there are any users for these. Additionally the participants informed that individual financial statements of subsidiaries are essential especially in case of multi-national organisations. One of the elements of Research Report No. X *Consolidated and Separate/Individual Financial Statements* is providing usefulness of the consolidated financial statements and at the same time noting feedback of the user community. It is believed that these observations would be useful for the CF project

(ii) A reference to Research Report No. X *Consolidated and Separate/Individual Financial Statements* is also provided in other AASB reports such as in the Discussion Paper covering “Improving Financial Reporting for Australian Charities”. Thus, the Research Report No. X exploring issues relating to consolidation versus single-entity information would be useful for such other projects as well

Agenda Paper 7.2 Project Plan: *Consolidated and Separate/Individual Financial Statements*

10. Agenda Paper 7.2 presents a detailed project plan.

Question for Board members

4. Do Board members agree with the proposed project rationale, objective and project approach (including proposed plan to cover broader outreach) set out in paragraphs 3-10 of the Agenda Paper 7.2 and the proposed project plan set out in paragraph 12 of the Agenda Paper 7.2?
5. Do the Board members think the outreach relating to the for-profit sector needs to be extended to other international banks, investors and preparers such as those in the US, Europe, Asia, considering that this may strengthen the Research Report by providing international benchmarking. (This may have an impact on the proposed completion date by 2-3 months)
6. In relation to this project, once the ‘for-profit’ research is done, would the Board want us to undertake separate research in relation to not-for-profit private and public

sectors, or whether the findings for the for-profit sector would be appropriate for those sectors without us undertaking further research? Additionally are there any sector specific issues relating to the not-for-profit private and public sectors that the board members identify we should start thinking about right now?