



# Clarity in financial reporting

## Proprietary company classification threshold increases

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### What's changed?

### When do the new thresholds apply?

### What the impacts and other considerations?

### Conclusion

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### Talking points

- The thresholds for determining whether a proprietary company is small or large will change as a result of amendments to the *Corporations Regulations 2001*
- Under the new regulation, a proprietary company will be classified as large if it meets at least two of the following thresholds in respect of a given financial year:
  - \$50 million or more in consolidated revenue
  - \$25 million or more in consolidated gross assets
  - 100 or more employees
- The regulations have the effect of doubling the existing thresholds contained in s.45A of the *Corporations Act 2001*. Because the thresholds are part of the determination of an entity's reporting obligations under the Act, more proprietary companies may, subject to the other provisions of the law, be exempt from financial reporting as a result of this change
- The new thresholds apply to financial years beginning on or after 1 July 2019 and so do not impact proprietary company reporting obligations for the upcoming financial reporting seasons (e.g. financial reporting ending on 30 June 2019 or 31 December 2019)
- Some classes of proprietary companies may be indirectly impacted by the changes, e.g. foreign controlled small proprietary companies and entities preparing general purpose financial statements because they are significant global entities under income tax law.

For more information please see the following websites:

[www.deloitte.com/au/models](http://www.deloitte.com/au/models)

[www.iasplus.com](http://www.iasplus.com)

## What's changed?

### Background

One of the key determinants of a proprietary company's reporting requirements is its relative size. In particular, all proprietary companies are classified as either 'small proprietary companies' or 'large proprietary companies', depending upon the entity's assets, revenue and employees.

In general, most large proprietary companies are required to prepare and lodge audited financial reports under Part 2M.3 of the *Corporations Act 2001* (Corporations Act). Therefore, being classified as a large proprietary company will generally increase the level of reporting required by those entities.

In general, most small proprietary companies are not required to prepare financial reports under Part 2M.3 of the *Corporations Act 2001*.

Regardless of classification, several categories of proprietary companies are included or excluded from financial reporting by other requirements of the law and Australian Securities and Investments Commission (ASIC) Corporations Instruments and Class Orders.

### Details of the changes

The definitions of 'large proprietary company' and 'small proprietary company' are contained in s.45A of the Corporations Act. The Act permits the thresholds applied in the definition to be amended by Regulation. To this end, the Federal Government made *Corporations Amendment (Proprietary Company Thresholds) Regulations 2019* in April 2019, which have the effect of increasing the relevant thresholds from 1 July 2019.

The following table summarises the old and new thresholds. A proprietary company is classified as a large proprietary company when it meets **two or more** of the following criteria in respect of a financial year:

Condition	OLD threshold	NEW threshold
<b>Consolidated revenue</b> for the financial year of the company and the entities it controls (if any)	\$25 million or more	\$50 million or more
Value of the <b>consolidated gross assets</b> at the end of the financial year of the company and the entities it controls	\$12.5 million or more	\$25 million or more
Number of <b>employees</b> of the company and the entities it controls at the end of the financial year	50 or more	100 or more

### Why were the thresholds changed?

The thresholds have not been adjusted since 2007. In the Explanatory Statement accompanying the Regulations, the Treasurer noted the following, among other, justifications for the increase in thresholds:

- The revenue and assets thresholds were increased to account for nominal economic growth since the 2007, accounting for both inflation and economic growth
- The doubling of the employee threshold is seen as being a relevant indicator of the size and significance of an entity
- The changes are designed to ensure financial reporting obligations are targeted at economically significant companies, while reducing costs for smaller sized companies.

The Explanatory Statement explains that Treasury expects around one third of large proprietary companies will now be considered to be small proprietary companies under the new definitions.

### When do the new thresholds apply?

#### Effective date

The new regulations commence from 1 July 2019. The application provisions of the regulations note that changes to the thresholds apply "in relation to the 2019-20 financial year and later financial years".

This raises the question of whether financial years ending in 2020 before 30 June 2020 are considered "the 2019-20 financial year", e.g. an entity with a 12 month financial year ending 30 April 2020 (which is effectively its '2019-20 financial year').

In our view, this is not the intention of the regulations and, consistent with the wording adopted in the Explanatory Statement accompanying the effecting regulations, should apply to **financial years beginning on or after 1 July 2019**. For entities with a 12 month financial year, this means the new thresholds will apply for 30 June 2020 and later financial years.

## What are the impacts and other considerations?

### No impact on current reporting

As the thresholds apply to financial years beginning on or after 1 July 2019, the thresholds applying to financial years beginning before this date will not change.

For example, the old thresholds in the table above will apply for the purposes of entities with 12 month financial years ending on 30 June 2019 and 31 December 2019.

As noted earlier, 12 month financial years ending in 2020 before 30 June 2020 will also be subject to the old thresholds.

### Foreign controlled small proprietary companies

Under s.292(2) of the Corporations Act, small proprietary companies that are controlled by a foreign company for all or part of the financial year must prepare and lodge audited financial reports with ASIC *unless* it was consolidated into financial statements lodged with ASIC by a registered foreign company or Australian company, registered scheme or disclosing entity.

However, *ASIC Corporations (Foreign Controlled Company Reports) Instrument 2017/204* relieves certain foreign controlled small proprietary companies from their financial reporting obligation under Chapter 2M.3 of the Corporations Act where that entity is not part of a 'large group' (as defined in the Instrument). The premise of a 'large group' in the Instrument is linked to the concept of a small proprietary company under the *Corporations Act 2001*.

Because of the link in the Instrument to the definition of a small proprietary company in the Corporations Act, which itself refers to the regulations, the new thresholds implemented by the regulations will also apply to the determination of whether or not a foreign controlled small proprietary company is a member of a large group. Again, this will only apply to financial years beginning on or after 1 July 2019.

In essence, relief is only provided to foreign controlled small proprietary companies when the economic presence of the foreign parent in Australia in total (across all entities and operations) is less than the small proprietary company thresholds. For these purposes, a 'group' is essentially all subsidiaries of a foreign entity that are incorporated in, or operate in, Australia, together with any subsidiaries of any of those entities (a 'group' for the purposes of the Instrument).

Accordingly, a 'group' is a 'large group' when, on a combined basis, the 'group' satisfies at least two of the following conditions for the financial year of the company in question (i.e. the small proprietary company):

Condition	OLD threshold	NEW threshold
Combined <b>revenue</b> of the group for the relevant financial year	\$25 million or greater	\$50 million or greater
Combined value of the <b>gross assets</b> of the group at the end of the relevant financial year	\$12.5 million or greater	\$25 million or greater
Number of <b>employees</b> of the group (part time employees being counted as an appropriate fraction of a full-time equivalent) at the end of the financial year	50 or more	100 or more

Where an entity is a member of a 'large group', it is *not* entitled to relief under the Instrument and must prepare and lodge audited financial statements with ASIC.

### Closely held registered foreign companies

In addition to relief for certain foreign controlled small proprietary companies, *ASIC Corporations (Foreign Controlled Company Reports) Instrument 2017/204* provides relief from the obligations for registered foreign companies to lodge financial statements with ASIC under s.601CK where the registered foreign company is closely held and subject to restrictions similar to proprietary companies in Australia.

One of the conditions of the relief is that the registered foreign company not be a member of a 'large group' for the purposes of the Instrument (as discussed above). Accordingly, the new thresholds will apply to financial years beginning on or after 1 July 2019, and may permit more registered foreign companies to obtain relief under the Instrument.

## Significant global entities for income tax purposes

Broadly, entities or groups of entities with income in excess of A\$1 billion are considered 'significant global entities' (SGEs) under Australian income tax law. Where an SGE which is an Australian corporate tax entity, or a foreign resident corporate tax entity operating a permanent establishment in Australia, has not lodged 'general purpose financial statements' with ASIC, they are required to lodge general purpose financial statements with the Australian Taxation Office (ATO) (the 'GPFS requirements').

The new thresholds apply in relation to the financial reporting mandate under the Corporations Act. As a result, entities with a reporting obligation under the GPFS requirements will not be directly impacted by the changed thresholds, i.e. the obligation to lodge general purpose financial statements with the Australian Taxation Office will remain in place even if the entity is no longer required to report under the Corporations Act.

However, the increased thresholds implemented by the Regulations can have indirect consequences on options available to the entity in meeting the GPFS requirements. This is because the accounting standards and principles used in the preparation of the general purpose financial statements are determined by the accounting standards applying to the impacted Australian corporate tax entity captured by the GPFS requirements.

The following broad categories of entities may be below the new thresholds (either under the Regulations or related ASIC Instruments) from 1 July 2019, and therefore no longer be required to prepare and lodge financial reports with ASIC:

- Proprietary companies in Australian corporate groups now falling beneath the increased thresholds
- Foreign controlled small proprietary companies which are no longer considered to be members of a 'large group' using the new thresholds
- Closely held registered foreign companies that are no longer members of a 'large group' using the new thresholds.

These entities may then be able to satisfy their GPFS requirements by lodging the general purpose financial statements of their foreign parent prepared in accordance with 'commercially accepted accounting principles' (CAAP), rather than Australian Accounting Standards. This may substantially reduce the reporting burden for those entities.

## Impact of new standard on leasing

The numeric amounts used in testing whether an entity meets the thresholds are required to be determined in accordance with applicable Australian Accounting Standards, and on a consolidated basis where relevant. Therefore, significant changes in Australian Accounting Standards can impact the determination of those numeric amounts.

AASB 16 *Leases* applies to annual periods beginning on or after 1 January 2019. In simplistic terms, the new leasing standard will often increase the total gross assets recognised on an entity's balance sheet, particularly where the entity is the lessee in leases previously classified as 'operating leases'. This may mean that an entity, perhaps unexpectedly, will have higher total assets than otherwise expected.

It is important to consider the impact of AASB 16, particularly where the entity is expecting to be close to the revised thresholds. Entities should carefully assess the impacts of AASB 16 before making plans to cease financial reporting under the Corporations Act as the higher level of assets may partially ameliorate the benefits of the higher thresholds.

Other changes in Australian Accounting Standards may also have an impact on the determination of the amounts used in testing the thresholds.

## No impact on other entities

The new thresholds only apply to **proprietary companies**, and certain foreign entities due to the operation of ASIC Corporations Instruments. Accordingly, the thresholds have no impact on other types of companies or other entities, e.g. public companies, trusts and partnerships.

Equally, some proprietary companies may be captured by other requirements of the Corporations Act and be required to prepare financial reports in some circumstances, e.g. entities engaging in crowd-sourced funding, under a direction from shareholders or ASIC to prepare financial reports, or be required to prepare financial reports under other aspects of the law.

## Conclusion

The revised thresholds for the classification of proprietary companies represent a significant lessening of the financial reporting obligations for those affected entities. However, there are numerous consequential considerations to be considered by entities before immediately concluding all their financial reporting burdens are extinguished under Australian law.

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