



## Staff FAQs

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1. What is the problem? .....	1
2. What does ‘self-assessment of reporting requirements’ mean?.....	2
3. What are the current reporting requirements for SPFS lodged with ASIC or ACNC? .....	2
4. Is the self-assessing of GPFS or SPFS being done appropriately?.....	3
5. What is the AASB proposing?.....	3
6. Who is not impacted by these proposals and how will their financial reporting needs be catered for? .....	4
7. What regulators have been engaged as part of this review? .....	5
8. What inputs can constituents provide to help the AASB better understand the impact of the proposals on entities and what transitional relief may be helpful? .	5

### For-profit entities

9. Will the regulatory burden increase in the for profit sector?.....	6
10. Is it also timely to review the size threshold test for entities to publicly report? .	8
11. Are there any users of the financial statements lodged with ASIC? Do they use the financial report information?.....	8
12. Nobody has complained about us doing SPFS, so why change now? .....	9
13. Just because there have been few court cases on inappropriate use of SPFS doesn’t mean there won’t be more in the future. ....	9

### Not-for-profit entities

14. Will the regulatory burden increase in the not-for profit sector?.....	9
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## 1. What is the problem?

The International Accounting Standards Board’s recently revised *Conceptual Framework* has highlighted that Australia is unique, and not in a good way. We are the only country that allows entities required by legislation to prepare financial reports in accordance with the Accounting Standards to self-assess and determine those reporting requirements.

Accordingly, Australia’s financial reporting requirements are complex, making it challenging for directors, preparers and users to understand what an entity’s reporting requirements are.

Australia’s reporting requirements are currently not fair or transparent, in fact, they have enshrined a level of competitive disadvantage to those complying with regulatory guidance compared to those who have chosen not to comply.

[back to top](#)

## 2. What does ‘self-assessment of reporting requirements’ mean?

Currently when an entity is required by legislation or otherwise to prepare financial reports in accordance with Australian Accounting Standards (AAS), the entity applies criteria in Statement of Accounting Concepts SAC 1 *Definition of Reporting Entity* and self-assesses whether it prepares general purpose financial statements (GPFS) or special purpose financial statements (SPFS).

### Key points

- Entities that prepare GPFS comply with the AAS reporting requirements.
- Entities that prepare SPFS choose the reporting requirements they want to comply with.

[back to top](#)

## 3. What are the current reporting requirements for SPFS lodged with ASIC or ACNC?

ASIC’s Regulatory Guide 85 (RG 85) applies to SPFS lodged with ASIC, The ACNC Act and regulations apply to SPFS lodged with the ACNC.

Required for SPFS lodged with ASIC	Required for SPFS lodged with ACNC
<ul style="list-style-type: none"><li>• All recognition and measurement requirements of AAS (to comply with the <i>Corporations Act</i> requirements to present a true and fair view)</li><li>• Five disclosures standards that basically require a profit and loss statement, balance sheet, cash flow statement and accounting policy notes. The required disclosures do not include related party disclosures.</li></ul>	<ul style="list-style-type: none"><li>• True and fair view (to comply with the ACNC Act and ACNC regulations)</li><li>• Five disclosures standards that basically require a profit and loss statement, balance sheet, cash flow statement and accounting policy notes. The required disclosures do not include related party disclosures.</li></ul>

[back to top](#)

## 4. Is the self-assessing of GPFS or SPFS being done appropriately?

No, evidence suggests self-assessment is not working.

### Key criteria for preparing GPFS

- A. AASB's SAC 1 says entities with users that cannot demand specific financial information, or that have greater economic/political significance or size or indebtedness should prepare GPFS.
- B. The *Corporations Act* Explanatory Memorandum makes it clear that the small/large criteria were determined based on 'economic significance'. There is a strong argument that all large proprietary companies<sup>1</sup> and unlisted public companies (who by definition have more than 50 investors) should be preparing GPFS.

Our empirical research shows the criteria of users, economic significance, size and/or indebtedness is not being used to determine when an entity chooses to prepare SPFS. Therefore, it's clear that the principles of SAC 1 are not being applied properly.

Anecdotally we have heard that the decision driving the preparation of SPFS for many entities is based on cost, not wanting to comply with AAS and/or wanting to avoid related party disclosures. None of these reasons are principles of SAC 1!

This means there are many cases of two economically similar entities where one will be preparing GPFS while the other is preparing SPFS. How fair is that?

Is it fair that entities inappropriately self-assessing as SPFS continue to put their competitors at a disadvantage?

[back to top](#)

## 5. What is the AASB proposing?

The AASB is proposing to remove the ability for entities who are required to prepare financial statements in accordance with AAS to self-assess whether they have to prepare GPFS or not.

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<sup>11</sup> Refer *Incat Australia Pty Ltd v Australian Securities and Investment Commission - [2000] FCA 58*

The AASB will set two simple yet robust tiers of financial reporting to improve comparability, trust and transparency of financial reporting:

1. Tier 1 GPFS<sup>2</sup> triggered when an entity is publicly accountable (eg listed entities and those with fiduciary responsibilities such as banks and insurance companies).
2. Tier 2 GPFS – Reduced Disclosure Requirements (RDR)<sup>3</sup> or<sup>4</sup> Tier 2 GPFS – Specified Disclosure Requirements (SDR)<sup>5</sup>.

Both Tier 1 and Tier 2 require full recognition and measurement with AAS; and consolidation and equity accounting (where required<sup>6</sup>) to ensure a level playing field and facilitate user access to consistent and comparable financial statements.

Tier 2 GPFS-SDR effectively adds four incremental disclosures to disclosures already required by ACNC regulations and ASIC's RG 85. These additional disclosures are on areas of importance to any user:

1. related party disclosures
2. revenue
3. impairment of assets
4. income taxes.

[back to top](#)

## 6. Who is not impacted by these proposals and how will their financial reporting needs be catered for?

These proposals will not apply to:

- small proprietary companies (other than those that are foreign owned)
- small charities
- small incorporated associations in WA, Tas, Vic
- Self-Managed Superannuation Funds

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<sup>2</sup> Tier 1 GPFS consist of full recognition and measurement, consolidation and equity disclosures, all disclosures.

<sup>3</sup> Tier 2 GPFS-RDR consist of full recognition and measurement, consolidation and equity disclosures, all disclosures at a reduced level.

<sup>4</sup> Consultation Paper (ITC 39) is asking constituents to choose which Tier 2 GPFS alternative they prefer (ie there will only be one Tier 2 GPFS framework).

<sup>5</sup> Tier 2 GPFS-SDR consist of full recognition and measurement, consolidation and equity disclosures, nine disclosures in full (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*, AASB 1054 *Australian Additional Disclosures, Related Party Disclosures, Impairment of Assets, Revenue and Income Taxes*).

<sup>6</sup> There are exemptions within AAS from preparing consolidated financial statements where the ultimate Australian parent is preparing consolidated financial statements.

- entities of any size or nature not required by legislation or otherwise (such as a constitutional document) to prepare financial statements in accordance with AAS.

These proposals will not change:

- public lodgment relief (s1408 *Corps Act*) granted to grandfathered proprietary companies
- ASIC's small/large proprietary test (s45A *Corps Act*).

These entities get to keep doing what they are currently doing. However, disclosing a profit and loss statement, balance sheet, cash flows and accounting policies isn't really a framework.

Current SPFS is by definition a free choice, particularly regarding recognition and measurement requirements. The AASB is considering whether there is a need for a cash accounting standard that would have some standard templates for the for-profit and not-for-profit (NFP) sector, similar to New Zealand's Tier 4 that could link in with tax returns and ACNC annual information statements for these types of entities. We will seek feedback on this.

[back to top](#)

## 7. What regulators have been engaged as part of this review?

The AASB has been consulting extensively with all regulators involved in these proposals: Treasury, the ACNC, ASIC, ATO and the state regulators. We will continue to keep them updated on the feedback we receive and work with them when developing final proposals.

[back to top](#)

## 8. What inputs can constituents provide to help the AASB better understand the impact of the proposals on entities and what transitional relief maybe helpful?

The AASB is undertaking extensive research to better understand the impact of the proposals as part of the Regulation Impact Statement (RIS) process which includes detailed cost-benefit analysis. We're asking constituents to facilitate this process by providing:

- redacted examples of entities impacted by consolidation and equity accounting to demonstrate the impact of the changes and trial transitional relief to alleviate the burden
- statistics to help us better understand the extent of the impact (ie firms could provide estimates of the number of their clients who would be moving from SPFS to Tier 2 GPFS, including those that would be required to consolidate and/or equity account)

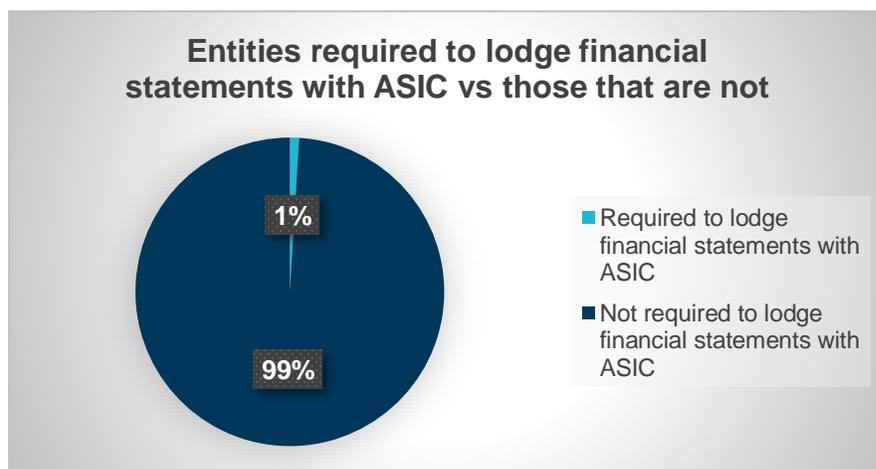
- information about entities not regulated by ASIC or the ACNC who are required to prepare financial statements in accordance with AAS (including what legislation or otherwise requires this reporting, an estimation of the number of entities likely to be impacted etc)
- estimates of the costs incurred by clients who have moved from SPFS to Tier 2 GPFS as a result of the ATO's Significant Global Entity (SGE) requirements
- suggestions on the types of transitional relief and ongoing support (such as guidance and education) to alleviate the reporting burden.

[back to top](#)

## For-profit entities

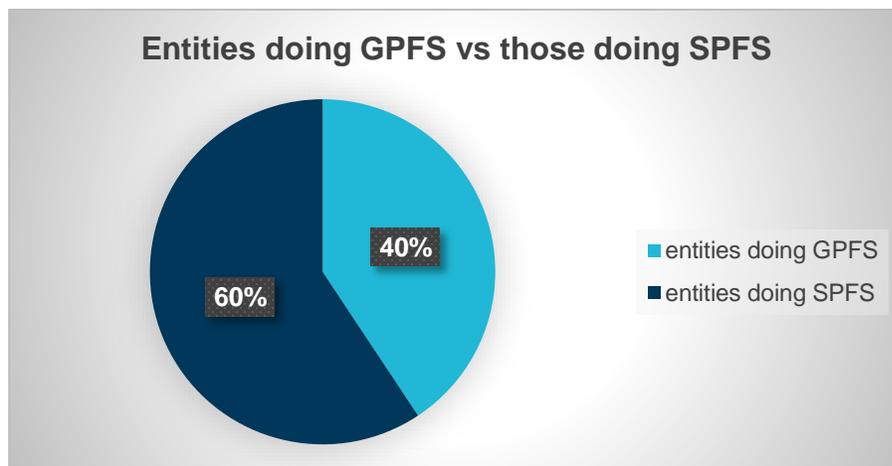
### 9. Will the regulatory burden increase in the for profit sector?

There will be costs, however, it's important to understand how many entities are expected to be impacted. Of the 2.5 million companies registered with ASIC, only ~24,000 large proprietary companies, unlisted public companies, small foreign-owned companies and public companies limited by guarantee entities<sup>7</sup> are required to lodge financial statements with ASIC.



Of these 24,000, research indicates 40% are already doing GPFS while 60% are doing SPFS – that's only 14,000 entities doing SPFS. Of those, 60% are complying with RG 85, 20% are definitely not and we can't tell what the other 20% are doing.

<sup>7</sup> Excludes listed entities and registered schemes.



The worst case scenario is that only 6,000 entities that are not currently complying with RG 85 will be significantly impacted by the AASB's proposals. This number is under review and, anecdotally, we expect it to be significantly less given the Significant Global Entities (SGE) tax legislation has forced more entities to adopt GPFS and accounting firms have been encouraging more use of RG 85.

One of the AASB's legislative obligations is to provide accounting standards that promote comparability. With that in mind, we are focusing on removing the competitive disadvantage affecting those who are complying with RG 85 as a result of the others not being held to the same standard of account.

While we acknowledge the increased costs for a small number of for-profit entities, in most cases this is the result of their current corporate governance practices and choice not to comply with ASIC regulatory guidance.

The additional proposed disclosures above RG 85 are not expected to introduce significant additional costs. We know some entities will be impacted by the clarification that consolidation and equity accounting will be required and we are talking to those entities to best gauge what transitional relief will be needed.

Overall, reporting requirements will be simpler and easier to apply, with reduced risk for directors, preparers and auditors. For users they will provide comparability and increased trust and transparency. And they will also be enforceable by regulators.

While these benefits are harder to measure than the direct costs of the proposals, they are substantial none-the-less.

[back to top](#)

## 10. Is it also timely to review the size threshold test for entities to publicly report?

Of the 2.5 million companies currently registered with ASIC, only 840,000 are trading. For those who argue the small/ large thresholds haven't been updated and should be revised because the reporting requirements are burdensome, approximately 10,000 (1% of trading enterprises) are large proprietary companies.

As a reminder, large proprietaries have two or more of the following characteristics:

- \$25 million or more in revenue
- \$12.5 million or more in assets
- 50 or more employees.

By contrast, large charities are those with more \$1 million in annual revenue. When compared with overseas jurisdictions such as the UK (where all companies regardless of size have to lodge financial statements) and even the US (where proprietary companies do not have to lodge at all), it's hard to argue that Australian company requirements are unduly burdensome if only 1% of trading enterprises are large proprietary companies required to report. In contrast, 30% of charities are currently lodging financial statements with the ACNC.

[back to top](#)

## 11. Are there any users of the financial statements lodged with ASIC? Do they use the financial report information?

There are users of the financial statements lodged with ASIC:

- Credit analysts are using them to provide tailored information to their clients, for credit ratings, for private equity investments and other purposes.
- The general public is interested in how much tax the corporates are paying (as indicated by the support for the Significant Global Entities tax requirements).
- The media is interested in parties who are not disclosing related party information and where similar entities in the same sectors are preparing different types of financial statements.
- Investors are particularly interested in foreign controlled entities.

In any case, as noted earlier, focusing only on the number of current and potential users is not consistent with SAC 1. The small/large test is designed to hold accountable those entities who benefit most from the protection of limited liability and those with economic significance, so focusing only on the number of users is not appropriate.

User needs in both the for-profit and the NFP sectors were explored through research and consultation while developing these proposals, and will continue to be part of the AASB's consultation program through to the end of the comment period (November 2018).

[back to top](#)

## **12. Nobody has complained about us doing SPFS, so why change now?**

The Significant Global Entities tax legislation resulted from concerns over SPFS and there is evidently media interest in entities using SPFS to hide related party transactions and provide themselves with a competitive advantage.

[back to top](#)

## **13. Just because there have been few court cases on inappropriate use of SPFS doesn't mean there won't be more in the future.**

Directors have obligations under legislation to sign off that the financial statements present a true and fair view. SPFS increases risk for directors, in cases where they do not comply with recognition and measurement requirements and do not provide relevant disclosures to assess whether a true and fair view has been presented, it's more difficult for directors to demonstrate they have met their obligations.

[back to top](#)

## **Not-for-profit entities**

### **14. Will the regulatory burden increase in the not-for profit sector?**

The AASB will await the ACNC Legislative Review Recommendations before determining how to proceed with the NFP sector.

# Replacing the reporting entity concept and removing the option for Special Purpose Financial Statements



We are working with state regulators to consider how best to address incorporated associations, co-operatives, mutuals, and other types of NFP entities required to lodge financial statements in accordance with AAS.

Outreach conducted in 2017 indicated there is a need for three tiers of reporting for charities; potentially with some very simplified accounting to provide proportionate financial reporting that balances costs to preparers and user needs.

Depending on the ACNC Legislative Review Recommendations, there may be an opportunity to provide comparability, and reduce the regulatory burden for some.

[back to top](#)

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*We want your feedback on the impact of these proposals, so please attend one of our outreach sessions or contact the AASB via standard@asb.gov.au or telephone 03 9617 7600.*