



Clarity in financial reporting

Proposals to eliminate special purpose financial statements for most for-profit entities and introduce new 'Tier 2' financial statements

What's being proposed?

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- **Requirement for consolidation and equity accounting**
- **New 'Tier 2' reporting framework**

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- The Australian Accounting Standards Board (AASB) has two exposure drafts on issue proposing:
 - To eliminate the ability of most for-profit private sector entities to prepare special purpose financial statements
 - A new 'simplified disclosures' framework for 'Tier 2' general purpose financial statements, applying to both for-profit and not-for-profit entities
- The proposed new 'Tier 2' would be closely aligned to the disclosures from the *IFRS for SMEs*, but would include additional disclosures where different Australian Accounting Standards requirements apply, and for not-for-profit entities
- Consolidation and equity accounting principles would be required to be applied in general purpose financial statements
- To assist constituents in understanding the proposals, we have prepared model financial statements illustrating how the general purpose financial statements might be prepared under the proposals. These models highlight the broad impacts on entities moving from special purpose financial statements to general purpose financial statements, and the impacts of consolidation
- The AASB intends the proposals to be applicable from 1 July 2020
- Comments on the AASB's proposals close on 30 November 2019. The AASB has indicated it will not accept comments after this date and entities need to act quickly to understand and respond to the proposals.

For more information please see the following websites:

www.deloitte.com/au/clarity

www.deloitte.com/au/models

www.iasplus.com

What's being proposed?

In a nutshell

Key proposal	For-profit entities	Not-for-profit entities
Removal of special purpose financial statements (SFPS) and requiring the preparation of general purpose financial statements if financial statements are required to be prepared in accordance with Australian Accounting Standards or, in some cases, 'accounting standards'	Yes (with limited exceptions)	No (separate project for not-for-profit entities)
Consolidation and equity accounting principles being applied much more widely in the preparation of financial statements. Ultimate Australian holding companies would not be able to rely on the preparation of consolidated financial statements prepared in accordance with IFRS by foreign parents to avoid consolidation	Yes (particularly ultimate Australian holding companies)	No (unless already required or being applied)
New framework for 'Tier 2' general purpose financial statements, replacing 'Reduced Disclosure Requirements' (RDR), based on the <i>IFRS for SMEs</i> , generally resulting in more disclosure than in SFPS but less than in the existing 'Tier 2' 'Reduced Disclosure Requirements' (RDR) framework	Yes	Only if GPFS prepared

Two exposure drafts

In early August 2019, the Australian Accounting Standards Board (AASB) published ED 295 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (ED 295, available at www.aasb.gov.au). This exposure draft outlines the AASB's proposals for a new 'Tier 2' reporting framework to be used by entities preparing general purpose financial statements. 'Tier 2' applies, in broad terms, to those for-profit entities that do *not* have public accountability, and not-for-profit entities that are reporting entities, including public sector entities.

Subsequently, in mid-August 2019, the AASB released ED 297 *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (ED 297, available at www.aasb.gov.au). This exposure draft proposes to remove the ability of most for-profit private sector entities to prepare special purpose financial statements.

Comments on the AASB's proposals in both ED 295 and ED 297 close on 30 November 2019¹.

Entities impacted by the removal of special purpose financial statements

Not all for-profit entities would be required to prepare general purpose financial statements under the proposals in ED 297.

The following entities would be explicitly required to prepare general purpose financial statements, using either 'Tier 1' or 'Tier 2':

- **Corporations Act 2001 financial reports** – all for-profit companies preparing and lodging financial statements under the *Corporations Act 2001*, except where the financial statements are being prepared in accordance with an ASIC or shareholders direction (unless the direction itself requires the financial statements to be prepared in accordance with Australian Accounting Standards)
- **Other legislation²** – entities with financial reporting obligations under other legislation that require the preparation of financial statements in accordance with Australian Accounting Standards or 'accounting standards'
- **Australian Accounting Standards** – entities required to prepare financial statements in accordance with Australian Accounting Standards (*not* 'accounting standards') under their constituting or other document (subject to certain transitional relief, discussed below)
- **Voluntary compliance** – entities voluntarily preparing general purpose financial statements and also applying the revised *Conceptual Framework for Financial Reporting*.

¹ When originally issued, the comment period for the Exposure Drafts was set as 15 November 2019. However, in response to constituent feedback, the AASB decided at its September 2019 meeting to extend the comment deadline to 30 November 2019. In its [Action Alert](#) from the meeting, the AASB also noted that "submissions received after the revised closing date for comments on the EDs will not be considered by the Board, as it is important to progress the projects related to ED 295 and ED 297 so that any final Standards resulting from the proposals in the EDs are made available for entities to early adopt by 30 June 2020".

² Other legislation refers to financial reporting obligations arising under Federal, State or Territory legislation, e.g. co-operatives, incorporated associations and higher education providers.

Note that the broader 'accounting standard' requirements would only apply where financial statements are required to be prepared under Federal, State or Territory legislation. Where financial statements are being prepared due to a requirement in an entity's constituting or other document, the requirement to prepare general purpose financial statements would only apply where the document requires the financial statements to be prepared in accordance with 'Australian Accounting Standards' (subject to certain transitional relief discussed below). This latter category of entities might include trusts, partnerships and superannuation entities.



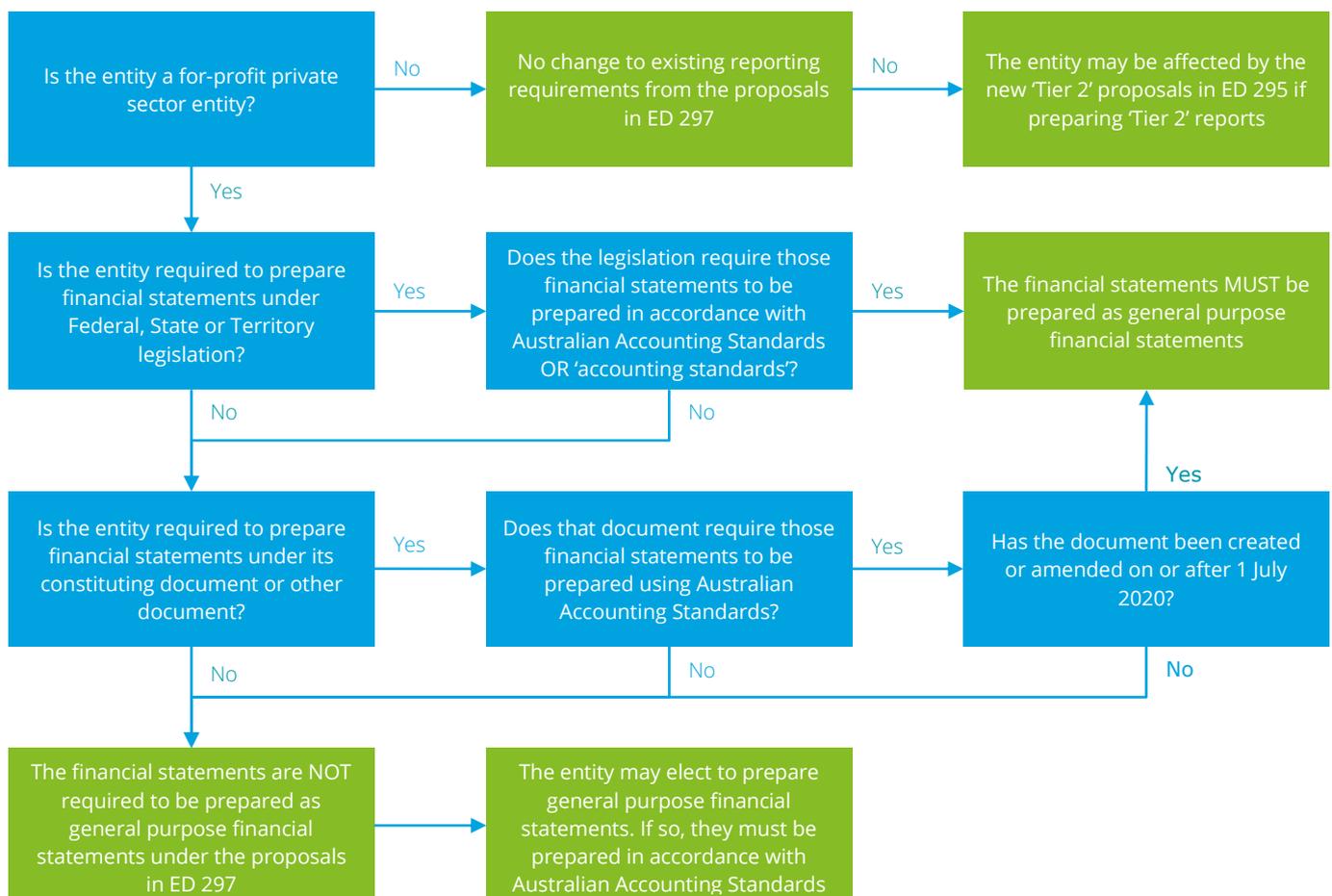
Thinking it through – meaning of 'accounting standards'

The proposals referring to a legislative requirement to prepare financial statements in accordance with 'accounting standards' appears to be quite broad in its impact. Theoretically, any legislative requirement referring to the preparation of financial statements in accordance with 'accounting standards' could be captured.

For instance, entities preparing general purpose financial statements under the *Tax Administration Act 1953* (because they are a 'significant global entity' that is a corporate tax entity) are permitted to use 'commercially accepted principles relating to accounting'. Would this be read as requiring financial statements in accordance with 'accounting standards'?

It may be that the AASB needs to clarify the requirements to ensure they capture the intended population of financial statements that must be prepared in accordance with Australian Accounting Standards.

The flowchart below summarises those entities which would be captured by the requirement to prepare general purpose financial statements under the proposals in ED 297.



The following would *not* be impacted by the proposals to remove special purpose financial statements:

- Entities voluntarily preparing financial statements, or preparing financial statements for other purposes, e.g. small proprietary companies that choose to prepare a financial report for the directors' information needs
- Not-for-profit entities. Reporting requirements for these entities will be subject to a separate AASB project
- For-profit public sector entities
- Other types of financial reports, e.g. financial reports of friendly societies, superannuation funds and retirement villages, or other financial reports not in the form of financial statements.

However, these entities may be impacted by the proposals in ED 295 where they prepare 'Tier 2' general purpose financial statements.

Requirement for consolidation and equity accounting

The requirement to prepare general purpose financial statements in accordance with the recognition and measurement requirements of all Australian Accounting Standards would mean that entities with investments in subsidiaries, joint ventures or associates would be required to adopt consolidation and equity accounting principles. This may significantly broaden the financial reporting burden for affected entities.

The proposed changes would, by eliminating the reporting entity concept, also remove the ability of an ultimate Australian parent entity to prepare 'stand-alone' general purpose financial statements where it is a subsidiary of a foreign parent entity preparing financial statements in accordance with International Financial Reporting Standards (IFRS). This is because all ultimate Australian parent entities would be required to consolidate and apply equity accounting, not just those that are 'reporting entities'.



Key entities affected

The impact of consolidation and equity accounting may be most acutely felt by foreign owned Australian entities, including those currently preparing general purpose financial statements in accordance with Australian Accounting Standards under the 'GPFS for significant global entities' requirements of the *Tax Administration Act 1953*. The preparation of 'stand-alone' GPFS would not be permitted as the only financial statements for these entities.

New 'Tier 2' reporting framework

ED 295 proposes a new 'Tier 2' framework which is based on the International Accounting Standards Board (IASB) *International Financial Reporting Standard for Small- and Medium-sized Entities* (the *IFRS for SMEs*). The proposals seek to align the disclosures made by 'Tier 2' entities with those applying under the *IFRS for SMEs* as closely as possible, adjusted for differences between the requirements of the *IFRS for SMEs* and existing Australian Accounting Standards (which themselves are compliant with IFRS for private sector for-profit entities). Australian specific disclosures are prefaced with an 'Aus' paragraph, and an additional section is proposed for not-for-profit entities.

The proposals in ED 295 run to some 80 pages, including the AASB's request for comment, proposed amendments to other standards and the accompanying basis for conclusions. The core disclosure requirements amount to 40 pages of proposed disclosure requirements, and many are based on equivalent disclosures in IFRS (and so Australian Accounting Standards).

The AASB staff have also prepared a 'summary of key facts' about the proposed new 'Tier 2' reporting framework, including which disclosures would be removed from the existing RDR framework, and those disclosures that would be added if the proposals are finalised. The AASB staff summary can be found at www.aasb.gov.au.



Model financial statements

To assist constituents in understanding and commenting on the proposed 'Tier 2' reporting framework, we have prepared model financial statements illustrating how the general purpose financial statements might be prepared under the proposals in ED 295. These models highlight the broad impacts on entities moving from special purpose financial statements to general purpose financial statements, and the impacts of consolidation.

The model financial statements can be obtained at www.deloitte.com/au/models.

Understanding the impacts

Overview

The impacts of the new 'simplified disclosure' framework (Tier 2 (SD)) would depend upon the nature of the entity and the existing financial reporting framework adopted.

The table below summarises the impact on various classes of entities:

Entity	Existing framework	New framework	Impact
For-profit entity with public accountability and not-for-profit entities preparing Tier 1 financial reports	Tier 1	Tier 1	None (1)
For-profit entity reporting entity without public accountability	Tier 2 (RDR)	Tier 2 (SD)	<i>Reduction</i> in disclosure, partially offset by some new disclosure (2)
For-profit non-reporting entity moving from consolidated SPFS to Tier 2 (3)	SPFS (consolidated)	Tier 2 (SD) (consolidated)	Likely to be an <i>increase</i> in disclosure, with limited offset from removed disclosures (4)
For-profit non-reporting parent entity moving from unconsolidated SPFS to Tier 2 (3)	SPFS (unconsolidated)	Tier 2 (SD) (consolidated)	Likely to be a <i>substantial increase</i> in disclosure, with limited offset from removed disclosures (4) (5)
Single-for-profit non-reporting moving from unconsolidated SPFS to Tier 2 (3)	SPFS (unconsolidated)	Tier 2 (SD) (unconsolidated)	Likely to be an <i>increase</i> in disclosure, with limited offset from removed disclosures (4)
Not-for-profit reporting entities preparing Tier 2 financial statements	Tier 2 (RDR)	Tier 2 (SD)	<i>Reduction</i> in disclosure, partially offset by some new disclosure (2)
Significant global entities (SGEs) preparing GPFS under Australian Accounting Standards under tax legislation	Tier 2 (RDR)	Tier 2 (SD)	<i>Reduction</i> in disclosure, partially offset by some new disclosure and potentially a new requirement to consolidate (2)(6)
Not-for-profit non-reporting entities	SPFS	SPFS	None (1)

- (1) The proposals in ED 295 only apply to 'Tier 2' reports and those in ED 297 only apply to entities currently preparing special purpose financial statements. Accordingly, the proposals are not expected to have direct impacts on entities adopting 'Tier 1' or those entities continuing to prepare SPFS. Entities preparing SPFS would also need to consider the separate proposals to include additional disclosures outlined in ED 293 *Amendments to Australian Accounting Standards – Disclosure in Special Purpose Financial Statements in Compliance with Recognition and Measurement Requirements* (although recent AASB redeliberations suggest these may only apply to certain not-for-profit entities, rather than more broadly as originally proposed)
- (2) ED 295 outlines a number of disclosures from the *IFRS for SMEs* which are not currently required under the RDR framework. The basis for conclusions (proposed paragraph BC59) explains these additional disclosures are proposed to avoid differences between the new 'Tier 2' framework and the *IFRS for SMEs*
- (3) This circumstance would apply if the AASB proceeds with the proposals in ED 297 to remove the ability of most for-profit entities preparing financial statements in accordance with Australian Accounting Standards, or in some cases, accounting standards, from preparing special purpose financial statements. These entities would be required to prepare general purpose financial statements in all cases if the AASB's proposals in ED 297 are ultimately enacted
- (4) These impacts of the new 'Tier 2' will vary depending on the nature of the entity and its particular circumstances. New disclosures would be required in relation to revenues, financial instruments, related parties, employee benefits, income tax and share-based payment. In addition, there would be new requirements for movement schedules and additional information in many areas. These new disclosures would be partially offset by a reduction in some of the disclosures currently included in the 'core' standards applying in SPFS. The impacts are highlighted in our model proposed simplified Tier 2 disclosures, available at www.deloitte.com/au/models
- (5) The significant impact is due to impacts of both (a) moving from SPFS to the new 'Tier 2' disclosures and (b) producing consolidated information and disclosures not previously prepared
- (6) For instance, the requirement to prepare consolidated financial statements might apply to an Australian parent company of a foreign group, which itself has subsidiaries. In addition to other impacts, these entities may be impacted by the removal of the reporting entity concept as they may be required to prepare consolidated financial statements as the consolidation exemption in AASB 10.4(a) will likely not be available for ultimate Australian parent entities. In other words, these entities could no longer prepare 'stand-alone' GPFS to satisfy their SGE reporting requirements under s.3CA of the *Tax Administration Act 1953* (or alternatively, under Part 2M.3 of the *Corporations Act 2001*).

Proposed transitional requirements

Exemption for certain for-profit entities with non-legislative requirements to comply with Australian Accounting Standards

For-profit private sector entities that are required *only* by their constituting document or another document to prepare financial statements in accordance with Australian Accounting Standards would only be required to prepare general purpose financial statements where the relevant document was created or amended on or after 1 July 2020. Such entities could therefore continue to prepare special purpose financial statements so long as the constituent document is not subsequently amended.

This concession is designed to remove the burden of transitioning to general purpose financial statements where the requirement for general purpose financial statements was clearly not contemplated when drafting the constituting document, e.g. certain trusts where financial statements are prepared for specific users such as beneficiaries, and those financial statements are not lodged on the public record.

Additional disclosures in first 'Tier 2' financial statements prepared under the proposed new framework

The proposals in ED 295 carry over and slightly expand upon the disclosure requirements of the *IFRS for SMEs* in relation to first-time adoption of those requirements. The disclosures required are similar to those required under *AASB 1 First-time Application of Australian Accounting Standards* as applicable in existing 'Tier 2' (RDR) financial statements.

The entity is required to explain how the transition to the new 'Tier 2' affected its reported financial position, financial performance and cash flows, including a description of each change in accounting policy, reconciliations of equity and profit and loss, and the corrections of any errors identified. Specific relief is proposed for certain not-for-profit public sector entities.

Short-term exemption from adjusting comparatives

Included in the proposals in ED 297 is a 'short-term exemption' from the requirement to restate comparative information. This exemption would only be available in a for-profit entity's first 'Tier 2' general purpose financial statements for a reporting period beginning on or after 1 July 2020 but before 1 July 2021.

For-profit entities affected by the removal of special purpose financial statements would be eligible for the exemption where they have not previously applied the recognition and measurement requirements of all Australian Accounting Standards and/or have not prepared consolidated financial statements. Such entities will not be required to restate comparative information, but would be required to include additional disclosures and information in the financial statements.

Entities taking advantage of the short-term exemption would be required to present alternate financial statements and transitional disclosures in their first financial reporting period adopting the requirements, as follows:

- Two statements of financial position – as at the beginning and end of the first reporting period, both prepared in accordance with all of the recognition and measurement requirements of Australian Accounting Standards
- Two statements of profit or loss and other comprehensive income:
 - For the current reporting period, prepared in accordance with all of the recognition and measurement requirements of Australian Accounting Standards
 - Comparative information for the prior reporting period, presented in accordance with the most recent special purpose financial statements. This information would be labelled as not being compliant with Australian Accounting Standards, and the nature of the adjustments required to make the information compliant would be disclosed in the notes to the financial statements.

In addition, the notes to the financial statements would be required to disclose the statement of financial position as at the end of the previous reporting period as presented in the most recent special purpose financial statements and describe the main adjustments required to prepare the statement of financial position at the beginning of the current period (referred to the first bullet point above).

Why is the AASB proposing these changes?

Background

The issue of ED 295 and ED 297 follow an earlier Invitation to Comment which had proposed removing the ability to prepare special purpose financial statements under Australian Accounting Standards and either the retention of the existing 'Reduced Disclosure Requirements' (RDR) for Tier 2 entities, or an alternative of 'Simplified Disclosure Requirements' (SDR), which would require full compliance with the disclosure requirements of specified standards, such as revenue, income taxes, related parties and impairment (together with those dealing with the primary financial statements). The original Invitation Comment is available at www.aasb.gov.au.

Feedback on the AASB's Invitation to Comment, together with further AASB research and analysis, determined a new way forward for 'Tier 2': the so-called 'Australian Accounting Standards – Simplified Disclosures'. ED 295 outlines this disclosure framework, which would become a single presentation and disclosure standard that would be applied for 'Tier 2' entities in lieu of the RDR 'shading' approach currently adopted throughout pronouncements. However, consistent with the existing 'Tier 2' requirements, the recognition and measurement of all Australian Accounting Standards would be required to be followed.

If enacted, the proposals in ED 295 (the new 'Tier 2' requirements) would apply to both for-profit and not-for-profit entities preparing 'Tier 2' general purpose financial reports, and are intended to apply to annual periods beginning on or after 1 July 2020. The proposals in ED 297 (removing special purpose financial statements) would apply to affected for-profit entities and are also intended to apply to annual periods beginning on or after 1 July 2020.

The financial reporting framework for not-for-profit entities is being explored as a separate project.

Rationale for the removal of special purpose financial statements

The AASB has had a long-term project on the Australian financial reporting framework on its agenda. As part of this broader project, the AASB has been seeking to address perceived issues with the preparation of special purpose financial statements. To this end, the AASB:

- Commissioned research into the reporting practices of specified for-profit entities lodging financial statements with the Australian Securities and Investments Commission (ASIC). An initial report was prepared in June 2014, and a subsequent report was issued in conjunction with ED 297 in mid-August 2019 (the latest research report is available at www.aasb.gov.au)³. This research showed that only approximately 71% of entities were lodging special purpose financial statements with ASIC, of which at least 76% were fully compliant with the recognition and measurement requirements of Australian Accounting Standards (as is required by ASIC Regulatory Guide RG 85 *Reporting requirements for non-reporting entities*)
- Investigated the use of financial statements lodged with ASIC, finding over 98,000 copies of financial statements were purchased annually from ASIC, and that data aggregators rely on such publicly available information to assist their clients with determining the viability, capacity and credit risk associated with a company
- Sought feedback from analysts, investors and creditors, which indicated strong support for the use of recognition and measurement requirements in all Australian Accounting Standards, that comparability, transparency, comprehensibility and consistency are paramount, and that special purpose financial statements lack disclosures, comparability and information about recognition and measurement that these users expect.

On the basis of this and other research and feedback, the AASB concluded "it is time for the AASB to play its role in improving the consistency, comparability, transparency and enforceability of financial statements to meet user needs, whilst mitigating, where appropriate, the increased reporting burden for entities that would no longer be able to prepare special purpose financial statements".

In effect, the AASB has reached the view that special purpose financial statements are no longer appropriate for for-profit entities as they are often non-compliant with recognition and measurement requirements, and appear to have many users, contrary to the basis for an entity to be considered a 'non-reporting entity'.

Basis for the new framework

By starting with the *IFRS with SMEs* disclosures and developing a separate standard for the new 'Tier 2' reporting framework (which the AASB considers a 'bottom-up approach'), rather than existing disclosures in Australian Accounting Standards (considered a 'top-down approach'), the AASB expects the level of disclosure to be reduced when compared to the existing 'Tier 2' (RDR) framework.

Furthermore, by including all disclosures for 'Tier 2' entities in a single standard, it is hoped that the new framework will be easier to understand and apply in practice when compared with the existing 'shading' approach across all standards.

By both building on the IASB's work which has international application, whilst also reducing disclosures for existing 'Tier 2' entities in an easier to understand single standard, the proposals in ED 295 are effectively seen as more likely to be acceptable to constituents whilst improving the transparency of financial reporting.

The IASB itself also has a similar project on financial reporting by subsidiaries investigating whether it would be feasible to permit small and medium-sized entities that are subsidiaries to apply the recognition and measurement requirements of IFRS Standards but with the disclosure requirements of the *IFRS for SMEs*. Consistent with the IASB's initial decisions in this longer-term project, the proposals in ED 295 closely align with the *IFRS for SMEs* and differences have been minimised.

³ A summary of the report was provided at the September 2019 AASB meeting and is available at www.aasb.gov.au.

Conclusion

The AASB's proposals in ED 295 and ED 297 represent a significant change to existing reporting requirements in Australia.

We recommend entities that are currently preparing special purpose financial statements (particularly for-profit entities), and those preparing financial statements in accordance with the existing 'Tier 2' 'Reduced Disclosure Requirements' framework, familiarise themselves with the AASB's proposals. These entities may wish to consider making a submission to the AASB on any unexpected or other impacts, particularly when they would have a significant impact on the entity's financial reporting systems and procedures, or where additional transitional relief would be helpful in adopting the proposals.

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