

The time has come

Changes to Australian financial reporting

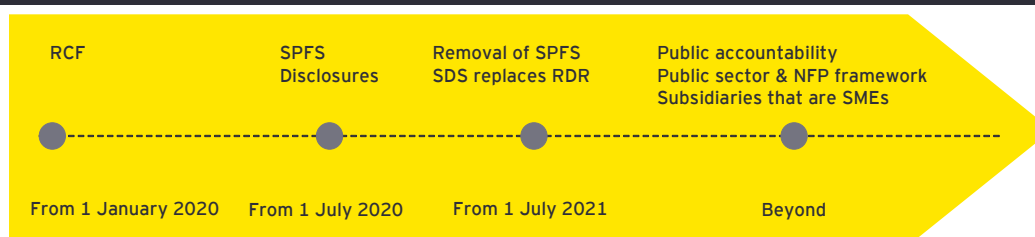


Major changes in Australia's financial reporting landscape

The AASB has largely completed its reporting framework reform for for-profit private sector entities following the release of AASB 2020-2. This effectively removes the 'reporting entity' concept that has been part of our framework for many years. To make the transition easier from Special Purpose Financial Statements (SPFS) to General Purpose Financial Statements (GPFS), disclosure relief is available for those choosing to early adopt. In addition, the AASB has issued AASB 1060 that replaces the current Reduced Disclosure Requirements (RDR) with Simplified Disclosures (SDS) for GPFS (Tier 2) reporting. The changes become mandatory for annual periods beginning 1 July 2021.

The timing of change has somewhat been driven by the IASB amendments to the conceptual framework (RCF), and the change is argued to improve the quality of financial reporting in Australia. This is not the end and further changes are expected to the Australian landscape in years beyond 30 June 2021.

This timeline depicts the application dates relating to changes in Australia's financial reporting framework:



The RCF

The AASB adopted the RCF by issuing an amending standard (AASB 2019-1). The RCF is applicable for:

- ▶ For-profit private sector entities that have public accountability; are required by legislation to comply with Australian Accounting Standards (AAS); or those that want to voluntarily comply with IFRS as issued by the IASB;
- ▶ Any other for-profit entities (including public sector entities and trusts) that prepare GPFS.

The purpose of Australia adopting the RCF is for entities to remain IFRS compliant. It is effective for annual periods beginning on or after 1 January 2020 if stating compliance with IFRS, and from 1 July 2021 for other entities.

The adoption of the Revised Conceptual Framework may impact those that developed an accounting policy using the former conceptual framework.

SPFS disclosures on compliance with AAS recognition and measurement at 30 June 2021 (standard not yet issued)

The removal of the reporting entity concept, and therefore the ability to prepare Special Purpose Financial Statements (SPFS) for for-profit private sector entities, will not be mandatory until reporting periods beginning on or after 1 July 2021.

Therefore, to increase the usefulness of SPFS in the meantime, the AASB decided to require disclosure of the extent of compliance with AAS recognition and measurement requirements (contained in AASB 2019-4 but as written at the moment only for not-for-profit entities) by for-profit private sector entities preparing SPFS at 30 June 2021. At this stage, there is no indication this disclosure will be required in SPFS for earlier years. The amending Standard to require this disclosure by for-profit private sector entities is expected to be issued soon.

Simplified Disclosures from 1 July 2021 (AASB 1060)

AASB 1060 "General Purpose Financial Statements - Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities" replaces the current RDR for Tier 2 reporting, applicable for reporting years commencing from 1 July 2021. Entities applying Tier 2 reporting will apply all AAS recognition and measurement requirements, including consolidation, as applied for Tier 1 reporting. Due to the costs of following RDR outweighing its benefits, SDS aims to reduce the reporting burden by requiring disclosures based on those in the IASB's *IFRS for SMEs* standard.

The key features of SDS are:

- ▶ A single standard (AASB 1060) with all disclosures required by entities applying Tier 2 reporting (including public sector and not-for-profit entities).

Entities that have been preparing RDR financial statements to comply with the Significant Global Entities legislation must also make the transition to SDS.

- ▶ Developed based on the IASB's *IFRS for SMEs* standard with some modifications to account for differences in Australia's recognition and measurement requirements (i.e. in following full IFRS recognition and measurement by Tier 2 reporting), and Australian specific disclosure needs.
 - ▶ Some Australian specific disclosures include:
 - ▶ disclosures of fees for audit and review services
 - ▶ disclosure of imputation tax credits
- These disclosures were previously in AASB 1054.
- ▶ A numerical tax reconciliation will also be required on the basis that this is a public policy issue.

Overall, SDS will attract less disclosures than RDR, but more than many SPFSs currently provide, in the areas of financial instruments, interests in other entities, revenue and leases.

The AASB has 'stepped ahead' of the IASB when it developed SDS disclosures for recent standards (eg Revenue and Leases). The IASB is yet to amend *IFRS for SMEs* for these recent Standards.

Removal of SPFS from 1 July 2021 (AASB 2020-2)

AASB 2020-2 "Amendments to Australian Accounting Standards - Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities" removes the ability for Corporations Act entities and many others to self-assess their basis of financial statement preparation (to be 'non-reporting entities') and prepare SPFS. The AASB considers its role is to determine the appropriate accounting framework (and not leave it to preparers to decide) for entities preparing financial statements **in accordance with AAS** (or where Australian legislation requires, **in accordance with accounting standards**).

The impact for entities affected is that they will need to prepare GPFS, either Tier 1 (full IFRS) or Tier 2 (simplified disclosures). Both will bring increased disclosures compared to SPFS currently, but more importantly consolidated financial statements will need to be prepared by an Australian head entity of a group unless an exemption in AASB 10 *Consolidated Financial Statements* applies.

The new requirements apply to:

- ▶ For-profit private sector entities that are required by Australian legislation to prepare financial statements complying with either "AAS" or "accounting standards."
- ▶ Other for-profit private sector entities that are required otherwise by a document (e.g. constitution or lending agreement) to prepare financial statements in accordance with "AAS".

Consequently, SPFS are no longer permitted if the document requiring compliance with "AAS" is created (or amended in any way) on or after 1 July 2021. This effectively permits grandfathering the use of SPFS for these *existing* arrangements until the documents are amended. If the document simply references compliance with "accounting standards", then the entity is never required to prepare GPFS (Tier 2).

For those affected, you should assess the entity's current compliance with all recognition and measurement requirements of AAS, including consolidation. You should also consider:

- ▶ The areas of change (measurement and disclosure)
- ▶ Whether to adopt GPFS (Tier 2) early for the transition relief from comparatives
- ▶ If adopting GPFS (Tier 2) early, then adopting SDS early (rather than adopting RDR and changing to SDS from 1 July 2021)
- ▶ Whether there is a need to prepare financial statements - refer revised large proprietary thresholds below
- ▶ The systems and processes in need of change to prepare GPFS

Entities that early adopt these changes by moving from SPFS to GPFS (Tier 2) before **30 June 2022** have the choice to not provide comparative information in the year of transition - i.e. not restate (assuming consolidation is required, but the financial statements were previously not prepared on that basis) and to not provide comparatives for its new disclosures.

The relief means that regardless of the disclosures provided in its previous SPFS, an entity will not be required to provide comparatives for disclosures now required unless they were previously provided.

Does the entity have a non-legislative requirement (e.g. trust deed) to prepare financial statements in accordance with "AAS"?

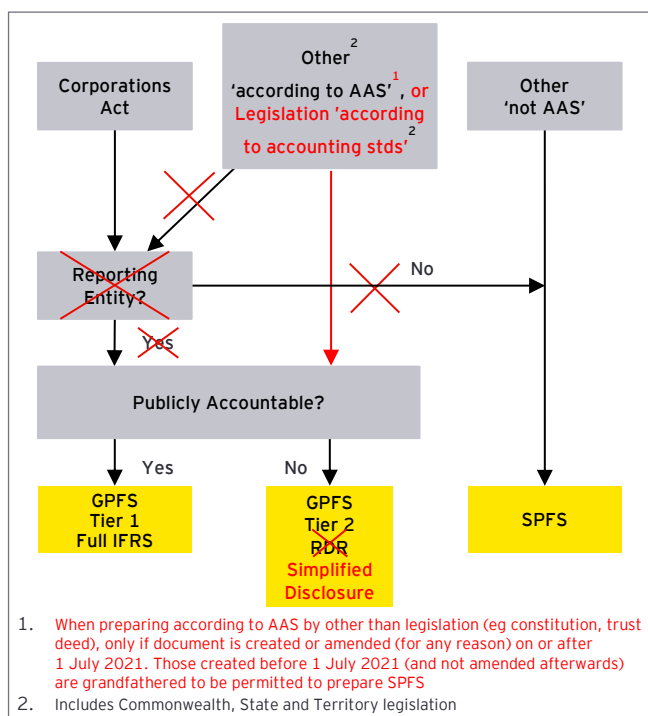
- ▶ Consider the driver for financial reporting.
- ▶ Be mindful that if the document requiring preparation in "accordance with AAS" is ever amended for any reason from 1 July 2021, then:
 - ▶ This will trigger a requirement to prepare GPFS
 - ▶ The only way to avoid preparing a GPFS is for those charged with governance to also change the basis of preparation at the same time to "accounting standards".

In our view economic significance is one of many factors to consider in determining whether an entity is a reporting entity. This was the case prior to the change in law and remains the case. For any large proprietary companies that prepare SPFS for years ending up to 30 June 2021, directors should document the basis.

If directors determine the entity to be a reporting entity, they might early adopt SDS rather than adopt RDR (due to less disclosures), and apply transitional relief from comparative disclosures.

Revised large proprietary thresholds

The reporting entity concept has historically played a critical role in the Australian financial reporting framework. 2019 saw the doubling of the large proprietary company thresholds under the Corporations Act for financial years beginning on or after 1 July 2019, that set whether a proprietary limited company needs to prepare and lodge an audited financial report with ASIC. The explanatory statement noted that companies with economic significance should provide their financial statements to the public, and that the larger the size, the more likely it is there will exist users dependent on GPFS as a basis for making economic decisions.



What lies beyond?

Much has been achieved by the AASB since first publishing a consultation paper in mid-2018. Going forward, the AASB is still to consider reforms in the not-for-profit and public sectors, in conjunction with government policy makers and regulators. It is also considering the definitions of public accountability and not-for-profit. The AASB is encouraging the IASB to continue with its project for subsidiaries that are SMEs, and suggesting it apply the recognition and measurement requirements of IFRS with the disclosures in *IFRS for SMEs*.

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