

17 August 2018

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By email: standard@asb.gov.au

Dear Kris

Invitation to Comment – ITC 39 Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems (Phase 1)

Thank you for the opportunity to comment on Invitation to Comment – ITC 39 Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems (Phase 1).

The provided comments have been prepared after considering the ITC and participating in sessions held by the Australian Accounting Standards Board (AASB).

Initiatives of the AASB to explore approaches that improve the quality of general purpose financial reporting are an important part of its work program.

However, as rightly acknowledged by the AASB in the ITC it is only player in this space. Its role is to specify what framework and accounting standards should apply to general purpose financial statements.

In contrast, it is the role of the lawmaker to determine who of its regulated entities should prepare general purpose financial statements.¹

I support this division of responsibilities.

The ITC identifies two matters – special purpose financial statements and the clash of the reporting entity definitions – that the AASB believes are problematic and require resolution.

I agree that there is merit in the AASB examining the two matters. My recommendations and the basis for those recommendations follow.

Recommendations

1. Regarding special purpose financial statements, I support the withdrawal of SAC 1 *Definition of the Reporting Entity* and 'self assessment', but not in isolation of an explicit statement from the lawmaker about who of its regulated entities should prepare general purpose financial statements.

To withdraw SAC 1 and self assessment without that action from the lawmaker would not be consistent with the past intention of our *Corporations Act 2001* lawmakers (and those lawmakers in other

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¹ For non-regulated entities it is for the members through the entity's constitution to specify a requirement to produce general purpose financial statements.

jurisdictions who have replicated in their own laws requirements the same as the *Corporations Act*).

2. Regarding the clash of the reporting entity definitions, I do not think a pragmatic stop-gap solution to incorporating the revised conceptual framework into the Australian Accounting Standards framework is required.

I do not think the AASB has provided sufficient evidence in support of its assertion about a clash of definitions. I think SAC 1 and the revised conceptual framework can successfully co-exist until the lawmaker articulates who of its regulated entities should prepare general purpose financial statements.

Nevertheless, if the AASB decides to proceed with its pragmatic stop-gap solution I could accept its unnecessary action in the short term as long as the AASB is certain that there will be no unintended consequences.

Special Purpose Financial Statements

The ITC refers to the numerous issues identified in the *AASB Research Report No 1* with the current mechanism for differential reporting whereby preparers self-assess what type of financial reporting is required when a regulator requires the preparation and public lodgement of financial statements.

It is my view that it is the role of the lawmaker to determine who of its regulated entities should prepare general purpose financial statements.

Currently, we have SAC 1 and AASB 1057 *Application of Australian Accounting Standards* answering the who question and I agree with the AASB on the need to remove self assessment from the Australian Accounting Standards Framework.

However, I do not agree with the AASB position to progress with the removal of self assessment without legislative amendments.

To do so would not be consistent with the intentions of the lawmaker.

The *Corporations Act* s296(1) states "The financial report for a financial year must comply with the accounting standards."

I acknowledge that the *Corporations Act* does not explicitly refer to the reporting entity concept as described in SAC 1.

However, I contend that the lawmaker was very aware of the SACs and their role in self assessment and it was a deliberate decision of the lawmaker that the law reference is to 'accounting standards' and not 'general purpose financial statements (reports)'.

Support for this view include (underlining used by me for emphasis):

- The Explanatory Memorandum to the Company Law Review Bill (1997) an antecedent law to the *Corporations Act* that includes a discussion of SAC 2: *Objectives of General Purpose Financial Reporting*.
- The Explanatory Memorandum states, "A financial report will be required to comply with accounting standards and any further requirements in the *Corporations Regulations* (Bill s 296). This requirement does not repeat the existing reference in section 298 to

'applicable accounting standards' because each standard describes the companies and entities to which it applies." (paragraph 13.30).²

- The Auditing Standards Board Exposure Draft 50 *The Audit Report on Financial Information Other Than a General Purpose Financial Report*: "legally the financial statements of a company which is not a reporting entity can be properly drawn up in accordance with applicable Accounting Standards without actually applying any of the substantive requirements of the Standards." (see Picker, R *The Author Replies* Australian Accounting Review 1992 November p15).

Clash of the reporting entity definitions

The AASB position is that the release of the International Accounting Standards Board (IASB) revised conceptual framework requires urgent action by the AASB to remove the Australian reporting entity concept.

The action is justified as necessary to resolve the issue that comes from having different definitions of reporting entity - the definition in SAC 1 and the different IASB definition incorporated into the revised conceptual framework.

Preparing General purpose Financial Statements

SAC 1 answers the question who should prepare general purpose financial statements as under SAC 1 it is reporting entities that are to prepare general purpose financial statements. SAC 1 also answers the what question - general purpose financial statements are prepared in compliance with accounting standards.

In contrast, the revised conceptual framework does not answer the who question as the revised conceptual framework applies to reporting entities defined as entities that are obliged by law or choose to prepare general purpose financial statements (see the revised conceptual framework paragraph 3.1, footnote 7 to paragraph 3.1, and paragraph 3.10). It answers the question of what requirements are to be imposed on those entities.

Notwithstanding SAC 1 answering who and what questions and the revised conceptual framework answering only what questions, I do not agree with the AASB's assertion about a clash of definitions.

I consider both definitions describe the same group of preparers insofar as the type of financial statements is concerned.

Boundary of the Reporting Entity

The AASB position is that SAC 1 is not consistent with the description of the boundary of the reporting entity included in the revised conceptual framework.

SAC 1 paragraphs 14 and 15 address the identification of the boundary of a reporting entity and make clear that the boundary of a reporting entity is based on the information needs of users and not for example based on a class of legal entity.

The revised conceptual framework paragraphs 3.13 and 3.14 include similar guidance.

² For example, the application paragraph of AASB 1024 Consolidated Accounts (May 1992). This Standard:

- (a) applies to each company that is the parent entity in an economic entity which is a reporting entity in relation to the economic entity's first financial year that ends on or after 30 June 1992 and later financial years; and
- (b) when operative, supersedes Accounting Standard AASB 1024: Consolidated Accounts, the making of which was notified in Gazette No. S260 on 20 September 1991.

I acknowledge that the discussion in the revised conceptual framework addresses what "faithful representation" means in the context of economic activities of the reporting entity.

However, I contend it would be most unlikely that SAC 1 and the revised conceptual framework discussions would result in a different boundary of a reporting entity. I do not agree with the AASB position that they are fundamentally different.

The attachment includes answers to some of the specific questions asked along with some other comments.

If you have any queries on the provided comments, please contact me at mshying@swin.edu.au.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'm shying', with a stylized flourish at the end.

Dr Mark Shying CA
Swinburne Business School

Specific questions/ comments

1. Do you agree with the short-term approach to maintain IFRS compliance by introducing the RCF in Australia?

No. I do not think a pragmatic stop-gap solution to incorporating the revised conceptual framework into the AAS framework is required. I think SAC 1 and the revised conceptual framework can successfully co-exist until the lawmaker articulates who of its regulated entities must prepare general purpose financial statements.

Nevertheless, if the AASB decides to proceed with its pragmatic stop-gap solution I could accept its unnecessary action in the short term as long as the AASB is certain that there will be no unintended consequences.

2. Do you agree that the short-term approach should be made applicable to both publicly accountable for-profit private sector and public sector entities?

See my above comments in response to Q1.

3. Are you aware of publicly accountable for-profit entities currently self-assessing as nonreporting entities and preparing SPFS that would have implications under the AASB's short-term approach?

I encourage the AASB to explore further the interplay of its proposals with the reporting requirements of:

- Unlisted managed fund, including those unlisted managed funds admitted for settlement under the ASX Operating Rules and available to investors through the mFund Settlement Service.
- Entities that include Special Purpose Financial Statements in a prospectus document (see ASIC RG 228 *Prospectuses: Effective disclosure for retail investors* paragraph 95).
- Entities that include Special Purpose Financial Statements in a demerger scheme document (e.g., the demerger scheme document for the OneMarket demerger from Westfield).
- Unlisted public companies accessing crowd-source funding, given the absence of a secondary market.
- Small proprietary companies who access crowd-source funding if the proposals to enable this to occur are passed (see Explanatory Memorandum Corporations Amendment (Crowd-sourced funding for Proprietary Companies) Bill 2017. I note a secondary market is not expected.

4. Do you agree with the AASB's amendments to the definition of 'public accountability' in AASB 1053 per IFRS for SMEs Standard?

See my comments above in response to Q1, and my comments about the *IFRS for Small and Medium-Sized Entities* (IFRS for SMEs) standard in Other comments in this submission.

5. Do you agree with the proposed amendments to SAC 1 Definition of the Reporting Entity and the following Australian Accounting Standards set out in Appendix A?

See my comments above in response to Q1.

Other comments

For its Phase 1 approach, the AASB has chosen the revised 'public accountability' definition in the IFRS for SMEs standard as the mechanism to distinguish entities that state compliance with IFRS from entities that do not state such compliance.

Notwithstanding this decision, the AASB does not consider the IFRS for SMEs as an appropriate solution for further consideration as part of these proposals.

I encourage the AASB to reconsider its position on the IFRS for SMEs standard.

For its Phase 1 approach, the AASB does not plan to issue an Exposure Draft. I encourage the AASB to reconsider its position, which represents a departure from due process.