ITC39 Revised Conceptual Framework – Phase 1 – Additional comments – David Hardidge

ITC 39 Consultation Paper - Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems – Phase 1

I was involved in contributing to the Australasian Council of Auditors-General (ACAG) submission, as part of my role as Technical Director at Queensland Audit Office.

I support that submission and submit the attached comments covering:

- Application of the RCF to Tier 2 entities and non-reporting entities before Phase 2
- AASB 1048 RCF Note description
- Other AASB 1048 drafting
- Unintended consequences of referring to "required"

My comments are applicable to for-profit entities.

Regards,

David Hardidge
21 August 2018

Application of the RCF to Tier 2 entities and non-reporting entities before Phase 2

I interpret the consequences of the proposals as going beyond the AASB's stated scope of "entities that are required to prepare Tier 1 GPFS and other entities that are voluntarily reporting compliance with IFRS" (paragraph 164(a)). The proposals appear to require the use of the revised conceptual framework (RCF) from 1 January 2020 until the start of Phase 2 by:

- entities preparing Tier 2 GPFS – this will allow Tier 2 and Tier 1 entities to use the same recognition and measurement criteria
- non-reporting entities required to comply with AASB 108 (i.e. ACNC entities and companies following ASIC RG 85) – this will mean the clash of terminology in the short-term until Phase 2 commences.

My reasoning is based on my expectation that AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* (paragraph 11) will be amended by AASB 2018-X, being the equivalent to *Amendments to References to the Conceptual Framework in IFRS Standards.* AASB 108 paragraph 11 relates to the selection of accounting policies in the absence of a suitable standard. While AASB 2018-X was not included in ITC39, I expect the amendments to be based on:

> **Amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors***
>
> **Selection and application of accounting policies**
>
> ...
>
> **11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:**
>
> **(a) the requirements in IFRSs dealing with similar and related issues; and**
>
> **(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *~~Framework~~Conceptual Framework for Financial Reporting* (*Conceptual Framework*).~~*~~†**
>
> ~~* In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.~~
>
> † Paragraph 54G explains how this requirement is amended for regulatory account balances.
>
> Extract from *Amendments to References to the Conceptual Framework in IFRS Standards*

AASB 108 is mandatory for entities preparing Tier 2 financial statements, and for non-reporting entities required to comply with AASB 108 (i.e. ACNC entities and companies following ASIC RG 85). Therefore, from 1 January 2020, the RCF will be applicable to those entities – unless the AASB makes other amendments.

AASB 1048 RCF Note description

I interpret the draft proposals as being there will be no mandatory changes until financial years beginning on or after 1 January 2020 (paragraph 157).

With the issue of the *Conceptual Framework*, the associated *Amendments to References to the Conceptual Framework in IFRS Standards* (proposed AASB 2018-X), and the amendments proposed in Appendix A, the following entities can early adopt the RCF before 1 January 2020:

- Tier 1 entities

- other entities that are voluntarily reporting compliance with IFRS
- Tier 2 entities
- non-reporting entities applying AASB 108.

As I explained above, I interpret the proposals as being mandatory from 1 January 2020 for the above entities, including Tier 2 entities and non-reporting entities applying AASB 108.

ITC39 Appendix A (page 33) includes the following proposed Note associated with the amendments to AASB 1048 for the RCF (Table 3):

> Conceptual Framework for Financial Reporting
> Note – this pronouncement is applicable only to for-profit entities that have public accountability that are required to comply with Australian Accounting Standards and other for-profit entities that elect to apply this Framework

Based on my reasoning, I believe the Note contains two errors (until the Note is removed on the commencement of Phase 2):

- The first is that the Note refers to the amendment being applicable to "other for-profit entities that elect to apply this Framework." While that statement may be correct for the period until 1 January 2020, it is not correct for Tier 1 entities for periods after then as there will be no election choice.
- The second is that the Note refers to "for-profit entities that have public accountability that are required to comply with Australian Accounting Standards". While this statement is correct after 1 January 2020, when the amendments become mandatory, it is not correct during the early adoption period until 1 January 2020.

Other AASB 1048 drafting

I suggest modifying the wording of AASB 1048 paragraph 10 and paragraph 11 as the current drafting (that is not proposed to be updated under Phase 1) appears to:

- Retain the references to the title of the conceptual framework as *Framework for the Preparation and Presentation of Financial Statements*, even though the title has changed to *Conceptual Framework for Financial Reporting* (*Conceptual Framework*)
- Assume that there is only one conceptual framework for any particular financial year – which does not seem to cater for the retention of the old conceptual framework for AASB 3 and AASB 14, when the RCF commences.

Extracts from AASB 1048:

10 Each reference to the *Framework for the Preparation and Presentation of Financial Statements* (or *Framework*) in other Australian Accounting Standards (including Interpretations) is taken to be a reference to the relevant pronouncement listed in Table 3 below. Each row in Table 3 is to be treated as a separate provision of this Standard.

[Table 3 omitted]

11 This Standard updates references to the *Framework* in Australian Accounting Standards (including Interpretations) to the relevant amended version of the *Framework*. The principal application date listed in each row of Table 3 is a reference to annual reporting periods beginning or ending (as indicated) on or after the date specified. An entity may elect to apply an amended version of the pronouncement to

annual reporting periods in advance of that stated in Table 3, subject to any early application paragraphs.

Unintended consequences of referring to "required"

The ACAG submission notes that the ITC includes applicability paragraphs that includes "*for-profit entities that have public accountability that are required to comply with Australian Accounting Standards*". ACAG suggested the AASB clearly articulates what the term "required" refers to. For example, is the "requirement" prescribed by legislation, ASIC regulations, the entity's constitution, a contractual funding agreement or another instrument?

I suggest that different wording be used to avoid possible unintended consequences. An example of such unintended consequences arising from the use of similar references to "require" were introduced by amendments to the Corporations Act section 295(2) in 2011. These amendments were to allow removal of parent entity financial statements when consolidated financial statements are prepared. The wording used was:

> *Financial statements*
>
> (2) The financial statements for the year are:
>
> (a) unless paragraph (b) applies—the financial statements in relation to the company, registered scheme or disclosing entity required by the accounting standards; or
>
> (b) if the accounting standards **require** the company, registered scheme or disclosing entity to prepare financial statements in relation to a consolidated entity—the financial statements in relation to the consolidated entity required by the accounting standards.
>
> (Emphasis added)

Some interpretations of those amendments are that a non-reporting entity preparing consolidated special purpose financial reports is not able to take advantage of the amendments. This is because as they are a non-reporting entity, the entity is not "required" to prepare consolidated financial statements. This interpretation means that an unlisted non-reporting entity has greater reporting obligations than a listed entity.

This issue was raised in responses to Treasury's Proposed Amendments to the Corporations Act (November 2011). Comment letters are located at:
https://treasury.gov.au/consultation/proposed-amendments-to-the-corporations-act/

Responses from the four large accounting firms were:

- Deloitte – States that wording is unclear
- EY – States that a significant number believe that non-reporting entities are ineligible for relief
- KPMG – States that entities preparing consolidated special purpose financial statements are precluded from the relief
- PwC – Notes the different views, and that they believe the entity should be exempted from preparing parent entity financial statements.

Further background was included in PwC Value Accounts – Special Purpose – Annual financial reporting 2014:

Separate parent entity financial statements

VALUE ACCOUNTS Special Purpose Pty Limited does not include separate financial statements for the parent entity in the financial report. Instead, we have provided condensed financial information for the parent entity in a separate note (note 27), as required under *Corporations Regulation* 2M.3.01.

Entities should be aware that there are different views about the application of the law in respect of the separate parent entity information that must be presented in special purpose financial statements. Some commentators argue that the removal of the separate entity financial statements by non-reporting entities is not permitted under the revised section 295 of the *Corporations Act* 2001 (the Act) as amended by the *Corporations Amendment (Corporate Reporting Reform) Act 2011*. Others hold the opposite view.

Section 295 of the Act requires separate parent entity financial statements to be presented if the accounting standards do not require consolidated financial statements. AASB 127 *Consolidated and separate financial statements* does not apply to non-reporting entities; ASIC has stated in Regulatory Guide 85 *Reporting requirements for non-reporting entities* (RG 85) that non-reporting entities do not need to prepare and lodge consolidated financial statements if neither the parent entity nor the group are a reporting entity. On that basis, some commentators argue that consolidated financial statements are not required by non-reporting entities; therefore, section 295 still requires the preparation of separate parent entity financial statements.

In our view, non-reporting entities should not be subject to more onerous reporting requirements than reporting entities. Consolidation is prima facie a recognition and measurement requirement. RG 85 states that non-reporting entities, which are required to prepare financial reports in accordance with the Act, must still comply with the recognition and measurement requirements of all applicable accounting standards in order to give a true and fair view of their financial position and results of their operations. If a parent entity considers consolidation necessary in order to provide users of the financial report with a true and fair view, then we believe the entity should be allowed to remove the separate parent entity financial statements from its financial report under section 295 of the Act.

Given the different views in practice, entities may choose to obtain legal advice on the appropriate course of action before lodging a financial report without full parent entity financial statements.

Source:

PwC Value Accounts – Special Purpose – Annual financial reporting 2014
https://www.pwc.com.au/assurance/ifrs/assets/value-accounts-special-purpose-2014.pdf