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Ms Kris Peach
Chair and CEO
Australian Accounting Standards Board
Podium Level
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AASB Exposure Draft '*Removal of Special Purpose Financial Statements for Certain For-Profit Sector Entities*' ('ED 297')

Dear Ms Peach

We welcome the opportunity to provide our comments in relation to the AASB's proposals with respect to ED 297.

Consistent with our comments in response to ITC 39 '*Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems (Phase 1)*', we welcome the removal of Special Purpose Financial Statements ('SPFS') as a reporting option and agree that Australia should have its reporting requirements aligned with other countries that have adopted IFRS.

The appendix attached contains our responses to the specific matters for which comment was invited in ED 297.

Should you wish to discuss any aspects of our submission, kindly contact either:

- Vik Bhandari on 0411 091 263 or by email at vik.bhandari@frs.com.au
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Yours faithfully

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About Financial Reporting Specialists ('FRS')
FRS are a firm of chartered accountants that are specialists in preparing financial statements, both directly to our clients and indirectly via auditor outsourcing arrangements. We have significant experience in compiling GPFS Tier 1, GPFS Tier 2 (RDR) and SPFS as well as providing technical accounting guidance to our clients. Our clients range from ASX multinationals to NFP charities.

Appendix

Specific matters for comment

1. ***The proposed amendments identify the for-profit entities required to comply with Australian Accounting Standards (or accounting standards) that would no longer have the ability to prepare SPFS. Do you agree that:***

   (a) the amendments set out in this ED effectively remove the ability to prepare SPFS for the for-profit entities identified in AASB 1057 'Application of Australian Accounting Standards' as entities for which the reporting entity definition is not relevant (also identified in paragraph Aus1.1 of the Conceptual Framework for Financial Reporting)? If not, please provide your reasons.

   (b) as an exception, other for-profit private sector entities that are required only by their constituting document or another document to prepare financial statements that comply with AAS should retain the ability to prepare SPFS, provided that the relevant document was not created or amended on or after 1 July 2020? If not, please provide your reasons (see paragraphs BC73-BC83).

   (c) for-profit public sector entities should also retain the ability to prepare SPFS as discussions about the public sector reporting framework are continuing? If not, please provide your reasons.

Response 1(a)

Yes. We agree that the amendments remove the ability to prepare SPFS for for-profit entities.

Response 1(b)

Prima facie, we are concerned with this proposal. We believe that the overarching objective of making amendments to the Framework and Australian Accounting Standards ('AAS') at this time should be to eliminate the current 'reporting entity concept' in its entirety and the ability of certain entities to self-select accounting policies. To quarantine the 'SPFS problem' to a sector of the market (e.g. trusts, partnerships) does not appear to be in the best interests of the community and complicates financial reporting by introducing multiple frameworks.

To support this view, we note the following from the ED:

(i) The Background paragraph to the ED describes that the SPFS problem "reduces the comparability of financial reporting for entities of similar economic circumstances and undermines the fundamental principles of consistency, comparability, transparency and enforceability." However, the ED risks not achieving its objective in circumstances where a significant non-corporate business enterprise (such as a trading Trust) prepares SPFS (rightly or wrongly) which may not be comparable to the General Purpose Financial Statements ('GPFS') of a similar business conducted via private or public company;

(ii) Paragraph (b) (page 6) under the heading "The issues with SPFS" states that "ASIC and other regulators have advised that the reporting entity concept is not enforceable as it is too judgemental". Whilst such entities are unlikely to be within the jurisdiction of being regulated by ASIC, retaining SPFS for certain entities for which there may be users unable to obtain tailored financial information to meet their needs therefore remains problematic. Such users would not have any form of recourse where the entity continues inappropriately to supply SPFS on the basis that the 'reporting entity' concept is unenforceable.

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Should the AASB continue with its proposal by deeming out-of-scope those entities with a constituting document or another document dated pre 1 July 2020 and which requires preparation of financial statements, we believe that such entities should be in-scope in circumstances where such entities have been previously been preparing GPFS. Such entities should not see the proposals as an opportunity to downgrade their financial statements on the basis that the AASB has intentionally pushed them outside of the remit of GPFS under the ED's proposals.

Furthermore, we suggest that any grandfathering should have a finite time on it (e.g. 5-years) in which time the entity concerned is required to amend their governing documentation if they wish to prepare financial statements other than in accordance with AAS.

Response 1(c)

We are of the view that the ability to prepare SPFS for the for-profit public sector may be retained whilst work on the public sector framework continues.

2. Have you identified any arguments additional to those addressed in the Basis for Conclusions or unintended consequences that should be considered by the AASB in determining whether the ability to prepare SPFS should be removed from certain for-profit private sector entities as set out in this ED?

Response 2

We note that the Explanatory Statement to the Corporate Regulations 2001 '*Corporations Amendment (Proprietary Company Thresholds) Regulations 2019*' which increased the thresholds for large proprietary limited companies was undertaken having regard to the "economic significance" of such entities. We also note that both AASB and ASIC stated at the Melbourne and Sydney roundtable events that, in their views, it would be likely that with the new size thresholds, large proprietary companies could be classified as 'reporting entities' in regard to their economic significance. Having regard to the commentary made by the AASB and ASIC above, if such entities are indeed classified as 'reporting entities', it will create an obligation for them to prepare GPFS.

Under the current legislation, the increased thresholds apply from 1 July 2019. By definition, large trusts, partnerships and other entities not governed by legislation but which are of equivalent size to a large company would also be regarded as 'reporting entities' under SAC 1.

Where such entities are moving from SPFS to GPFS from 1 July 2019, such entities will need to progress to either full GPFS Tier 1 or the Tier 2 Reduced Disclosure Requirements ('RDR') Framework as it currently stands for their 30 June 2020 financial reports.

As mentioned in the ED, such entities can potentially early adopt the Simplified Disclosure Requirements ('SDR') proposals for their year ended 30 June 2020, however, it is unlikely that the profession, including software providers, will be ready for SDR implementation, and therefore such entities will find it difficult to achieve SDR compliance at this time.

If such entities are forced to adopt GPFS and apply GPFS Tier 2 RDR for June 2020, from 1 July 2020, large companies and reporting entities caught under SAC 1 will then need to again switch frameworks to the proposed SDR Framework. In the space of 4 or 5 years, such entities could find themselves within 4 different frameworks, have gone from SPFS, to RDR, to SDR (AASB), and then to SDR/SMEs (IASB). This cannot be considered to be a favourable evolution of financial reporting for such entities and could attract criticism of the profession.

We believe this creates a potentially onerous situation on entities having to produce GPFS for the first time at 30 June 2020 – both under SDR Framework and entities caught within SAC 1.

In this regard, we believe that consideration could be given to approaching ASIC to consider providing a one year relief period such that large companies, under the new thresholds, that would otherwise be required to prepare GPFS for the first time at 30 June 2020, may continue using their existing framework for an additional year before moving to the revised SDR Framework from 1 July 2020 to coincide with the AASB's implementation of its proposals.

This would provide time for preparers and software developers to adequately plan for a one time transition from SPFS to GPFS under a stable platform. It may also provide the AASB with time to develop and deliver the proposals for the NFP and public sector that are not within the scope of the current proposals.

For SAC 1 reporting entities that would otherwise be required to prepare first time GPFS Tier 2 RDR at 30 June 2020 (or 31 December 2019) as triggered by the 'economic significance' argument, such entities seem likely to be caught having to deal with RDR one year, and SDR the next.

3. Do you agree that:

(a) for-profit private sector entities that are neither required by legislation to prepare financial statements that comply with AAS or accounting standards nor required by a document (created or amended on or after 1 July 2020) to prepare financial statements that comply with AAS; and

(b) for-profit public sector entities;

should be able to voluntarily prepare GPFS and in doing so apply either the Conceptual Framework for Financial Reporting or the Framework for the Preparation and Presentation of Financial Statements? Please provide your reasons, including whether there are any adverse or unintended consequences that should be considered by the AASB in determining whether the Framework for the Preparation and Presentation of Financial Statements should not be permitted to be applied in these circumstances.

Response 3

We support the voluntary production of GPFS where there is otherwise no statutory or legal requirement to do so. We believe that the operation of dual reporting frameworks complicates the financial reporting environment, and this creates a burden on the preparers and, where applicable, auditors, where knowledge of different frameworks and their requirements is needed. We are of the view that any GPFS prepared should be based on the reporting conceptual framework ('RCF') and the GPFS Tier 2 proposals.

4. Do you agree that entities that are not explicitly required to comply with accounting standards, but are required by legislation or otherwise to provide financial statements or financial information that gives a true and fair view, should not be covered by these proposals? If not, please provide your reasons (see paragraphs BC68-BC69).

Response 4

We are of the view that compliance with accounting standards will prima facie provide a true and fair view of an entity's financial position and performance.

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Providing an entity with a true and fair override, which appears to be seen as a governing principle in BC69, provides licence to preparers to introduce measurement, recognition and disclosure that may not be elements of generally acceptable accounting principles and which can be introduced due to lack of understanding of accounting treatments and concepts. This can create misreporting and both an absence of consistency and transparency.

Where legislation does not provide a reference to the required or expected framework to apply in the production of financial information that gives a true and fair view, AAS's should be seen as the best-practice guidance to be used.

Regard must also be had to the professional standards to which members of the accounting profession are obliged to follow. Where members of the accounting profession are involved in preparation, audit or review of financial statements, APES 205 '*Conformity with Accounting Standards*' requires members to have regard to AAS. Whilst APES 205 will likely be required to be updated as a result of the proposals, it would be a fundamental shift to convey a message that compliance with AAS may not be relied on to necessarily give a true and fair view. This would cast doubt on the integrity of the RCF and standards in general.

5. ***Do you agree with the proposal to amend AASB 1 to provide optional relief from the restatement of comparative information in the year of transition from SPFS to GPFS Tier 2 (see paragraphs BC112-BC122)? If not, please provide reasons. If yes, do you agree with the proposed disclosures in relation to the comparative period (see paragraph AusE8.4 for AASB 1 on page 20)? If not, please provide your reasons. Please consider these matters in conjunction with the AASB's proposals regarding a revised Tier 2 disclosure framework as set out in ED 295.***

Response 5

We agree with providing relief however we disagree with the proposed disclosures.

Consolidated financial statements

The current proposals (BC123-125) appear to require consolidation in the comparative period throughout an entity's first GPFS in circumstances where that entity had not previously prepared consolidated financial statements in its prior year SPFS.

The current proposals require a mix of comparative information in the primary statements (e.g. profit or loss (standalone parent) whilst statement of financial position (consolidated entity)) which can be confusing for users and adds considerable cost burden to software companies.

We believe that the relief in Appendix C of AASB 1 could be extended to allow for consolidation only from the start of the financial period in which GPFS are first prepared. This would lead to a first time GPFS that is prepared throughout in the current year in accordance with AAS but retains the previously presented SPFS financial information throughout in the comparative year.

Whilst there would be an absence of comparability between financial statements of the current and comparative year, we also note that the AASB is allowing for an absence of comparability in single entity profit or loss statements in its proposals, since it is proposing SPFS comparative information and AAS current year information.

Our proposal therefore eliminates the need to consolidate entirely in the comparative year, which would, to an extent, be alleviated through qualitative transitional information as required in the ED.

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We would suggest that the consolidated statement of financial position, as at the date of transition, be presented as additional disclosure within the notes to the financial statements as part of the transitional information rather than be on the face of the primary statement.

Single entity financial statements

The AASB is currently proposing that the statement of financial position contain AAS information in both the current and comparative periods, yet for the statement of financial performance it proposes AAS financial information in the current year and SPFS information in the comparative period.

We believe that this creates a mismatch of data within the financial statements and potentially detracts from the value of such financial statements. We are therefore of the view that the costs of presenting AAS information in the comparative period exceed the benefits derived.

As mentioned, we are of the view that additional relief of allowing SPFS data throughout the financial statements as comparative information would facilitate the transition to AAS in a more efficient and effective way.

Accounting policy notes

Where the AASB allows for a mix of AAS and SPFS financial information in the financial statements, it will need to consider the impact upon accounting policy note disclosures.

We would suggest that the accounting policies disclosed be restricted to those of the current period reflecting the adopted AAS polices and not need to refer to the policies of the comparative period to the extent they are different. Having potentially two sets of accounting policies would introduce too much clutter to the financial statements and be potentially confusing to users. Changes to policies required on transition to the revised Tier 2 could be explained in the qualitative discussion of transitional adjustments.

6. ***Do you agree that additional transition relief is not required (see paragraphs BC112-BC122)? If not, what transition relief should be provided and what are your reasons?***

Response 6

Please refer to our Response 5.

7. ***Do you agree with the proposal to amend AASB 1053 requirements for the first-time adoption of Tier 2 reporting requirements relating to whether a parent entity has complied with AASB 10 Consolidated Financial Statements in its previous SPFS (see paragraphs BC123-BC125)? If not, please provide your reasons. If non-compliance with AASB 10 was the only departure from AAS in the previous SPFS, should an entity be permitted to apply AASB 1, which could allow the restatement of amounts under various transition relief options?***

Response 7

Please refer to our Response 5.

8. ***Do you agree with the proposed effective date of annual reporting periods beginning on or after 1 July 2020 (see paragraphs BC126-BC129), with earlier application permitted? If not, please provide your reasons.***

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Response 8

We agree with the proposed effective date. However, please refer to our Response 2.

General matters for comment

9. Whether the AASB's For-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in this ED?

Response 9

We note that the AASB's purview is to consider external reporting needs of users in general (paragraph 16 of the AASB's For-Profit Entity Standard-Setting Framework) and formulate accounting standards for other purposes. We believe that there should be more consideration given to providing guidance relating to the preparation of SPFS. Leaving such entities to derive their own reporting framework is problematic, and relies upon the ability of users and the entity to dictate and agree upon their specific information needs, and creates unnecessary transitional adjustments when, for example, a small private company becomes large and must move from SPFS to GPFS.

10. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?

Response 10

To the extent to which other professional statements, accounting standards and auditing standards refer to, or rely upon, the operation of the current reporting entity concept, these will need to be revised.

We have detailed our concerns in relation to timing in Response 2.

11. Whether, overall, the proposals would result in financial statements that would be useful to users?

Response 11

We believe that the proposals would result in financial statements that would be useful to users. We do believe that specific guidance should be provided to preparers of SPFS such that the available reporting frameworks be limited and minimum presentation requirements specified.

12. Whether the proposals are in the best interests of the Australian economy?

Response 12

We of the opinion that the proposals are a step forward in implementing a sound financial reporting framework in Australia.

13. Unless already provided in response to matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative? In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any

expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

In our experience, when moving from SPFS to RDR, excluding consolidation, the additional disclosures represent approximately a 15% increase in the volume of the report, which translates to a one-off increase in compilation costs of 15-30%. Subsequent to this, there is an approximate ongoing increase of 10% compared to the pre-RDR fee. On top of this, consideration needs to be given to the additional costs of auditing such additional disclosures.

Furthermore, in our experience clients that have moved from standalone SPFS to consolidated RDR have encountered significant costs, in some cases greater than 100% of the prior year compliance costs, as a result of the lack of relief provided in AASB 1 as it currently stands. This includes, but is not limited to, eliminating the parent's investment in subsidiaries and accounting for pre-acquisition retained earnings, fair value adjustments and goodwill. In some cases, the acquisitions occurred more than 10 years ago, and the required information is not readily on hand.