Deloitte.

Clarity in financial reporting

May 2020

Removal of special purpose financial statements

The ability of many for-profit entities to prepare special purpose financial statements has been removed with effect from 1 July 2021. In addition, a new 'Tier 2' 'Simplified Disclosure' Standard generally provides disclosure relief compared to the existing 'RDR'.

The key impacts include:

- The "reporting entity concept" has been a long-term feature of the Australian reporting framework. Its removal represents a major change to current practice
- Many private sector for-profit entities will be required to prepare general purpose financial statements (GPFS), including:
  - Entities reporting under the *Corporations Act 2001* or other legislation that are required to comply with Australian Accounting Standards or 'accounting standards', such as large proprietary companies, unlisted public companies and small foreign-controlled proprietary companies
  - Trusts, partnerships and similar entities where the constituting document or another document (such as a loan agreement) requires preparation of financial statements in accordance with Australian Accounting Standards – where these documents are created or amended on or after 1 July 2021
  - Any for-profit entity that chooses voluntarily to prepare GPFS
- The existing Reduced Disclosure Requirements (RDR) are replaced with new Simplified Disclosures to be used by Tier 2 entities (both for-profit and not-for-profit entities) that have fewer disclosures than RDR
- The ultimate Australian parent will need to prepare consolidated financial statements. There is no exemption for non-reporting entities. As a result, significant global entities will no longer be able to prepare stand-alone GPFS where a foreign parent prepares consolidated GPFS in accordance with International Financial Reporting Standards (IFRS).

There is no impact on:

- 'Tier 1' entities. Entities with public accountability and certain public sector entities continue to prepare Tier 1 GPFS
- Not-for-profit and public sector entities that prepare special purpose financial statements. These will be subject to a separate project.

Quick summary

What's happened?

The Australian Accounting Standards Board (AASB) has issued two new pronouncements which:

- Remove the ability to prepare special purpose financial statements for some for-profit entities – through an Amending Standard, AASB 2020-2 *Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (AASB 2020-2)
- Introduce a new Tier 2 'Simplified Disclosure' Standard (Tier 2 (SD)) which replaces the existing 'Reduce Disclosure Requirements' (RDR) – AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (AASB 1060).

  The new disclosures are based on the International Accounting Standards Board's *International Financial Reporting Standards for Small and Medium Sized Entities* (*IFRS for SMEs*).

The changes effectively eliminate the application of the 'reporting entity' concept by impacted entities. The AASB made these changes to deal with conflicts with the 'reporting entity' guidance in the revised *Conceptual Framework for Financial Reporting*. Accordingly, impacted entities are also required to the apply the new *Conceptual Framework*.

The AASB staff has also prepared two 'key facts' documents on the changes, which can be found at www.aasb.gov.au.

"This significant change in the reporting landscape needs careful attention and planning"

Alison White
Partner – Accounting Technical

Which entities can no longer prepare special purpose financial statements (SPFS)?

The following private sector for-profit entities will be required to prepare GPFS where they are:

- Preparing financial statements under the *Corporations Act 2001*. This includes large proprietary companies (as well as grandfathered companies), unlisted public companies other than small companies limited by guarantee, small proprietary companies controlled by a foreign company, small proprietary companies with crowd-sourced funding and financial service licensees
- Required by legislation to prepare financial statements in accordance with 'Australian Accounting Standards' or 'accounting standards', such as co-operatives, incorporated associations and higher education providers
- Required by their constituting document (e.g. trusts, partnerships, self-managed superannuation funds or joint arrangements) or another document (e.g. a loan agreement) to prepare financial statements in accordance with 'Australian Accounting Standards', but only where the document is created or amended on or after 1 July 2021.

Who does the new 'Simplified Disclosure' Standard apply to?

The new standard (AASB 1060) applies to <u>both</u> for-profit and not-for-profit entities preparing Tier 2 (SD) GPFS, including those that previously prepared SPFS or RDR GPFS.

Will there be many more disclosures in Tier 2 (SD) GPFS?

It depends.

Compared to SPFS, more disclosures are mandated and all apply to Tier 2 (SD) GPFS, unless they are not material. Broadly, there are more reconciliations of balances and significantly expanded disclosures in the notes for revenue, income tax, financial instruments, leases, share-based payments and related parties.

For entities transitioning from RDR to Tier 2 (SD), there will generally be fewer disclosures required and therefore these entities will benefit from the new Tier 2 (SD) requirements.

However, in both cases, where stand-alone financial statements were previously prepared and consolidated financial statements are required under Tier 2 (SD), a significant increase in disclosures can be expected.

What do Tier 2 (SD) look like?

We are preparing illustrative financial reports which will assist entities in understanding the types of disclosures required under AASB 1060. These will be made available at www.deloitte.com/au/models soon. In the meantime, illustrative financial reports are available based on the AASB's original proposals, and although the AASB has made some changes, these illustrative financial reports provide a good guide to most of the disclosures required by AASB 1060 for for-profit entities.

Is early adoption attractive?

It depends. Entities newly required to prepare GPFS, which are eligible to apply Tier 2 (SD), may choose to early adopt to save transitioning systems and processes twice. This includes newly established entities, those entities no longer considered 'non-reporting entities' prior to mandatory adoption, those choosing to prepare GPFS, and those that become classified as significant global entities (SGEs) for tax purposes. However, some SGEs may face consolidation for the first time and should consider the impact on adoption.

When do the new requirements apply?

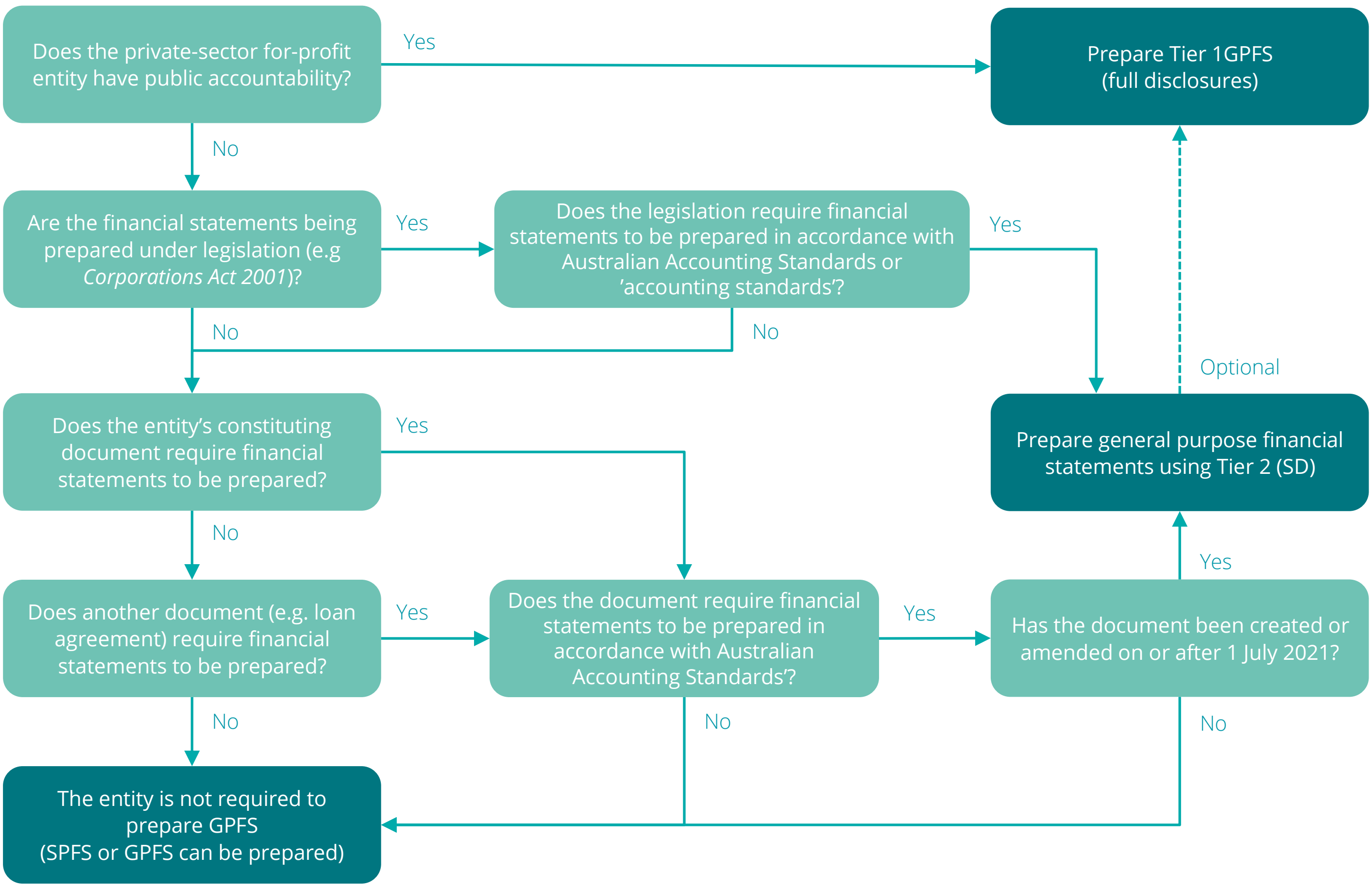
The new requirements apply to reporting periods beginning on or after 1 July 2021. There is transitional relief available, some of which is only available to those who early adopt.

Who is impacted by the removal of SPFS?

Overview

The removal of SPFS only applies to private sector for-profit entities, and only in specific circumstances. Determining which entities will be impacted depends on several factors.

The flowchart below outlines the decision-making process on which private sector for-profit entities will be required to prepare GPFS, and which type.



Applicability to trusts and similar entities with non-legislative financial statement requirements

Entities such as trusts, partnerships, joint arrangements and self-managed superannuation funds commonly have non-legislative requirements to prepare financial statements in their constituting documents. Many of these documents require those financial statements to be prepared in accordance with Australian Accounting Standards, and accordingly, are prima facie within the scope of the new requirements to prepare GPFS.

However, after research and consultation with constituents, the AASB decided to provide an exemption from the requirement to prepare GPFS for existing for-profit private sector entities. However, this exemption is only available where the constituting document or another document has been created or last amended before 1 July 2021.

Therefore, if such an entity amends its constituting or another document on or after 1 July 2021 for any reason, and the amended document refers to a requirement to prepare financial statements in accordance with Australian Accounting Standards, subsequent financial statements will be required to be GPFS.

It is important to note that the requirements to prepare GPFS do not apply where a non-legislative document requires financial statements to be prepared only in accordance with 'accounting standards' rather than Australian Accounting Standards. This is a key difference to a reporting mandate arising under a legislative requirement where reference to 'accounting standards' also triggers a requirement for GPFS.

'Another document' requiring financial statements

The requirement to prepare GPFS applies to private sector for-profit entities where any document created or amended on or after 1 July 2021 requires the preparation of financial statements in accordance with Australian Accounting Standards. For example, where the entity enters into a loan agreement on or after 1 July 2021, and the agreement requires financial statements prepared in accordance with Australian Accounting Standards, the financial statements must be prepared as GPFS.

This applies broadly, i.e. to any private sector for-profit entity (and not just trusts and similar entities). For instance, this applies where a small proprietary company that is otherwise exempt from preparing financial statements enters into a loan agreement which requires the preparation of financial statements in accordance with Australian Accounting Standards.

What is the impact?

The primary change for entities captured by the new requirements is the need to prepare GPFS instead of SPFS, or changing disclosures for entities moving from RDR to Tier 2 (SD) GPFS. However, this raises several considerations, including those presented in the table below:

Choosing which GPFS to prepare and the new Tier 2 (SD)

The new requirements permit entities without public accountability to prepare Tier 2 (SD) GPFS. The new Tier 2 (SD) is generally less onerous than the previous RDR. Entities with public accountability must continue to prepare Tier 1 GPFS and other entities can choose to do so. In practice, it is likely that most entities that can do so will choose Tier 2 (SD) GPFS applying AASB 1060.

Consolidation and equity accounting

The ability of an entity to prepare 'stand-alone' financial statements which do not consolidate its subsidiaries, or which do not apply the equity method to its investments in joint ventures and associates, is limited. The exemption from consolidation because an entity is not considered a 'reporting entity' has been removed.

Subsidiaries of an Australian parent preparing consolidated GPFS, which consolidate that subsidiary, may be able to continue to prepare stand-alone GPFS (where the general consolidation exemption conditions under paragraph 4(a) of AASB 10 *Consolidated Financial Statements* are met). However, ultimate Australian parent entities must consolidate and equity account (unless they are an investment entity). These entities may be able to apply the transitional provisions of AASB 1 *First-time Adoption of Australian Accounting Standards* to ease the transition to the new requirements.

Entities currently preparing RDR GPFS – for profit and not-for-profit

The new Tier 2 (SD) reporting replaces the existing Tier 2 (RDR) effective from 1 July 2021. This applies to both for-profit entities and not-for-profit entities that currently are required to apply Tier 2, or that will be applying Tier 2 (SD) due to the removal of SPFS.

This means those entities will need to determine which disclosures currently presented are no longer required, and additionally, which new disclosures will need to be prepared.

Examples of entities that will be impacted include SGEs preparing RDR GPFS to meet the ATO reporting requirements, and not-for-profit entities currently choosing or instructed to prepare Tier 2 GPFS.

Considering early adoption

Some entities may choose to apply the requirements early. Those most likely to benefit are entities already preparing consolidated Tier 2 GPFS (using RDR), such as some SGEs and not-for-profit entities, where the likely reduction in disclosures may be welcomed. Other entities reconsidering their 'reporting entity' status in light of recent focus from the AASB, Federal Parliament and others on the appropriateness of the 'reporting entity' concept, may also benefit.

Conversely, parent entities currently preparing stand-alone GPFS under Tier 2 (RDR) (due to not being a reporting entity) cannot continue this practice under Tier 2 (SD).

The optional relief from restating comparative information by early adopters may also influence decisions (see below).

Transition

The requirements to transition from SPFS to GPFS are included in AASB 1053 *Application of Tiers of Australian Accounting Standards* (AASB 1053.18A, Appendix C Chart 1 and Appendix E) and depend on:

- The nature of the GPFS being subsequently prepared (Tier 1 or Tier 2 (SD))
- Whether or not the entity that is subsequently required to present consolidated GPFS previously consolidated its subsidiaries
- The extent to which the recognition and measurement requirements of Australian Accounting Standards were previously applied.

In general, AASB 1053 requires entities to either apply AASB 1 or AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* (AASB 108). Entities able to apply AASB 1 may take advantage of its mandatory and optional exceptions from full retrospective restatement, including an option to adopt a 'short cut' method for previously unconsolidated subsidiaries, resetting of the foreign currency translation reserve and the adoption of 'deemed cost' for assets. Entities applying AASB 108 will generally be required to apply all requirements of Australian Accounting Standards fully retrospectively (under either Tier 1 or Tier 2 (SD)).

The table below outlines the transition requirements for entities moving to GPFS:

Transitional approach	Who is eligible?
1. Application of AASB 1	Entities moving from SPFS to GPFS Tier 1[1]
2. Accounting policy choice: Application of AASB 1 or AASB 108 (Should also consider whether optional relief 1 - 3 below is available)	Entities moving from SPFS to Tier 2 (SD) where **all** the recognition and measurement requirements of all Australian Accounting Standards have **not** been previously applied (including where consolidation and equity accounting have not been previously applied).
3. AASB 108 (Should also consider whether optional relief 2 below is available)	Entities moving from SPFS or Tier 2 (RDR) to Tier 2 (SD) where **all** the recognition and measurement requirements of all Australian Accounting Standards **have** been previously applied (including consolidation and equity accounting).

The transitional approach adopted dictates the transition disclosures required. In the case of Tier 2 (SD), these are quite extensive, but less than those required in Tier 1 GPFS under AASB 1.

The table below outlines the additional optional relief for entities moving to GPFS Tier 2 (AASB 1053 Appendix E):

Optional relief	When it is available?	Who is eligible?
1. Relief from restating comparative information in primary financial statements	Reporting periods beginning before 1 July 2021 (i.e. early adoption)	Private sector for-profit entities moving from SPFS to Tier 2 (SD) that choose to apply AASB 1 (under transitional approach 2 above)
2. Relief from providing comparative information for new note disclosures	Reporting periods beginning before 1 July 2021 (i.e. early adoption)	All entities moving to Tier 2 (SD)
3. Relief from distinguishing errors from changes in accounting policy	Reporting periods beginning before 1 July 2022 (i.e. first year of mandatory application)	Entities moving from SPFS to Tier 2 (SD) that have the choice of applying AASB 1 or AASB 108 (under transitional approach 2 above)

[1] Under AASB 1, there is an option for entities that have made a statement of compliance with IFRS in a preceding period such that they are permitted to apply AASB 108 instead of AASB 1, subject to making certain disclosures required by AASB 1 (see AASB 1.4A-4B). For example, a listed entity that was acquired by an unlisted entity may have subsequently prepared SPFS or Tier 2 GPFS in respect of the financial years after it was acquired. If in a later financial year, that entity is required, or chooses, to prepare Tier 1 GPFS, it would be able to choose apply AASB 108 or AASB 1 on transition to Tier 1.

The table below summarises the relief available on transition to Tier 2 (SD) for various types of entities, depending upon the SPFS previously prepared, whether the entity is required to prepare consolidated GPFS under the new requirements, and the extent of recognition and measurement applied.

Type of SPFS previously prepared	Transitional approach to adopt	Error vs. accounting policy relief[1]?	Options if early adopted	
			Comparatives relief?	Disclosure relief?
Entities with subsidiaries but exempt from consolidation under the new requirements[2]				
Stand-alone with full recognition and measurement	AASB 1060 and AASB 108	No	No	Yes
Stand-alone without full recognition and measurement	AASB 1 or AASB 108	Yes	Yes[4]	Yes
Entities with subsidiaries requiring consolidated GPFS under the new requirements[3]				
Consolidated with full recognition and measurement	AASB 1060 and AASB 108	No	No	Yes
Consolidated without full recognition and measurement	AASB 1 or AASB 108	Yes	Yes[4]	Yes
Stand-alone with full recognition and measurement	AASB 1 or AASB 108	Yes	Yes[4]	Yes
Stand-alone without full recognition and measurement	AASB 1 or AASB 108	Yes	Yes[4]	Yes
Entities without subsidiaries				
Stand-alone with full recognition and measurement	AASB 1060 and AASB 108	No	No	Yes
Stand-alone without full recognition and measurement	AASB 1 or AASB 108	Yes	Yes[4]	Yes

(1) This relief provides an optional exemption from differentiating between errors and accounting policy changes on transition. Where applicable, this relief is only available for financial reporting periods beginning before 1 July 2022.

(2) This would apply where an Australian parent prepares GPFS under Tier 1 or Tier 2 (SD) and the entity meets the conditions in AASB 10.4(a) to not prepare consolidated financial statements (mostly applicable to wholly owned subsidiaries), or where the entity is an investment entity that measures all of its subsidiaries at fair value through profit or loss.

(3) There is no 'general' exemption from consolidation under Tier 2 (SD). Specific exemptions are included in AASB 10 (as noted in footnote (2) above) and it is an Australian-specific requirement that the ultimate Australian parent prepare consolidated financial statements (unless it is an investment entity). Accordingly, many parents with subsidiaries will be required to prepare consolidated financial statements.

(4) Relief from restating comparative information is only available to a for-profit private sector entity that applies AASB 1 on transition.

Entities previously preparing SPFS under the *Corporations Act 2001*

It is important to note that most private sector for-profit entities preparing SPFS under the *Corporations Act 2001* should have applied the recognition and measurement requirements of all Australian Accounting Standards in accordance with the Australian Securities and Investments Commission (ASIC) Regulatory Guide RG 85 *Reporting requirements for non-reporting entities* (available at asic.gov.au). However, many such entities may not have prepared consolidated financial statements for the ultimate Australian parent, on the basis that the parent and the group were not a reporting entity. Therefore preparing consolidated financial statements for the ultimate Australian parent will likely be the biggest focus area for such entities (in addition to enhanced disclosures under AASB 1060).

Existing Tier 2 RDR preparers preparing stand-alone GPFS

The new requirements do not deal with entities moving from the existing Tier 2 (RDR) to the new Tier 2 (SD). These entities will already be applying all recognition and measurements requirements of Australian Accounting Standards. However, some such as subsidiaries of global multinationals that are considered SGEs may have prepared stand-alone GPFS because they considered themselves a non-reporting entity and had a foreign parent that prepared consolidated financial statements in accordance with IFRS. Transition for these entities is not currently considered in AASB 1053. Accordingly, they may not be able to apply AASB 1 on transition to the new Tier 2 (SD) and may need to instead apply AASB 108 or the transitional provisions in AASB 10. In this case, the transitional requirements of AASB 1 in respect of subsidiaries that have not been previously consolidated would not be available to these entities.

Summary of how entities will be impacted

As noted earlier in this publication, the impacts of the removal of SPFS and the new Tier 2 (SD) depend upon the nature of the entity and the existing financial reporting framework adopted. The table below summarises the impact on various classes of entities:

Entity	Existing framework	New framework	Impact
For-profit entity with public accountability and not-for-profit entities preparing Tier 1 financial reports	Tier 1	Tier 1	None (1)
For-profit reporting entity without public accountability	Tier 2 (RDR)	Tier 2 (SD)	*Reduction* in disclosure, partially offset by some new disclosure (2)
For-profit non-reporting entity moving from consolidated SPFS to Tier 2	SPFS (consolidated)	Tier 2 (SD) (consolidated)	Likely to be an *increase* in disclosure, with limited offset from removed disclosures (3)
For-profit non-reporting parent entity moving from unconsolidated SPFS to Tier 2	SPFS (unconsolidated)	Tier 2 (SD) (consolidated)	Likely to be a *substantial increase* in disclosure, with limited offset from removed disclosures (3) (4)
Single for-profit non-reporting entity moving from unconsolidated SPFS to Tier 2	SPFS (unconsolidated)	Tier 2 (SD) (unconsolidated)	Likely to be an *increase* in disclosure, with limited offset from removed disclosures (3)
Not-for-profit reporting entities preparing Tier 2 financial statements	Tier 2 (RDR)	Tier 2 (SD)	*Reduction* in disclosure, partially offset by some new disclosure (2)
SGEs preparing GPFS under Australian Accounting Standards under tax legislation	Tier 2 (RDR)	Tier 2 (SD)	*Reduction* in disclosure, partially offset by some new disclosure and potentially a new requirement to consolidate (2)(5)
Not-for-profit non-reporting entities	SPFS	SPFS	None (1)(6)

(1) AASB 1060 only applies to Tier 2 (SD) GPFS and AASB 2020-2 only applies to entities currently preparing SPFS. Accordingly, the new requirements do not have direct impacts on entities adopting 'Tier 1' or those entities continuing to prepare SPFS.

(2) AASB 1060 requires some disclosures from the *IFRS for SMEs* which are not required under the RDR framework. The basis for conclusions (paragraph BC70) explains these additional disclosures are proposed to avoid differences between Tier 2 (SD) and the *IFRS for SMEs*

(3) These impacts of Tier 2 (SD) will vary depending on the nature of the entity and its circumstances. New disclosures would be required in relation to revenues, financial instruments, related parties, employee benefits, income tax and share-based payment. In addition, there would be new requirements for movement schedules and additional information in many areas. These new disclosures would be partially offset by a reduction in some of the disclosures currently included in the 'core' standards applying to SPFS. The impacts are highlighted in our model Tier 2 (SD) illustrative financial statements, to be made available at www.deloitte.com/au/models

(4) The significant impact is due to impacts of both (a) moving from SPFS to the Tier 2 (SD) disclosures and (b) producing consolidated information and disclosures not previously prepared

(5) For instance, the requirement to prepare consolidated financial statements might apply to an Australian parent company of a foreign group, which itself has subsidiaries. In addition to other impacts, these entities will be impacted by the removal of the reporting entity concept as they may be required to prepare consolidated financial statements as the consolidation exemption in AASB 10.4(a) is not available for ultimate Australian parent entities (due to AASB 10.Aus4.2). In other words, these entities will not be able to prepare 'stand-alone' GPFS to satisfy their SGE reporting requirements under s.3CA of the *Tax Administration Act 1953* (or alternatively, under Part 2M.3 of the *Corporations Act 2001*)

(6) Entities preparing SPFS would also need to consider the disclosures in 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.* The AASB agreed at its April 2020 meeting to propose to extend similar disclosures to for-profit entities preparing SPFS.

Conclusion

The new requirements are a significant change in financial reporting in Australia. Impacted entities should not underestimate the preparations required to implement the new requirements, including system modifications and information gathering and should plan early. Those required to prepare consolidated GPFS will face additional considerations.

Contacts

Anita Simich
Director
asimich@deloitte.com.au

Frank Betkowski
Principal
fbetkowski@deloitte.com.au

Alison White
Partner
aliswhite@deloitte.com.au

Anna Crawford
Partner
acrawford@deloitte.com.au

Clive Mottershead
Partner
cmottershead@deloitte.com.au

Henri Venter
Partner
hventer@deloitte.com.au