

KEY THEMES

ROUNDTABLE

FOR-PROFIT ENTITIES AND THE REPORTING ENTITY CONCEPT – WHERE NOW FOR FINANCIAL REPORTING?

INTRODUCTION

In November 2014, CPA Australia hosted a half-day roundtable titled “For-profit entities and the reporting entity concept – where now for financial reporting?”. This roundtable aimed to aid understanding of the operation of the reporting entity concept and its interaction with general purpose financial statements (GPFS), as well as the purposes served when requiring financial reporting by private companies, including lodgement.

The roundtable attendees came from a variety of backgrounds, including private company financial reporting preparers, advisers, standard setters, auditors and Australian Treasury policy advisers. Participants discussed a range of financial reporting issues including those identified in the Australian Accounting Standards Board (AASB) Research Centre published report *Application of the Reporting Entity Concept and Lodgement of Special Purpose Financial Statements*.¹ The Report raised some fundamental questions about the adequacy of Australian financial reporting by large private companies.

Private business makes a major contribution to the Australian economy. Owners of private businesses use a myriad of structures to organise and operate their business activities. The most common type is the company structure where the owners of the business typically have limited liability for the company's debts and obligations. Unincorporated structures and trusts are also prevalent.

CPA Australia understands that there are more than 1.7 million private companies and of those only large private companies are legally obliged to prepare financial statements. Large private companies constitute less than one per cent of all private companies.

¹ http://www.aasb.gov.au/admin/file/content102/c3/AASB_RR-1_06-14_Reporting_Entities_and_SPFSs.pdf

Statement of Accounting Concept (SAC) 1 *Definition of the Reporting Entity* and AASB 1053 *Application of Tiers of Australian Accounting Standards* affect the statutory financial statements of large private companies. The SAC 1 reporting entity concept embodies a notion of differential reporting, whereby those large private companies that would not be identified as reporting entities would not be obliged to prepare GPFS to meet their statutory obligations. In contrast, a large private company that is a reporting entity according to the reporting entity concept enunciated in SAC 1 would prepare GPFS.

The AASB research has raised questions as to whether the SAC 1 reporting entity concept is being correctly applied by large private companies. Discussions held at the roundtable revolved around the AASB research findings and their implications for those charged with the governance of large private companies, considerations for Australian Treasury policy advisers given their responsibility for the Corporations Act, the Australian Securities Investment Commission (ASIC) and the AASB.

From the discussions at the roundtable, a number of key themes emerged and these are detailed in the following section.

The information reported here is expected to assist CPA Australia further develop its positioning on the topic and assist roundtable participants in the refinement of their own position.

KEY THEMES

KEY THEME 1 – ECONOMIC SIGNIFICANCE

The Corporations Act categorises economically significant private companies as large and requires that large private companies prepare financial statements, which are lodged with ASIC. Amongst roundtable participants, there was some acknowledgement that requiring financial reporting by economically significant private companies does serve some needs of the economy and society. However, setting the thresholds for economic significance at the right level is critical and there is the conundrum of how much information a large private company should be required to share with the public.

KEY THEME 2 – USERS

It is important to understand who are the users of the financial statements of large private companies and their needs, and to acknowledge that there are situations where selected users can demand and will receive selective information. Although the ASIC RG 43 *Financial reports and audit relief* discussion emphasises the audience for financial statement reporting is a wide range of users, there is a view that there should be some limits. For example, some roundtable participants were of the view that the user audience should be limited to substantive users. Some participants were concerned that the only users of their financial statements are their competitors and thought it inappropriate that a large private company in this situation be required to prepare GPFS.

KEY THEME 3 – TIER 2 REPORTING AND CONSOLIDATION

The AASB Reduced Disclosure Regime (Tier 2 reporting) requires the preparation of consolidated financial statements. Some roundtable participants noted that a requirement to consolidate has a significant effect on the decision of some large private companies to prepare GPFS and it was their expectation that if the requirement to consolidate was removed from Tier 2 reporting more large private companies would produce GPFS using Tier 2, in place of their current special purpose financial statement (SPFS) reporting. Participants noted that currently, the AASB uses the IFRS for SMEs standard to inform its Tier 2 reporting requirements. Some participants questioned whether this is the right starting point.

KEY THEME 4 – GPFS: AN OUTCOME OF JUDGEMENT

The relationship of ‘lodgment on the public record’ and ‘GPFS’ is a topic that engenders robust discussion. Most roundtable participants believe there is a need to distinguish between lodgments with ASIC and GPFS. Lodgment with ASIC is a function of economic significance and is represented by thresholds. Currently, the production of GPFS is a function of accountants applying their professional judgment. Should the decision remain a function of judgment or should the decision as to whether a large private company is a reporting entity become a function of applying thresholds that are set at a level to reflect the concept of the reporting entity? Moreover, if thresholds were to be introduced – at what level should they be set?

KEY THEME 5 – SPFS

Roundtable participants debated the need for the SPFS of large private companies to comply with ASIC RG 85 *Reporting requirements for non-reporting entities* and other bases of accounting used in SPFS. Some participants described SPFS prepared in compliance with RG 85 as a Tier 3 reporting framework. One view expressed was that RG 85 needs to be more authoritative, as at the moment, its lack of authority causes problems for practitioners in convincing large private company clients to follow RG 85 as opposed to preparing SPFS using a ‘pick and choose’ approach to accounting standards as the basis for their accounting.

Generally, roundtable participants agreed that lodged SPFS with ASIC are reliable and arguably SPFS are more valuable than GPFS as they contain targeted information to meet specific user needs.

Roundtable participants discussed the need of large private companies for a further simplification of recognition and measurement requirements, including whether there is a role for an IFRS for SMEs type standard. It was acknowledged that there are deficiencies with the IFRS for SMEs standard and that it may not be appropriate to replicate the requirements of UK GAAP that is informed by the IFRS for SMEs standard. It was also acknowledged that a development of this type would require the AASB to produce and maintain the standard and that there would be implications for training.

THE WAY AHEAD

The AASB has indicated its plan is to retain SAC 1 and to clarify the meaning of the reporting entity concept and its operation, ‘educate’ policy makers and regulators on the meaning of GPFS and discuss lodgment of SPFS on the public record. The AASB view on SAC 1 is if it does not contain enough guidance, then there is a need to supplement SAC 1 with a clarification of what constitutes GPFS in the Australian context.

In addition, the Australian Government’s policy position on deregulation needs to be considered as it relates to the Corporations Act, accounting standards and ASIC.

CPA Australia will seek to consolidate the findings from the recent roundtable discussed above with findings from another roundtable held in November considering the impact of the reporting entity concept on not-for-profit entities. The current intention is to develop a discussion paper that sets out the key themes emerging from the two roundtables for further discussion and feedback with a wider group of stakeholders. We believe these policy initiatives will assist CPA Australia, the AASB and a number of Commonwealth and State/Territory lawmakers in determining appropriate reporting frameworks that effectively meet stakeholders’ needs whilst reducing excessive regulatory burden arising from unnecessary financial reporting requirements.