Be clear on basis of preparation - ED 293
Reporting Update
10 July 2019, 19RU-011

Highlights
• In a nutshell...
• What’s being proposed?
• Why?
• Australian framework taking shape

In a nutshell...
The AASB has issued Exposure Draft 293 Amendments to Australian Accounting Standards – Disclosure in Special Purpose Financial Statements of Compliance with Recognition and Measurement Requirements (ED 293). It is the next step in the wider Australian financial reporting reform project currently being undertaken by the Australian Accounting Standards Board (AASB).

The wider project is to implement the Conceptual Framework for Financial Reporting (RCF) in Australia. For a summary of steps in this project refer to the Appendix.

ED 293 proposes to amend AASB 1054 Australian Additional Disclosures. It will impact all entities preparing special purpose financial statements (SPFS) that are required, through legislation, to comply with AASB 101 Presentation of Financial Statements and AASB 1054. This includes:

• each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act 2001
• each entity lodging SPFS with the Australian Charities Not-for-profits Commission (ACNC) in accordance with the ACNC Act 2012.

The disclosures proposed by ED 293 do not require entities to change their existing accounting policies. They are instead based on an entity’s existing financial reporting policies and practices. Refer to What’s being proposed? (below) for further detail on the three proposed disclosures.

The AASB see the amendments in ED 293 as a practical interim means of improving the quality of information provided to users of SPFS. The broader Australian financial reporting reform project still proposes to address the problems of SPFS – by removing that ability for certain entities to prepare SPFS when they are required to comply with Australian Accounting Standards.

Timing
The AASB’s current expectation is that the amending standard proposed by ED 293 will be effective for annual periods ending on or after 30 June 2020.

Submissions on ED 293 are due by 19 August 2019.
What’s being proposed?

The AASB proposal is to amend AASB 1054. For-profit entities lodging SPFS and not-for-profit entities (NFP) who are directly (or indirectly) required to comply with AASB 1054 and who prepare SPFS, additional disclosures will be required. This will typically affect for-profit entities lodging financial statements under requirements of the Corporations Act 2001 and NFP entities lodging financial statements with the ACNC.

At a high level the proposals cover disclosure of information about the compliance with the recognition and measurement (R&M) requirements in Australian Accounting Standards. More specifically, an entity preparing SPFS must cover the following three areas.

Basis of preparation

The basis on which the decision was made to prepare special purpose financial statements will be required to be disclosed.

Illustrative disclosure

The illustrative disclosure could be as simple as:

Example Proprietary Company Ltd, a for-profit entity, has prepared special purpose financial statements as, in the opinion of the directors, there are unlikely to exist users of these financial statements who are not in a position to require the preparation of reports tailored to their information needs.

Subsidiaries, associates, joint ventures

Where the entity has investments in subsidiaries, associates or joint ventures, an entity will be required to disclose whether they have been consolidated or equity accounted as appropriate, in accordance with Australian Accounting Standards. If not consolidated or equity accounted, an explanation of why not is required. If the entity is a NFP entity, and hasn’t undertaken this assessment, it would instead disclose this fact.

Illustrative disclosure

A number of examples are provided in the ‘Implementation guidance and illustrative examples’ section of ED 293.

Recognition and measurement

An entity must disclose whether the accounting policies applied in the financial statements comply with all the R&M requirements in Australian Accounting Standards, and if not, an indication of where they do not comply.

Illustrative disclosure

The illustrative disclosure could be as simple as:

The special purpose financial statements comply with all recognition and measurement requirements in Australian Accounting Standards. The significant accounting policies adopted in the special purpose financial statements are set out in ….

Importantly the extent of any non-compliance does not need to be quantified. This is deliberate as the AASB is not aiming to make the required disclosures onerous.

Alternative example wording where an entity has not applied all R&M is contained in the ‘Implementation guidance and illustrative examples’ section of ED 293.
Following from the various AASB research projects the AASB has expressed concern that the quality of disclosures in a significant number of SPFS is not sufficient to enable a user to determine what additional information they may need to make decisions about the allocation of economic resources.

The AASB have stated that they consider it unacceptable for financial statements available on public record to have such low levels of transparency.

Until Phase 2 is implemented, entities that are not publicly accountable will continue to report under the existing (“old”) Conceptual Framework. This means that entities that are not publicly accountable continue to have the ability to prepare general purpose financial statements (GPFS) using either Tier 1 or Tier 2 or SPFS, depending on their self-assessment of whether they are a reporting entity.

With the progression of the project there is a widely held view that entities preparing SPFS should be transparent and clearly articulate the basis of preparation of such financial statements. In response to this, the AASB has issued ED 293 to require specific disclosures around the compliance with R&M aspects of Australian Accounting Standards.

The AASB also considers that this will help entities assess their level of compliance with R&M requirements in Australian Accounting Standards in preparation for transition from SPFS to GPFS once Phase 2 is fully implemented, i.e. the option to prepare SPFS is removed from those required to comply with Australian Accounting Standards.

"We acknowledge the consistent feedback that the AASB has received on the need to improve comparability, consistency, transparency and enforceability in SPFS.

On our initial reading of ED 293 it appears that the additional disclosures are based on an entity’s existing financial reporting and practices. The additional compliance cost should be minimal.

As an interim measure it will address (albeit to a limited extent) the AASB’s concerns on the quality of disclosures in SPFS.”

Michael Voogt
Director, Department of Professional Practice

The IASB issued the RCF in March 2018. In response, to be consistent with the AASB’s strategy and the Financial Reporting Council’s directive, the RCF needs to be applied in Australia. In the course of considering applying the RCF in Australia, the AASB identified an inconsistency in the definition of ‘reporting entity’ in the RCF and the widely used and understood Australian ‘reporting entity concept’ set out in Statement of Accounting Concepts SAC 1 Definition of the Reporting Entity (SAC 1).

This drew attention to the more emotionally-charged issue of special purpose financial statements (SPFS). In response to the above the AASB issued ITC 39 Applying the IASB’s revised conceptual framework and solving the reporting entity and special purpose financial statement problems (ITC 39).
Australia is the only country permitting entities to self-assess what type of financial statements are required where financial statements are required by a regulator. The AASB sees this as a way to contribute to the current environment of building trust and comparability through transparency.

ITC 39 released in May 2018 put forward a preferred option for adopting the RCF in Australia – a two-phased approach.

In May 2019 the AASB released the RCF and an amending standard AASB 2019-1 Amendments to Australian Accounting Standards – References to the Conceptual Framework. The pronouncements are effective for financial years beginning on or after 1 January 2020.

The application of the RCF is at present limited 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 that voluntarily elect to apply the RCF.

Further details on the above are set out in 19RU-006 The new financial reporting framework is coming.

Until Phase 2 is implemented, for-profit entities that are not publicly accountable, and NFP entities, will continue to report under the existing (“old”) Conceptual Framework. This means that these entities continue to have the ability to prepare GPFS using Tier 2 or SPFS, depending on their self-assessment of whether they are a reporting entity.

Attached is a summary of the many parts of the wider Australian financial reporting reform project.

The attachment is a useful reference point in understanding all of the separate parts that go into implementing the RCF in Australia. As the separate projects progress KPMG will issue further updates and guidance.
Appendix – AASB projects in implementing financial reporting reform

To implement the Conceptual Framework for Financial Reporting (RCF) in Australia a number of separate projects are required. The image below highlights the most important changes that are required to transition to the RCF.

Conceptual framework

The IASB issued the RCF in March 2018. In the course of considering applying the RCF in Australia, the AASB identified an inconsistency in the definition of ‘reporting entity’ in the RCF and the widely used and understood Australian ‘reporting entity concept’. This also drew attention to the more emotionally-charged issue of special purpose financial statements (SPFS). The AASB proposed a two-phased approach to address the issues identified in ITC 39 Applying the IASB’s Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems (ITC 39).

For-profit

This project applies to all for-profit private sector entities that have a statutory requirement to prepare financial statements that comply with Australian Accounting Standards. The aim is to develop a consistent, comparable, transparent and enforceable financial reporting framework. Once complete the ability of such entities to prepare SPFS will be removed.

Refer to the following section for further detail on the two-phased AASB implementation approach for for-profit entities.

Not-for-profit

The AASB decided that the proposals in ITC 39 would apply only to for-profit entities after hearing concerns from not-for-profit (NFP) entities, and considering the discussions with the ACNC and other State and Territory regulators regarding recommendations in the ACNC Legislative Review report. As recognition of the more significant impact of removing SPFS for NFP entities, a separate consultation document with targeted proposals for NFP private sector entities will be developed.
GPFS – Tier 1
In May 2019 the AASB released the RCF and an amending standard AASB 2019-1 Amendments to Australian Accounting Standards – References to the Conceptual Framework requiring for-profit entities preparing general purpose financial statements (GPFS) – Tier 1 financial statements (publicly accountable entities and entities voluntarily reporting compliance with IFRS) to apply the RCF. The standard is effective for financial years beginning on or after 1 January 2020. This ensures Tier 1 entities are able to maintain IFRS compliance.

Further details on the above are set out in 19RU-006 The new financial reporting framework is coming.

GPFS – Tier 2 Disclosures
The AASB decided to develop a separate IFRS for SMEs (Small and Medium-sized Entities) based disclosure standard. This will be a new Tier 2 disclosure standard which will replace the current Reduced Disclosure Requirements framework. The disclosure standard will contain a minimum prescribed set of disclosures. Additional disclosures may also be necessary to provide financial statement users with an understanding of the entity’s financial performance and position.

Entities preparing GPFS – Tier 2 financial statements will need to comply with the full recognition and measurement (R&M) requirements of Australian Accounting Standards.

GPFS – Tier 2 Transition relief
The AASB is proposing to provide relief from restating and presenting comparative information in the year of transition for entities transitioning from SPFS, where they did not comply with full recognition and measurement requirements of Australian Accounting Standards, to preparing GPFS under Tier 2 requirements for the first time.

Proprietary company thresholds
Statutory financial reporting thresholds for proprietary companies for financial years beginning on or after 1 July 2019 have been amended. The amended regulations doubles the thresholds for determining whether a company is a large or small proprietary company for a financial year. A proprietary company is large if it meets two of the three thresholds at the end of its financial year. Otherwise it is small.

New thresholds, based on the financial year, are:
- Consolidated revenue $50 million or more
- Consolidated gross assets $25 million or more
- Employees of the consolidated entity 100 FTE employees or more

Further details on the above are set out in 19RU-004 Proprietary company threshold: When large becomes small.

Public accountability
If an entity is publicly accountable the Australian accounting framework requires the preparation of GPFS – Tier 1. The AASB identified a separate public accountability sub-project, which will consider whether there should be any changes to who is deemed to have public accountability.

Public accountability is defined by the IASB but needs to be applied in an Australian environment. The AASB’s sub-project will contemplate whether exemptions from the IASB public accountability definition would be in the Australian public interest and whether additional guidance should be included to assist in interpreting the public accountability definition in an Australian context.
Special purpose financial statements

SPFS continue to be able to be prepared during the implementation of the RCF. The AASB is proposing to require preparers of SPFS to disclose if all R&M requirements of Australian Accounting Standards have been complied with or not in preparing the SPFS. If not all R&M requirements have been complied with then sufficient information needs to be disclosed so users of the SPFS clearly understand the accounting policies.

Entities will also need to disclose whether they have subsidiaries and whether they have prepared consolidated financial statements. Where consolidated financial statements have not been prepared then an entity must disclose why not.

Finally, if an entity has investments in an associate or a joint venture, then disclosure of whether they have been accounted for in a manner consistent with AASB 128 Investments in Associates and Joint Ventures is proposed to be required.

Further details on the above are set out in this Reporting Update.

Public sector

The AASB decided that it would pursue financial reporting reform in the public sector via consultation based on the AASB Discussion Paper Improving Financial Reporting for Australian Public Sector, which was issued in June 2018.

Timeline for projects

<table>
<thead>
<tr>
<th>Project</th>
<th>Status</th>
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<tbody>
<tr>
<td>Conceptual Framework</td>
<td>RCF issued (May 2019)</td>
</tr>
<tr>
<td>F-P Private – Phase 1</td>
<td>AASB 2019-1 issued (May 2019)</td>
</tr>
<tr>
<td>F-P private – Phase 2</td>
<td>Exposure Draft expected Q3 of 2019 (application planned for 2021)</td>
</tr>
<tr>
<td>F-P public sector</td>
<td>AASB still in outreach stage – Discussion Paper (June 2018)</td>
</tr>
<tr>
<td>Not-for-profits</td>
<td>AASB still in outreach stage – Discussion Paper (May 2017)</td>
</tr>
<tr>
<td>Pty company thresholds</td>
<td>Corporations Regulations amendments issued (April 2019)</td>
</tr>
<tr>
<td>Public accountability</td>
<td>Exposure Draft expected Q4 of 2019 (application planned for 2021)</td>
</tr>
<tr>
<td>SPFS (R&amp;M)</td>
<td>Exposure Draft 293 now issued</td>
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</tbody>
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F-P = For-profit

Watch this space for more on each of these separate projects as they develop.

19RU-011 Be clear on basis of preparation – ED 293 – Appendix

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