



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 85

Reporting requirements for non-reporting entities

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What this guide is about

- 1 This guide provides guidance on application of the reporting entity test and the reporting obligations for non-reporting entities.
- 2 In particular, ASIC believes that non-reporting entities, which are required to prepare financial reports in accordance with Chapter 2M of the *Corporations Act 2001* (Act), should comply with the recognition and measurement requirements of accounting standards.
- 3 This guide also discusses:
 - (a) the obligations of directors and auditors to carefully consider whether an entity should be classified as a reporting entity or a non-reporting entity; and
 - (b) when consolidated financial reports must be prepared
- 4 This guide replaces Information Release [IR 00/025] *Reporting requirements for non-reporting entities* for financial reports for financial years commencing on or after 1 January 2005.
- 5 [IR 00/025] provided guidance on application of the reporting entity test to licensed securities dealers and futures brokers. The reporting requirements for Australian financial services licensees will be specified in upcoming revisions to ASIC forms FS 70 and FS 71.

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Section 1: Background

1.1 ASIC's reviews of financial reports have shown that some companies that claimed to be non-reporting entities should have been classified as reporting entities.

1.2 Those reviews have also revealed that recognition and measurement requirements of the accounting standards have not been complied with by a number of companies. These requirements include those relating to depreciation of non-current assets, tax effect accounting, lease accounting, measurement of inventories, and recognition and measurement of liabilities relating to employee entitlements.

1.3 ASIC believes that there needs to be assurance for all companies whose financial reports are prepared in accordance with the requirements of the Act that the balance sheet reflects all, and only all, assets and liabilities, and that the profit and loss statement (income statement) reflects all, and only all, revenues and expenses.

1.4 Key representatives of the accounting profession with whom ASIC has consulted in preparing this release share ASIC's concerns over the quality of financial reports.

1.5 The purpose of this guide is to provide guidance on the application of accounting standards to entities which are required to prepare a financial report in accordance with the Act.

Section 2: Accounting provisions applicable to non-reporting entities

2.1 The accounting standards provide a framework for determining a consistent meaning of ‘financial position’ and ‘profit or loss’ in financial reporting across entities.

2.2 In the absence of any such framework, the figures disclosed in financial statements would lose their meaning and could be determined completely at the whim of the directors of individual entities. The profit or loss reported by an individual entity would vary greatly depending upon which individuals were responsible for the preparation of its financial statements.

2.3 This would not be consistent with the requirements of the Act for financial reports to give a true and fair view (s297), prohibiting the giving of false and misleading information (s1308), and only permitting dividends to be paid out of profits (s254T).

2.4 The following requirements of accounting standards that apply to all entities reporting under Chapter 2M are also relevant:

- (a) Paragraph 13 of accounting standard AASB 101 ‘Presentation of Financial Statements’ requires the financial report to present fairly the financial position, financial performance and cash flows. Fair presentation requires ‘the faithful representation of the effects of transactions, other events and conditions’ in accordance with the definitions and recognition criteria for ‘assets’, ‘liabilities’, ‘income’ and ‘expenses’ set out in the ‘Framework for the Preparation and Presentation of Financial Statements’ (Framework).
- (b) Paragraph 25 of AASB 101 requires all entities reporting under Chapter 2M to apply the accrual basis of accounting.
- (c) Paragraphs 10 and 11 of AASB 108 ‘Accounting Policies, Changes in Accounting Estimates and Errors’ provides that, in the absence of an Australian accounting standard that specifically applies to a transaction, other event or condition, management should refer to, and consider the applicability of, the following sources in descending order:
 - (i) the requirements and guidance in Australian accounting standards dealing with similar and related issues; and
 - (ii) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

2.5 Hence, the recognition and measurement requirements of accounting standards must also be applied in order to determine the financial position and profit or loss of any entity preparing financial reports in accordance with the Act.

2.6 As noted earlier, the recognition and measurement requirements of the accounting standards include requirements relating to depreciation of non-current assets, tax effect accounting, lease accounting, measurement of inventories, and recognition and measurement of liabilities for employee entitlements.

2.7 The provisions of accounting standards dealing with the classification of items as assets, liabilities, equity, income and expenses also apply. This would include the provisions of AASB 132 'Financial Instruments: Disclosure and Presentation' concerning the classification of financial instruments issued as debt or equity.

2.8 Class Order [CO 05/639] *Application of accounting standards by non-reporting entities* allows non-reporting entities to take advantage of concessions to the measurement requirements of accounting standards. Examples of these concessions include the provisions of AASB 1 'First-time Adoption of Australian Equivalents to International Financial Reporting Standards' and transitional provisions in new accounting standards.

2.9 Directors of non-reporting entities must also consider carefully the need to make disclosures which are not directly prescribed by accounting standards, but which may be necessary in order for the financial statements to give a true and fair view. Such disclosures could include certain significant related party transactions.

2.10 ASIC will look closely at cases where non-reporting entities have not complied with the recognition and measurement requirements of accounting standards.

2.11 Non-reporting entities which hold out their financial reports to be general purpose financial reports must comply with all requirements of accounting standards.

Section 3: Significance of reporting entity status

3.1 Reporting entities required to prepare a financial report in accordance with Chapter 2M of the Act must comply with the requirements of all accounting standards.

3.2 The directors' determination as to whether a company should be classified as a reporting entity or a non-reporting entity is an important decision affecting the level of disclosure in the company's financial report. Directors are required under s295(4)(d) of the Act to make a declaration as to whether a company's financial statements comply with accounting standards. Directors need to make their decision regarding reporting entity status carefully in view of the requirement to make this declaration.

3.3 Directors of an entity that identifies itself as a non-reporting entity and elects not to adopt the requirements of all accounting standards would be in breach of the requirement to comply with accounting standards contained in s296 of the Act if the circumstances of the entity point to it being a reporting entity. 'Reporting entity' is defined in AASB 3 'Business Combinations' as follows:

'An entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial report for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.'

3.4 The auditor of a company will also need to make a decision about the appropriateness of the classification of an entity as a non-reporting entity in forming an opinion in accordance with s307 of the Act as to whether the entity's financial report complies with accounting standards.

3.5 The following accounting standards apply in full to all entities required to prepare a financial report in accordance with Chapter 2M of the Act, whether they are reporting entities or not:

- (a) AASB 101 'Presentation of Financial Statements';
- (b) AASB 107 'Cash Flow Statements';
- (c) AASB 108 'Accounting Policies, Changes in Accounting Estimates and Errors'; and
- (d) AASB 1048 'Interpretation and Application of Standards'.

Section 4: Classification as a non-reporting entity

4.1 In applying the definition of ‘reporting entity’, directors and auditors must consider whether there are existing or potential users who may be dependent on general purpose financial reports. Existing shareholders are not the only users to consider; therefore, an entity should not be regarded as a non-reporting entity solely because there is little or no separation between its members and management (e.g. the shareholders are involved in the day-to-day management of the company).

4.2 ASIC’s review of financial reports has revealed that some companies that claimed to be non-reporting entities should have been classified as reporting entities. These companies had a significant number of creditors and employees and it was reasonable to expect the existence of users dependent on general purpose financial reports. The financial reports of these companies had been accessed on ASIC’s public database on a number of occasions by external parties during a 12 month period.

4.3 ASIC will look closely at cases where entities claim to be non-reporting entities and will seek explanations from directors where it appears reasonable to expect that there are users dependent on general purpose financial reports.

Section 5: Consolidated financial statements

5.1 Some companies have failed to prepare consolidated financial statements on the grounds that the parent entity was not a reporting entity. Accounting standard AASB 127 'Consolidated and Separate Financial Statements' applies to each entity that is the parent of a group that is a reporting entity regardless of whether the parent entity itself is a reporting entity.

5.2 For example, a parent entity with nominal capital and no active operations is expected to prepare consolidated financial statements if the group is a reporting entity.

5.3 Considerations in determining whether a group is a reporting entity may include that creditors which provide finance to a company which has entered into deeds of cross guarantee with other entities within the group would be interested in the consolidated financial statements of the group.

5.4 Even where there are no such deeds, consolidated financial statements may provide creditors of a parent entity with information such as the activities of the group, assets within the group, and the ability of controlled entities to generate future income and pay dividends to the parent. Consolidated financial statements prepared by a parent entity may similarly provide creditors of one of its controlled entities with information on the ability of the other entities in the group to support the controlled entity.

5.5 The sole determining factor as to whether consolidated financial statements are required is whether the group is a reporting entity.

Key terms

In this guide, unless a contrary intention appears, the following terms have the following meanings:

AASB The Australian Accounting Standards Board

accounting standards As defined in s9 of the Act

Act The *Corporations Act 2001*, including regulations made for the purposes of the Act

[CO 05/639] (for example) An ASIC class order (in this example numbered 05/639)

Framework The 'Framework for the Preparation and Presentation of Financial Statements' as cited in Australian accounting standards

reporting entity See paragraph 3.3 of this guide.