Perspective

This is one of a series of articles where experts in assurance, reporting and regulatory matters discuss recent technical and policy developments in these areas

Implementing the *Conceptual Framework for Financial Reporting* in Australia and removing Special Purpose Financial Statements

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In May 2018, the Australian Accounting Standards Board (AASB) issued ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (ITC 39). ITC 39 outlines how the AASB proposes to make the International Accounting Standards Board's (IASB) *Conceptual Framework for Financial Reporting* (RCF) applicable in Australia.

The IASB's RCF is effective for annual reporting periods beginning on or after 1 January 2020. Many Australian entities currently state in their financial statements that they comply with International Financial Reporting Standards (IFRS). In order for these entities to continue to do so after 1 January 2020, the RCF needs to be operative in Australia by that date.

Applying the RCF in Australia is challenging due to the 'reporting entity clash', which arises because the IASB's definition of reporting entity and the reporting entity concept in Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity* are inconsistent.

Scope

It has also highlighted that Australia is the only country that allows entities that are required to prepare financial reports in accordance with Australian Accounting Standards to self-assess whether they prepare general purpose financial statements (GPFS) or special purpose financial statements (SPFS). This has enshrined a level of competitive disadvantage for those entities complying with regulatory guidance compared to those that have chosen not to.

To resolve these issues, the AASB has decided to implement the RCF via a phased approach, which would ultimately result in the removal of SAC 1 and the ability to prepare SPFS. A phased approach allows the AASB time for further research and outreach to better understand constituents' needs, and to consider mitigating actions to alleviate any additional burden faced by entities required by legislation or otherwise to comply with Australian Accounting Standards who are currently preparing SPFS.

The AASB's phased approach to applying the IASB's RCF in Australia.

Phase 1

- ✓ Applies the RCF for publicly accountable for-profit private sector entities required by legislation to comply with Australian Accounting Standards.
- ✓ Enables entities claiming IFRS compliance to continue doing so
- ✓ Other for-profit entities can adopt the RCF on a voluntary basis.
- ✓ Maintains the status quo for other entities in the short term, until an appropriate Tier 2 GPFS framework is determined via consultation and research.

Phase 2 – for-profit entities

- ✓ Applies the RCF for all for-profit entities in the medium term.
- ✓ Implements an appropriate Tier 2 GPFS framework for for-profit entities.
- ✓ Removes confusion and the risk of inappropriate accounting policy and interpretation decisions likely to arise from operating two conceptual frameworks

Not-for-profit entities

- ✓ Determines the not-for-profit financial reporting framework, considering the outcomes of the ACNC Legislative Review report, discussions with other State and Territory regulators and from dedicated not-for-profit consultations.

What is Phase 1 and who is impacted?

When the Phase 1 proposals were drafted, it was expected that any for-profit private sector entity with public accountability would also meet the definition of a reporting entity in SAC 1 and would therefore be preparing Tier 1 GPFS in accordance with AASB 1053 *Application of Tiers of Australian Accounting Standards* and be claiming IFRS compliance. Submissions received on Phase 1 indicated that this is not necessarily the case.

For example, there are a number of for-profit private sector entities that are currently preparing SPFS although they might be publicly accountable. These are predominately trust entities that have no legislative requirement to prepare financial statements. Their financial reporting requirements are governed by their trust deed, which requires compliance with Australian Accounting Standards.

The objective of Phase 1 is to ensure that the IASB's RCF can be applied by publicly accountable for-profit private sector entities and other for-profit entities currently claiming IFRS compliance.

Phase 1 is not intended to:

- capture entities that are currently not required by legislation to prepare financial statements
- apply to entities that are required by trust deeds or other constitutional documents (and not legislation) to prepare financial statements in accordance with Australian Accounting Standards and
- require for-profit public sector entities to adopt the RCF.

Which entities can and can't apply the revised conceptual framework?

✓ For-profit private sector entities that have public accountability and are required by legislation to comply with Australian Accounting Standards.

✓ Any for-profit entity that elects to voluntarily adopt.

✘ Not-for-profit entities.

For these reasons, the AASB decided that the RCF will only apply mandatorily to for-profit private sector entities that have public accountability and are required by legislation to comply with Australian Accounting Standards. Other for-profit entities will be able to adopt the RCF on a voluntary basis.

Not-for-profit entities will not be able to apply the RCF until the AASB has considered any necessary not-for-profit modifications to the RCF.

How will Phase 1 be implemented?

During Phase 1 there will be two conceptual frameworks.

Publicly accountable for-profit private sector entities that are required by legislation to comply with Australian Accounting Standards must apply the RCF. Other for-profit entities can adopt it on a voluntary basis. Entities that are not applying the RCF will continue to apply the *Framework for the Preparation and Presentation of Financial Statements* (old framework). This is only an interim solution and the AASB intends to have a single conceptual framework again in due course.

To implement the RCF and maintain IFRS compliance consequential amendments will be made to most Standards and Interpretations. To enable entities not affected by Phase 1 to continue to apply the old framework, equivalent AusCF paragraphs and footnotes will be added which will retain the existing text.

Addressing the reporting entity clash

Entities applying the RCF can no longer apply the reporting entity concept in SAC 1. These entities should refer to Chapter 3 of the RCF to determine what the term 'reporting entity' means to them.

Entities applying the old framework will continue referring to the reporting entity definition in AASB 1053 and SAC 1.

Public Accountability –deeming of entities and guidance

A number of constituents have asked for guidance on how to apply the AASB 1053 definition of public accountability. Some have also asked the AASB to revisit the types of entities that are currently deemed to have publicly accountability. To respond to this feedback the AASB will undertake a sub-project on public accountability, which will consider whether:

- there should be any changes to who is deemed to have public accountability
- entities that raise crowd-sourced equity funding and corporate collective investment vehicles have public accountability and
- additional guidance is needed to help entities apply the public accountability definition.

This sub-project will be undertaken as a priority and is scheduled to be discussed at the February 2019 Board meeting.

What's next?

AASB Exposure Draft on Phase 1 proposals

Having two conceptual frameworks applicable to a single set of Standards and Interpretations results in complex amendments to highlight which entities apply which conceptual framework (including which entities apply SAC 1). A limited-scope Exposure Draft of these proposed amendments will therefore be issued in January 2019. The Exposure Draft is expected to have a two-month comment period.

Phase 2: For-profit private sector entities

Phase 2 will make the RCF applicable for all other for-profit private sector entities. It will also remove the ability of those entities to prepare SPFS where they are required to prepare financial statements that comply with Australian Accounting Standards. The AASB is likely to provide considerable transitional relief to entities moving from SPFS to GPFS.

For-profit entities that do not have a requirement (legislative or otherwise) to prepare financial statements that comply with Australian Accounting Standards will not be impacted by Phase 2.

For example:

✘ *An entity that has no statutory financial reporting requirements, but is required to calculate their banking covenant ratios in accordance with Australian Accounting Standards, will not be impacted by Phase 2. This is because the calculation of banking covenants in accordance with Australian Accounting Standards is not a financial reporting requirement.*

✓ *A large proprietary company that is currently preparing SPFS will be impacted. This is because they are required by the Corporations Act 2001 to prepare financial statements in accordance with Australian Accounting Standards.*

The AASB conducted outreach events in September 2018 to garner feedback on Phase 2. Key messages from these outreach events were:

- 96% of attendees strongly agreed that the special purpose financial reporting problems need to be resolved, and that Tier 2 GPFS should comply with the recognition and measurement requirements of all Australian Accounting Standards.
- The vast majority of attendees felt that the specified disclosure regime proposed in ITC 39 was too onerous in some ways but too light in other ways. Attendees preferred a revised and more user-friendly version of the reduced disclosure regime instead.
- There was uncertainty on whether the transitional relief provided by AASB 1 *First-time Adoption of Australian Accounting Standards* was sufficient.
- Views regarding grandfathering of consolidations which occurred prior to the effective date of the RCF were mixed.
- Most attendees felt that comparatives should be required for any recognition and measurement changes which result from preparing GPFS for the first time.

Phase 2 submissions on ITC 39 were due by 9 November and are currently being analysed by Staff. The Board is expected to consider these submissions in February 2019.

Not-for-profit and public sector entities

While the AASB confirmed that its aim of achieving a simple, comparable, proportionate and transparent financial reporting framework remains unchanged, it also acknowledged that the impact of removing SPFS may be more significant for not-for-profit private sector entities. In light of the Australian Charities and Not-for-Profits Commission's Legislative Review recommendations and feedback from the not-for-profit sector and its regulators, the AASB therefore decided in September 2018 that Phase 2 would only apply to for-profit-private sector entities and that a separate consultation document containing targeted proposals for not-for-profit private sector entities would be issued in due course.

As public sector entities are not expected to be significantly affected by the removal of SPFS, the AASB's preference is to pursue financial reporting reform in this sector via consultations based on the AASB Discussion Paper *Improving Financial Reporting for Australian Public Sector*.