Australian Accounting Standards Board

Minimum Accounting Policy Disclosures in Special Purpose Financial Statements (SPFS) of For-Profit Private Sector Entities
(*based on* AASB ED 302 (June 2020) proposals)

Preliminary Assessment for RIS Purposes

Question	***Assessment***
1 What is the problem you are trying to solve?	The AASB's Australian financial reporting framework allows certain for-profit private sector entities to self-assess their requirements for preparing financial statements by permitting them to prepare special purpose financial statements (SPFS). Entities that prepare SPFS are able to self-select the accounting policies they apply in those SPFS. The ability of some entities to self-assess and self-select their reporting requirements has led to a fundamental problem: similar entities might prepare very different sets of financial statements, either general purpose financial statements (GPFS) that use the robust and consistent framework of the AASB's Australian Accounting Standards or else SPFS based on self-selected requirements.[1] Examples of the issues created by the self-assessment and self-selection of accounting requirements by some entities include: • the fundamental financial reporting principles of consistency, comparability, transparency and enforceability are undermined, for example there is reduced comparability of financial statements for entities of similar economic circumstances; • SPFS can state compliance with Australian Accounting Standards (AAS), however there are no minimum recognition and measurement (R&M) accounting policy requirements that entities explicitly must comply with in SPFS, which can make it difficult for investors and other readers (the "users") of the financial statements to understand them if the accounting policies applied are not clearly identified; and • there are some instances where SPFS are prepared and lodged on a public exchange to attract domestic and international investors or other contributors. In many cases, users of the financial statements are unaware that a statement of 'compliance with Australian Accounting Standards' can cover self-selected requirements that are in fact not consistent with AAS.
2 Why is government action needed?	It is necessary to improve the transparency and comparability of SPFS by ensuring the basis of preparation of the financial statements (i.e. the accounting policies adopted) is clear. This is a significant issue, as evidenced by the following factors: • feedback indicates that, on average, 93% of primary users and more than 95% of other users said comparability, transparency, comprehensibility and consistency are what they need most in financial statements. See AASB Staff

1 The AASB removed the ability of certain for-profit private sector entities to prepare SPFS via Australian Accounting Standard AASB 2020-2 *Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (March 2020). Therefore, the SPFS problems addressed in this document apply only to those for-profit private sector entities that are outside the scope of that Standard and able to continue to prepare SPFS.

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	Paper: For-profit User and Preparer Survey Results (December 2018)[2], page 4;
	• the quality of disclosures in a significant number of SPFS is not sufficient for users as only 43% of primary users and 56% of other users said they are satisfied with the information presented in SPFS. (AASB Staff Paper, page 4);
	• feedback also indicates that 30% of primary users and 46% of other users were unsure what accounting policies were being applied in SPFS and therefore whether and to what extent recognition and measurement (R&M) requirements in AAS were being applied (AASB Staff Paper, page 11);
	• research reported in AASB Research Report 12 (August 2019)[3] indicates (see page 2) that compliance with AAS was unclear for 34% of for-profit non-disclosing entities lodging SPFS with the Australian Securities and Investments Commission (ASIC). After a detailed, qualitative assessment of the accounting policies of the unclear SPFS, Research Report 12 concluded that:
	  ○ 10% of the total population of SPFS covered by the research did not appear to be following all R&M requirements in AAS; and
	  ○ the extent of compliance (or otherwise) with AAS remained unclear for 14% of the total population.
	Research Report 12 therefore found that potentially up to 24% of SPFS lodged with ASIC might not comply with the R&M requirements in AAS; and
	• SPFS prepared by other for-profit private sector entities, which are not lodged with ASIC or in many cases any other regulator, are hardly likely to present a better rate of compliance. They are indeed more likely to present a lower rate of compliance, particularly where their financial reporting is unregulated.
	
	A significant number of for-profit private sector entities will continue to be able to prepare SPFS for the foreseeable future. Additional disclosures therefore are necessary to meet users' stated needs to clearly understand the basis of preparation of for-profit private sector entities' SPFS when they refer to compliance with AAS.

3 What policy options did you consider?	(1) Do nothing. (2) Scope – applicable entities: (a) Option A – all for-profit private sector entities preparing SPFS, including those preparing financial statements voluntarily; (b) Option B – all for-profit private sector entities preparing SPFS that are either required by legislation to comply with AAS or accounting standards or that have a non-legislative requirement to comply with AAS

2 AASB Staff Paper *Enhancing the revised* Conceptual Framework *and replacing Special Purpose Financial Statements – For-profit User and Preparer Survey Results*. Primary users of financial statements are investors and analysts, lenders and other creditors.

3 AASB Research Report 12 *Financial Reporting Practices of For-Profit Entities Lodging Special Purpose Financial Statements*.

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	(provided the document requiring compliance with AAS was created before 1 July 2021 and not amended on or after that date);[4] or (c) Option C – only those for-profit private sector entities preparing SPFS that have a non-legislative requirement to comply with AAS (provided the document requiring compliance with AAS was created before 1 July 2021 and not amended on or after that date). (3) Possible new disclosure requirements for entities preparing SPFS: (a) Option 1 – state whether the entity has applied the consolidation and equity accounting requirements of AAS, given the particular interest of users of SPFS in the structure of groups of entities; (b) Option 2 – disclose the material accounting policies applied in the SPFS and state whether those policies comply with the R&M requirements in AAS and, if not, an indication of how the accounting policies applied do not comply with AAS; (c) Option 3 – a binary statement regarding compliance or non-compliance with all R&M requirements in AAS; (d) Option 4 – a statement of compliance with all R&M requirements in AAS only when applicable, i.e. no statement would be required if an entity's SPFS did not comply with all the R&M requirements in AAS; or (e) Option 5 – state whether all R&M requirements of AAS have been applied and, if not, either an indication of how the policies applied do not comply or else that an assessment has not been made, as appropriate.
4 What is the likely net benefit of each option?	(1) Do nothing – although this option would result in no additional effort, time or costs for preparers of SPFS, the issues of transparency, comparability and understandability of SPFS for the users would not be addressed. Entities would still be able to state that their SPFS were prepared in compliance with AAS, even though they may not comply with all R&M requirements. This is because most of the AAS do not apply explicitly to SPFS. Users of the financial statements may also continue to be unaware of the accounting policies applied in the SPFS or of any non-compliance with R&M requirements in AAS. (2) Scope – applicable entities: (a) Option A –although the objective of the proposed disclosures is to provide information to users of SPFS about whether or not the entity has complied with all the R&M requirements in AAS, and there would be

4 This option would be relevant only if the effective date of any new disclosures preceded the removal of SPFS for certain for-profit private sector entities – that is, if the effective date included periods beginning before 1 July 2021. For periods beginning on or after 1 July 2021, in accordance with AASB 2020-2, entities required by legislation to comply with AAS are no longer able to prepare SPFS and entities required to comply with AAS other than by legislation (e.g. by a constitution or other document) are only able to continue preparing SPFS where the relevant document was created before 1 July 2021 and not amended on or after that date.

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	merit in requiring all for-profit private sector entities preparing SPFS to make the disclosure, to do so is not warranted. This is consistent with the current scope of AAS and the AASB's role in determining the appropriate accounting framework that should apply where legislation, regulation or other authority requires the preparation of financial statements that comply with AAS. (b) Option B –the AASB's initial proposal in AASB Exposure Draft ED 302 *Amendments to Australian Accounting Standards – Disclosures in Special Purpose Financial Statements of Certain For-Profit Private Sector Entities* (June 2020) was that requiring the disclosures to be made by entities with a legislative requirement to comply with AAS (including those within the scope of AASB 2020-2) would be of benefit to users and, in normal circumstances, should not be too onerous for preparers. However, the AASB acknowledges the economic impact of COVID-19 has been significant, is ongoing, and could not have been predicted. On that basis, the AASB accepted the practical arguments that the introduction of new disclosure requirements for one year (e.g. the financial year 2020/21 or the calendar year 2021) for entities within the scope of AASB 2020-2 would add some incremental time and cost to preparing the SPFS for only limited benefit. This would be the only year these entities would be required to make the disclosures in their SPFS, before they transitioned to GPFS for subsequent years, as required by AASB 2020-2.[5] For-profit private sector entities preparing SPFS that have a non-legislative requirement to comply with AAS are addressed in Option C, as there is no difference between Options B and C in respect of this group. (c) Option C – the AASB acknowledges these entities prepare SPFS for specific users, have no external regulator and in most cases do not lodge their SPFS on the public record. However, these entities will be able to continue to prepare SPFS for the foreseeable future and thus potentially state that their SPFS have been prepared in compliance with AAS when they do not comply with all of the R&M requirements in AAS or else do not make their accounting policies clear. The AASB does not expect the proposed disclosures to be onerous. For-profit entities typically would be expected to have an understanding of their own accounting policies and the R&M requirements in AAS under a good-governance approach to financial reporting, with access to the resources needed to make the necessary accounting policy comparisons. However, if an entity considered the costs of preparing additional accounting policy disclosures would be disproportionately high, the entity would have the option of incurring the costs of changing its constituting or other document (such as a trust deed) to remove

5 ED 302 proposed an effective date of periods ending on or after 30 June 2021. The AASB decided in November 2020 that the Standard resulting from ED 302 should apply to periods beginning on or after 1 July 2021. In substance, those periods can now be covered by specifying an effective date of periods ending on or after 30 June 2022 for new SPFS disclosure requirements.

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	references to AAS, and thereby exclude itself from the scope of the proposals. (3) Possible new disclosure requirements for entities preparing SPFS: (a) Option 1 – the AASB previously concluded for not-for-profit entities in similar circumstances that disclosures about interests in other entities are important to users.[6] Although there may be some additional costs to for-profit entities to determine whether they have accounted for their interests in other entities in accordance with AAS, the additional disclosures would provide useful information for the users of the financial statements. However, this is only one area of accounting policies that would be of interest to users and therefore is of limited (but fundamental) benefit. (b) Option 2 – there is currently no AAS requirement for for-profit entities preparing SPFS to disclose information about the material accounting policies applied or the extent of their compliance or otherwise with the R&M requirements in AAS. Accordingly, the transparency and comparability of SPFS is compromised. Disclosing the accounting policies and whether or not an entity complies with all R&M requirements in AAS (and, if they do not comply, disclosing an indication of how they do not comply), is necessary for the users of the SPFS to be most informed. Although requiring entities to assess their compliance with the R&M requirements in AAS would increase costs to preparers, as noted above (see Option C) the AASB considers that for-profit entities typically would be expected to have an understanding of their own accounting policies and the R&M requirements in AAS under a good-governance approach to financial reporting. Furthermore, they are expected to have access to the resources necessary to make the required accounting policy comparisons if they haven't already done so. (c) Option 3 – this option would add a similar level of costs to preparers as Option 2. This is because in order for them to determine whether or not they have complied with R&M requirements in preparing their SPFS, an entity would need to compare each material accounting policy with the R&M requirements in AAS. However, a binary disclosure is not expected to be very useful to users of SPFS as they would not be able to discern the reasons for or extent of non-compliance where that was stated without further information. (d) Option 4 – this option would add a similar level of costs to preparers as Options 2 and 3, as entities would still be required to determine whether or not their accounting policies comply with R&M requirements in AAS. As with Option 3, users would not be able to discern the reasons for or

6 AASB 2019-4 *Amendments to Australian Accounting Standards – Disclosure in Special Purpose Financial Statements of Not-for-Profit Private Sector Entities on Compliance with Recognition and Measurement Requirements* (November 2019) requires disclosures in the SPFS of not-for-profit entities regarding the application of consolidation and equity accounting requirements, if assessed by the entity.

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	extent of non-compliance if no statement of compliance was made and no further information was disclosed in the SPFS. (e) Option 5 –in considering this option, the AASB acknowledges that there may be some merit in allowing for-profit entities to disclose that they have not assessed the extent of compliance with the R&M requirements in AAS, as it had done previously for not-for-profit entities under AASB 2019-4. However, although preparers would incur minimal costs if they are able to state merely that they have not assessed compliance with those R&M requirements, such a statement would provide little useful information to the users of the SPFS. Furthermore, the AASB considers that for-profit entities typically would be expected to have access to the resources needed to make the necessary accounting policy comparisons and should have an understanding of their own accounting policies and the R&M requirements in AAS under a good-governance approach to financial reporting. The AASB also considered that although many of these entities may be small in size, they typically would not have overly complex transactions and accounting policies, and their assessment of compliance should therefore be relatively straightforward.
5 Who did you consult about these options and how did you consult them?	The AASB consulted with key stakeholders, including preparers, users, professional bodies, regulators and professional services firms (accountants and auditors). The consultation included conducting user and preparer feedback surveys (see footnote 2), webinars, and roundtable events in various States and issuing the following consultation documents for public comment: • Invitation to Comment ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (May 2018) – 33 comment letters were received on these broad proposals; • AASB Exposure Draft ED 293 *Amendments to Australian Accounting Standards – Disclosure in Special Purpose Financial Statements of Compliance with Recognition and Measurement Requirements* (July 2019) – 14 comment letters were received; • AASB Exposure Draft ED 297 *Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (August 2019) – 19 comment letters were received; and • AASB Exposure Draft ED 302 *Amendments to Australian Accounting Standards – Disclosures in Special Purpose Financial Statements of Certain For-Profit Private Sector Entities* (June 2020) – 13 comment letters were received on these specific proposals.
6 What is the best option from those you have considered?	The AASB considers the most appropriate scope (applicable entities) option is Option C. Only those for-profit private sector entities preparing SPFS that have a non-legislative requirement to comply with AAS (provided the document requiring compliance with AAS was created before 1 July 2021 and not amended

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	on or after that date) would be required to comply with the proposed new disclosure requirements. The AASB considers the most appropriate disclosure requirement approach is to adopt both Option 1 and Option 2. This would require applicable entities to disclose the material accounting policies applied in the SPFS and whether or not they comply with the R&M requirements in AAS, including consolidation and equity accounting in respect of their interests in other entities. Some entities may already disclose this information in their SPFS. As noted previously, the AASB does not consider the proposed disclosures to be onerous. For-profit entities within the scope of the proposals typically would be expected to have access to the resources needed to make the necessary accounting policy assessments and should therefore have an understanding of the R&M requirements in AAS. Therefore, any additional costs would not be expected to be significant and would be expected largely to be eliminated after the initial adoption of the proposals (i.e. the AASB expects there would be minimal ongoing costs after the first year of implementation). Requiring an entity to disclose its material accounting policies is not onerous as it is information that is already known to the entity. The AASB notes that Options 1 and 2 together (like the other disclosure options) would not require an entity to make any changes to its accounting policies. However, the disclosures would provide the most useful information of all of the disclosure options, resulting in significant improvements in the information provided to users of SPFS. The AASB considers that the proposed disclosures under Options 1 and 2 are a proportionate approach to addressing the problems associated with SPFS reporting. The AASB's initial proposals in ITC 39 were to remove the ability of all for-profit private sector entities that had a requirement to comply with Australian Accounting Standards to prepare SPFS. However, the AASB acknowledged that certain entities within that group (those in Option C) typically prepare financial statements for specific users (who may have the ability to command the information that they require), have no external regulator and often do not lodge the SPFS on the public record. For these reasons, the AASB considers it is appropriate to provide some form of relief to these entities by allowing them to continue to prepare SPFS (subject to meeting certain criteria), instead of requiring them to prepare GPFS. However, the AASB also considers it is necessary to improve SPFS reporting by these entities and considers the proposed Options 1 and 2 disclosures to be a proportionate response that balances user needs and costs to be incurred by preparers.
7 How will you implement and evaluate your chosen option?	The AASB's chosen option would be implemented through amendments to Australian Accounting Standards AASB 1054 *Australian Additional Disclosures* and AASB 1057 *Application of Australian Accounting Standards*. These amendments would be followed up with educational materials to ensure relevant entities and stakeholders are aware of and understand the amendments and the potential effect on their SPFS.

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	The AASB would undertake a follow-up user and preparer survey to help evaluate how beneficial the chosen option has been in practice and whether any further amendments should be made to the requirements for SPFS.