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The Treasury
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Dear Ms. O'Rourke

Corporations Amendment (Proprietary Company Thresholds) Regulations 2018

Thank you for the opportunity to comment on the exposure of the draft *Corporations Amendment (Proprietary Company Thresholds) Regulations 2018* which are proposed to apply from 1 July 2019.

The IPA ***supports, with reservations***, increasing the thresholds for financial reporting, auditing and lodgement for small proprietary limited companies. We consider that revised thresholds are more likely to underpin the requirements for public accountability and user decision-making than the existing threshold tests.

We consider that the threshold increase should be co-ordinated with:

- The removal of the option to lodge special purpose financial statements with ASIC (and other regulators) that is currently being progressed by the Australian Accounting Standards Board (AASB), and
- The withdrawal of the Regulatory Guide 115 *Audit Relief for proprietary companies'* and ASIC *Corporations (Audit Relief) Instrument 2016/784*. The increase in the thresholds should see no need for them. The general relief provisions would still continue to be available.

We note reference is made to 'reducing the financial reporting burden by increasing the thresholds for large proprietary companies'. We do not consider financial reporting to be a burden per se.

Furthermore, the explanatory memorandum contains no reference to the *public interest* being served by the increased thresholds. We consider this to be the better argument to be prosecuted than the one currently advanced.

The stated rationale for threshold increases

We recall that the size thresholds were originally drawn from UK reporting requirements and these have been arbitrarily increased since then.

The explanation for the proposed change is that the existing thresholds have not been reviewed since 2007, that the proposed reforms will ensure the thresholds keep pace with economic growth and that financial reporting obligations are targeted at larger, *more economically significant companies*. Also, the increased thresholds will reduce the number of proprietary companies that are

required to have in place a whistleblower policy under the Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017 (if passed by Parliament).

The exposure draft regulations propose to increase the thresholds to the following levels:

- The consolidated revenue for the financial year of the company and the entities it controls from \$25 million to \$50 million
- The value of the consolidated gross assets at the end of the financial year of the company and the entities in controls from \$12.5 million to \$25 million, or
- The company and the entities it controls having 50 employees to 100 employees at end of the financial year.

We note the Treasurer's media release refers to:

'This is estimated to reduce the regulatory cost on these businesses by \$81.3 million annually, as the average cost of preparing and auditing financial reports is approximately \$36,950 per company, per year'.

For clarity, financial statements will still be needed to be prepared for management, shareholders, financiers, and for taxation purposes. Accordingly, the costs savings from financial reporting are likely to be marginal, with the majority of savings coming from the dispensing of the audit requirement for certain proprietary companies. ASIC Corporations' (Audit Relief) Instrument 2016/784 states that "the instrument relieves [only] certain proprietary companies from the requirement to appoint an audit and have its financial report audited provided it is well managed and in a sound financial condition".

In relation to the latter, this is likely to increase certain business risks as an audit is more than a mere compliance exercise of opining on compliance with accounting standards. Directors may not fully appreciate their increased risk exposures.

Poor compliance with existing thresholds

A self-assessment process is employed to ascertain whether the size thresholds are exceeded. Over the last 18-months through data sharing by the ATO with ASIC, ASIC has been able to question thousands of proprietary companies as to whether they complied with the existing size test threshold for financial reporting, audit and lodgement requirements. Until then, it was evident that many companies had not performed the annual size assessment process *contrary* to the requirements of the corporations' law.

The explanatory memorandum makes no reference to this compliance issue and ASIC enforcement results.

Given the threshold test is a self-assessment exercise and the lack of compliance, the penalties for non-compliance would need to be revisited.

Furthermore, it may be helpful if ASIC developed a regulatory guide on the size test threshold to assist directors better understand their responsibilities and how they can be met. This could also emphasise directors' existing obligations regarding accounting records, payment of dividends and solvency.

We draw to your attention recent amendments to the *Code of Ethics for Professional Accountants*. The *Code* requires accountants in business and those in public practice to report matters of potential

or actual material non-compliance with laws and regulations to appropriate regulatory authorities when they are observed and/or when the issue has not been satisfactory resolved by the entity concerned. This reporting is based on the *public interest*.

Shortcomings in the threshold increases

The doubling of the thresholds is rudimentary at best.

The explanatory memorandum contains no analysis of the number of times proprietary companies affected have had their financial statements accessed by users through the ASIC data-base. Such information would support, or otherwise, the public interest argument for increasing the thresholds. It just can't be about reducing costs.

We find this lack of analysis disappointing and a fatal flaw for the revised thresholds.

Inter-relationship of the size tests needs a re-think

The tests for determining size need reconsideration as they may not now be fit-for-purpose.

We propose a variation to the threshold tests to better reflect 'economic significance' – that being meeting one, rather two, of the three tests.

Furthermore, the number of employees should not be increased. We note increasing trend of poor compliance by some employers with payroll and taxation obligations. Again, some analysis of these issues in respect of companies affected by the proposed increase in the thresholds would be helpful.

The existing employee threshold also does not seem to cater well for franchise operators and this needs further consideration.

Inter-relationship with accounting standards and ASIC regulatory guides and class order

The size thresholds interact with the application of accounting standards, and two ASIC regulatory guides and a class order to grant audit relief.

The Australian Accounting Standards Board is currently considering removal of the self-assessment option for certain companies, such as large proprietary companies, to lodge special purpose financial statements with the ASIC.

ASIC has issued Regulatory Guide 115 *Audit Relief for proprietary companies'* and ASIC Corporations (*Audit Relief*) Instrument 2016/784. Given the proposed increase in thresholds is to better reflect 'economic significance', then the need for such relief is no longer required. RG 115 and class order can be dispensed with as parliament decides which proprietary companies should prepare and lodge audited financial statements to meet the public interest.

ASIC has also issued Regulatory Guide 85 *Reporting requirements for non-reporting entities* (July 2005). This guide needs to be revised to better reflect the proposed increase in size thresholds for proprietary companies that are considered to be 'economically significant'. More importantly, as the AASB is currently considering removing the use of *reporting entity concept* articulated in Statement of Accounting Concept 1 (SAC 1), RG 85 should also take a wider view of the public interest and include in their decision making corporate social responsibility and environmental matters such as

the use of natural resources and agriculture assets, as these issues will better inform the nature and extent of financial disclosure that should be required of private companies. We believe that all of these issues should be progressed in an integrated manner. The process to increase the size thresholds needs to acknowledge and take into account these related developments.

Our recommendations for more analysis of the public interest and co-ordination with AASB and ASIC on related issues may necessitate a short-term delay in increasing the threshold to ensure that the public interest is satisfied.

If you would like to discuss our comments, please contact me in the first instance at vicki.stylianou@publicaccountants.org.au or on 0419 942 733.

Yours sincerely



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About the IPA

The IPA is one of the three professional accounting bodies in Australia, with over 36,000 members and students, in over 80 countries. The IPA specialises in the small business and SME sectors with over three-quarters of our members either working in or advising those sectors. In 2014 the IPA merged with the Institute of Financial Accountants of the UK, making the new IPA Group the largest accounting body in the SMP/SME sector in the world.