Staff FAQs

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.

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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.

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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**
• All recognition and measurement requirements of AAS (to comply with the *Corporations Act* requirements to present a true and fair view) • 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.	• True and fair view (to comply with the ACNC Act and ACNC regulations) • 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.

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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[1] 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 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?

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

5. What is the AASB proposing for for-profit entities?

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

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

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

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

GPFS Tier 2 – 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.

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[2] GPFS Tier 1 consist of full recognition and measurement, consolidation and equity disclosures, all disclosures.
[3] GPFS Tier 2 – RDR consist of full recognition and measurement, consolidation and equity disclosures, all disclosures at a reduced level.
[4] Consultation Paper (ITC 39) is asking constituents to choose which GPFS Tier 2 alternative they prefer (ie there will only be one GPFS Tier 2 framework).
[5] GPFS Tier 2 – 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).
[6] There are exemptions within AAS from preparing consolidated financial statements where the ultimate Australian parent is preparing consolidated financial statements.

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
- 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.
- not-for-profit entities as reporting for these entities will be addressed separately

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.

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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, ASIC, ATO and the state and territory regulators.

ASIC has made the following statement in relation to the AASB's consultation program:

> "*ASIC fully supports the consultation to remove special purpose financial statements for entities regulated by ASIC and remove the subjective 'reporting entity' test under SAC 1 facilitating a comparable, consistent and transparent framework for preparation of financial statements in Australia.*"

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The ATO has made the following statement in relation to the AASB's consultation program:

> "*The ATO is supportive of the AASB's proposed approach to consulting on a series of principles or concepts for enhancing the transparency of entities currently preparing Special Purpose Financial Statements as part of adopting the revised Conceptual Framework issued by the International Accounting Standards Board and for inclusion in Australian Accounting Standards by 2021."*

We will continue to keep them updated on the feedback we receive and work with them when developing final proposals to improve the consistency, comparability and transparency of financial reports prepared in accordance with Australian Accounting Standards.

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8. What inputs can constituents provide to help the AASB better understand the impact of the proposals on for-profit 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 GPFS Tier 2, including those that would be required to consolidate and/or equity account)
- information about entities not regulated by ASIC 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 GPFS Tier 2 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.

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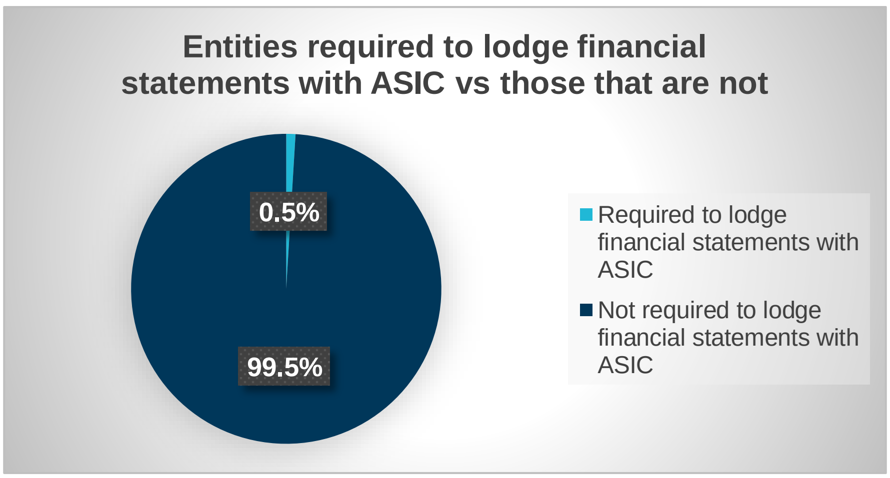
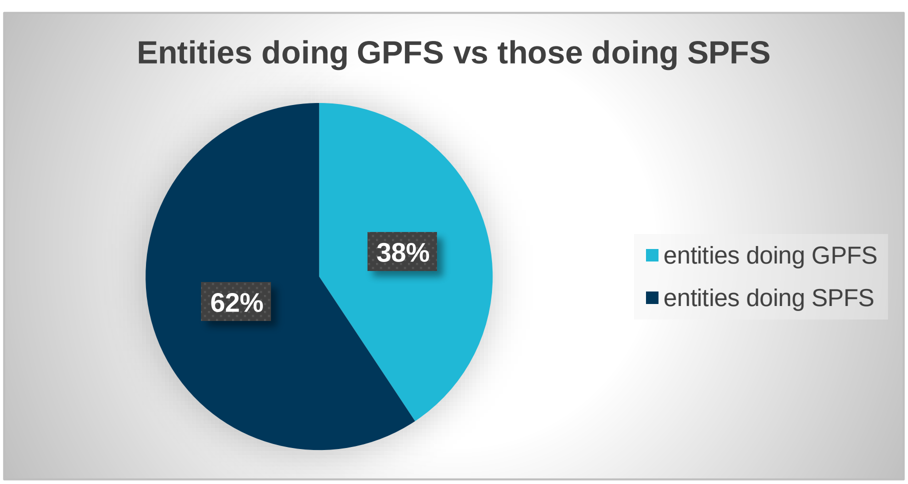
For-profit entities

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 ~12,800 large proprietary companies, foreign-controlled small proprietary companies and unlisted public companies[7] lodged financial statements with ASIC in 2017-2018.



Of these ~12,800, 38% are already doing GPFS while 62% are doing SPFS – that's only 7,936 entities doing SPFS.



[7] Excludes listed entities, registered schemes and public companies limited by guarantee.

Based on research of financial reports lodged with ASIC by large proprietary companies, foreign-controlled small proprietary companies and unlisted public companies in 2010-2011, 65% stated they complied with RG 85, 12% stated they did not and the remaining 23% were unclear.

The worst case scenario is that only 2,800 entities that are not 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.

Preliminary findings from the consultation with preparers of financial reports indicates that the most significant impact of moving from SPFS to GPFS (or from GPFS Tier 2 – RDR to SDR) is detailed disclosures on specified standards, whereas the application of recognition and measurement requirements and consolidation and equity accounting are less of a concern. Accordingly, only 31% of financial report preparers find the transitional relief under AASB 1 *First-time Adoption of Australian Accounting Standards* to be useful, suggesting to have an exemption from disclosing comparatives and/or restating prior periods.

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.

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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 6800 (less than 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 currently 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.

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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:

- ~98,000 copies of financial statements are purchased from ASIC annually (80% proprietary companies, 16% unlisted public companies and 4% disclosing entities)
- 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 were explored through research and consultation while developing these proposals and will continue to be part of the AASB's consultation program.

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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.

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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.

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Not-for-profit entities

14. What does this mean for not-for-profit (NFP) private sector entities?

As foreshadowed in ITC 39, the approach to removing SPFS for NFP private sector entities is dependent on ACNC Legislation Review proposals, and discussions with the ACNC and state and territory regulators about reporting requirements. As a result of feedback from the NFP sector and recent promising discussions with the ACNC and the other regulators, the AASB considers the proposals in ITC 39 are most relevant to for-profit-entities only.

While our aim – to replace SPFS with a simple, comparable, proportionate, transparent financial reporting framework remains unchanged – we recognize the journey for NFP private sector entities will be very different to that of the for-profit private sector. In this regard, we will continue to extensively research optimal outcomes, collaborate with regulators, and regularly consult with NFP entities to ensure a simple and fair framework and a smooth transition for NFP private sector entities. In particular, we think as the impact of removing special purpose financial statements is more significant, there are more options, and a longer timeframe that will need to be considered for the NFP private sector.

The AASB will issue a separate consultation document containing targeted proposals for NFP private sector entities in due course.

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15. What does this mean for NFP public sector entities?

The removal of special purpose financial statements is expected to have little impact in the public sector. The AASB's preference is to pursue financial reporting reform in the public sector via consultation around AASB Discussion Paper *Improving Financial Reporting for Australian Public Sector*.

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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@aasb.gov.au or telephone 03 9617 7600.