For-profit entities moving from SPFS to GPFS

April 2021

Introduction

For-profit (FP) private sector entities will bid farewell to the Australian 'reporting entity' concept, and many FPs will need to cease preparing special purpose financial statements (SPFS) and move to general purpose financial statements (GPFS) for annual periods beginning 1 July 2021. Two tiers of GPFS continue to exist, however, the current GPFS (Tier 2) disclosure requirements i.e. Reduced Disclosure Requirements (RDR) will be replaced with Simplified Disclosures (SDS).

We discuss a number of choices to be made such as the tier of GPFS reporting to transition to, whether to transition early for 30 June 2021 (31 December 2021) year ends, and the options under AASB 1 that can be applied on first time adoption of GPFS.

Removing SPFS and replacing GPFS (Tier 2) with SDS

As we previously published in The time has come, certain FP private sector entities will need to move from SPFS to GPFS on 1 July 2021[1]. In addition, those preparing GPFS (Tier 2) will need to apply SDS instead of RDR[2].

For some, the move to GPFS might prove challenging, particularly if they did not apply all recognition and measurement requirements in Australian Accounting Standards[3] (AAS), or did not prepare consolidated financial statements. These entities need to understand the transition options available to them for deciding next steps.

Entities affected

Examples of entities that will move to preparing GPFS are large proprietary companies, foreign-controlled small proprietary companies and unlisted public companies that prepare financial statements under the Corporations Act. Certain other for-profit entities such as co-operatives, associations and higher education providers that are required to prepare financial statements in accordance with AAS will also need to move to GPFS. Many of these entities historically assessed themselves as non-reporting entities and prepared SPFS.

Not-for-profit entities are not affected thus far and can continue to prepare SPFS and claim compliance with AAS. However, where a not-for-profit entity already prepares a GPFS (Tier 2), then it too will need to transition to SDS from 1 July 2021.

Transitioning from SPFS

For those moving from SPFS to GPFS under the revised reporting framework, whether now or in the future, the transition requirements will depend on whether they are moving to Tier 1 or Tier 2, and their level of compliance with recognition and measurement requirements in AAS, including consolidation, prior to transition.

From 1 July 2021, AAS have two tiers of GPFS:

a. Tier 1: AAS, incorporates all requirements in IFRS Standards issued by the IASB and includes some Australian specific requirements

b. Tier 2: AAS – SDS, incorporates all recognition and measurement requirements of Tier 1 and simplified disclosures. The disclosures are set out in one standard, AASB 1060.

[1] *AASB 2020-2 Amendments to Australian Accounting Standards-Removal of Special Purpose Financial statements for Certain For-Profit Entities*

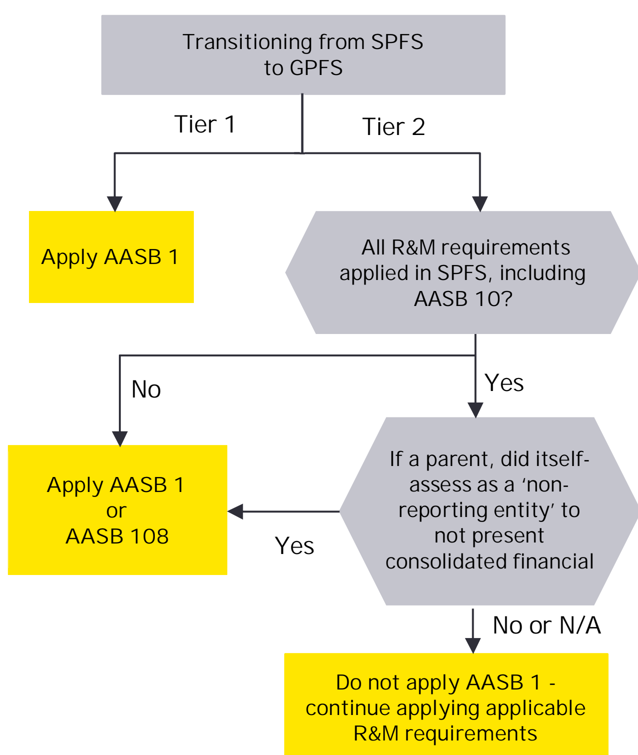
[2] *AASB 1060 General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*

[3] ASIC's Regulatory Guide 85 *Reporting requirements for non-reporting entities* requires non-reporting entities that prepare financial reports in accordance with the Corporations Act 2001 to have complied with the recognition and measurement requirements of accounting standards.

The most common transition path in moving from SPFS to GPFS is to adopt Tier 2[4]. In such instance, if:

- All recognition and measurement requirements in AAS, including consolidation, were followed in its SPFS, then the entity must continue applying the recognition and measurement policies it previously followed and amend its disclosures. It cannot apply AASB 1[5]
- It did not follow all recognition and measurement requirements in AAS, including consolidation, in its SPFS, then the entity has a choice of applying AASB 1 or AASB 108[6].

Some entities may transition from SPFS to GPFS (Tier 1). In these cases, they must apply AASB 1 irrespective of level of compliance with recognition and measurement (R&M) requirements in AAS in its SPFS, in order to claim compliance with IFRS



For those already preparing GPFS (Tier 2), they will need to move from RDR to SDS for annual periods beginning 1 July 2021. There are no transition requirements (other than amending disclosures), unless it's an ultimate Australian parent that did not previously prepare consolidated financial statements due to assessing as a non-reporting entity. In such instances, the ultimate Australian parent must now prepare consolidated financial statements and will be considered a first-time adopter that can choose to apply AASB 1 or AASB 108.

Timing of transition – early adoption considerations

An entity can transition early from SPFS to GPFS (Tier 2 – SDS) in annual reporting periods commencing *before* 1 July 2021 (e.g. 30 June 2021 or 31 Dec 2021 year ends) and take advantage of the early adoption exemptions provided. However, if significant effort is expected (additional disclosures or transition adjustments), management may decide to transition only when mandatory (i.e. from 1 July 2021) and use the extra time to prepare for the change.

Irrespective of SDS and the removal of the ability to prepare SPFS, an entity may already be considering moving to GPFS this year (e.g. 30 June 2021 or 31 Dec 2021 year ends).

Why you may consider moving to GPFS early:

- Likely to change status (e.g., to a "large" proprietary company or becoming "publicly accountable") soon
- Becoming a significant global entity for tax purposes and is required to lodge GPFS with the ATO
- Desire to state compliance with IFRS7
- Desire to improve consistency, comparability and quality of financial reporting earlier

If the entity has plans for becoming publicly accountable soon (which would require preparation of GPFS (Tier 1)), then jumping past GPFS (Tier 2) reporting now and going to Tier 1 directly will save effort.

For those transitioning early and preparing GPFS (Tier 2), they may choose to move to RDR or SDS. SDS is likely to be more attractive due to avoiding changing twice (once to RDR now and again when required to SDS in the next reporting period), and exemptions from providing comparative information not previously disclosed in the notes, and relief from restating comparatives. However, if comparable information is an important consideration, or if financial reporting systems are unable to cope with not updating comparative information, then this exemption may be meaningless.

[4] For reporting periods beginning *before* 1 July 2021, transition can be to RDR or SDS. However, from 1 July 2021, only SDS can be applied.
[5] AASB 1 *First-time Adoption of Australian Accounting Standards*
[6] AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*
[7] Applicable to Tier 1 entities only

Applying AASB 1 or AASB 108

When transitioning from SPFS to GPFS (Tier 2), and the entity has not previously applied all recognition and measurement requirements of AAS, there is a choice of applying AASB 1 or AASB 108.

Some entities may transition from SPFS to GPFS (Tier 1), and in these cases, they must apply AASB 1.

Applying AASB 1

The fundamental principle of AASB 1 is to require full retrospective application of the standards in force at the end of an entity's first AAS reporting period (e.g., 30 June 2022 for a financial report at that period end), with some exceptions for the opening statement of financial position at the date of transition.

Normally the date of transition is the beginning of the *comparative* period (e.g., 1 July 2020 for a 30 June 2022 financial report); however, where AASB 1 is applied along with early adopting SDS, the date of transition is the beginning of the *current* period (e.g., 1 July 2020 for a 30 June 2021 financial report) given the relief from restating comparative information.

When selecting accounting policies on transition using AASB 1, management is to:

- Apply the version of accounting standards effective at the end of its first AAS financial reporting period (e.g., 30 June 2022 year end), unless it is permitted to and adopts a new standard not yet effective early;
- Determine the AASB 1 optional exemptions it will apply

> Practical considerations
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> - Rethinking your accounting policies can be complex and time-consuming, but is an opportunity to reassess previous choices
> - Choices can "reset the clock" on carrying amounts of assets and liabilities in the opening statement of financial position, even where policies previously complied with the recognition and measurement requirements of AAS
> - Weighing up whether to use those optional exemptions that do not require retrospective application, which might provide much relief for those that had not complied with the recognition and measurement requirements of AAS including consolidation and equity accounting in their SPFS.

The appendices of AASB 1 provide numerous exemptions from retrospective application of the Standards. We discuss below three of those exemptions that are likely to be frequently relied upon by entities.

Business combinations exemption (and related consolidation issues)

AASB 1 provides options when applying the most recent version of AASB 3 *Business Combinations*:

1. Restate all business combinations that occurred prior to the date of transition;
2. Restate all business combinations after a specific date (earlier than the date of transition); or
3. Not restate business combinations that occurred prior to the date of transition.

AASB 3 has been amended numerous times with significant changes affecting acquisition costs, contingent consideration, step acquisitions, intangible assets and most recently the definition of a business. Management should consider the extent of these changes impacting on its historical acquisitions in narrowing the options realistically available to it.

Many are likely to not restate business combinations that occurred before the date of transition, particularly where consolidated financial statements have not historically been prepared and fair value information at the date of acquisition is not be available.

Consolidated financial statements historically prepared

If management chooses to not restate past business combinations, most assets and liabilities recognised will retain the previous carrying values assigned, except if there are unrecognised assets or liabilities that should have been recognised and measured under AAS in the statement of financial position of the acquiree. Any amounts that do not qualify for recognition under AAS shall be derecognised. Goodwill is adjusted only where an intangible asset is (or doesn't qualify) to be recognised, or goodwill is impaired; otherwise retained earnings is adjusted.

Consolidated financial statements NOT historically prepared

Where management has previously prepared separate SPFS, but there were subsidiaries that would have required consolidation if it had been a reporting entity, then it will need to determine how these subsidiaries came into existence before determining how to account for them at the date of transition.

Subsidiaries acquired in business combinations

An entity should recognise the assets and liabilities of its subsidiaries in its consolidated financial statements on transition.

In circumstances where the entity is the ultimate Australian parent and it has an unconsolidated subsidiary that:

a. Has previously adopted AAS, then the entity uses the same carrying amounts as in the AAS financial statements of the subsidiary; or

b. Has not previously adopted AAS, then the entity uses the carrying amounts that AAS would require in the subsidiary's statement of financial position

after adjusting for consolidation procedures and for the effects of the business combination in which it acquired the subsidiary.

Goodwill will be determined as the difference between the parent's interest in the carrying amount of the assets and liabilities derived above, and the cost of investment in the parent's separate financial statements.

Subsidiaries not acquired in a business combination (i.e. internally created)

The options to determine assets and liabilities of a subsidiary are the same as the options available for subsidiaries acquired in a business combination (see above). However, goodwill is not recognised in relation to consolidating these subsidiaries. Any difference between the cost of investment in the parent's separate financial statements and the identifiable net assets is adjusted against retained earnings (representing the accumulated profits or losses that would have been recognised if the subsidiary had always been consolidated).

Subsidiary applies AASB 1 later than its parent

In circumstances where the transitioning entity is a subsidiary of an Australian parent that already applied AASB 1 (and consolidated its subsidiaries) then the entity could use:

a. It's carrying amounts that have been included in its parent's consolidated financial statements, only if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the entity. (Only available if entity acquired before the parent's date of transition); or

b. It's carrying amounts required by the rest of AASB 1.

Foreign currency translation reserve

AASB 1 also includes an exemption that allows an entity to reset its foreign currency translation reserve (FCTR) to zero at the date of transition, rather than applying AASB 121 *The Effects of Changes in Foreign Exchange Rates* retrospectively. Where the FCTR was reset to zero in 2005 when the Australian equivalents to IFRS were introduced, in most cases an entity will effectively be required to reset it to zero again (due to lack of historical information for determining the FCTR throughout time) unless all material foreign operations that existed in 2005 have since been sold prior to the date of transition. An entity could also voluntarily reset the FCTR to zero even if they have the information to determine retrospective application, as this may be advantageous to avoiding cumulative exchange losses being recognised in future profit or loss.

Deemed cost exemption

Due to the potentially onerous effort to restate many assets at cost, AASB 1 includes the notion of using a 'deemed cost'. This is not the 'true' cost that complies with AAS, but rather a surrogate deemed to be a suitable starting point.

There are five separate deemed cost exemptions in AASB 1, however the most relevant in Australia is the choice of:

1. Fair value at the date of transition; or
2. Previous GAAP revalued amount at or before date of transition

as deemed cost at the date of transition for assets that will apply a policy of cost, such as property, plant and equipment, investment property, right-of-use assets and intangible assets (that meet the recognition and revaluation criteria in AASB 138 *Intangible Assets*).

> The choice is available on an asset by asset basis irrespective of whether 'cost' as determined under AAS can actually be determined and can result in a one-off uplift in an asset's value without triggering a revaluation accounting policy going forward or a downward adjustment thereby avoiding future impairment

Applying AASB 108

If an entity chooses not to apply AASB 1, then it retrospectively restates its financial statements in accordance with AASB 108, which is as if it had always applied the recognition and measurement requirements of AAS as they changed over the years. This may be challenging (and hence not a viable option) where an entity has not previously maintained compliance with the recognition and measurement requirements of AAS.

Applying AASB 108 becomes even more difficult when new/amended standards might have been issued during the history of the company that requires information not obtained at the time the transactions occurred. In addition, if an entity adopted AASB 1 in 2005 when Australian equivalents to IFRS were introduced and applied exemptions in AASB 1, it will be difficult to retrospectively apply AASB 108 today.

However, where recognition and measurement requirements of AAS, including consolidation, have been complied with in previous SPFS, then applying AASB 108 may simply lead to an increase in disclosures and only a few quantifiable transition adjustments.

Action

Clearly there are many details to consider when transitioning from SPFS. Not only is it a question of timing of when to transition to GPFS, but how will you manage the transition process. For some, the transition will be straight forward, and for others it will be challenging. Rethinking your accounting policies and the options available is an opportunity to reassess, reset and determine the most appropriate approach going forward. Consider these issues early for a smooth transition to GPFS.

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