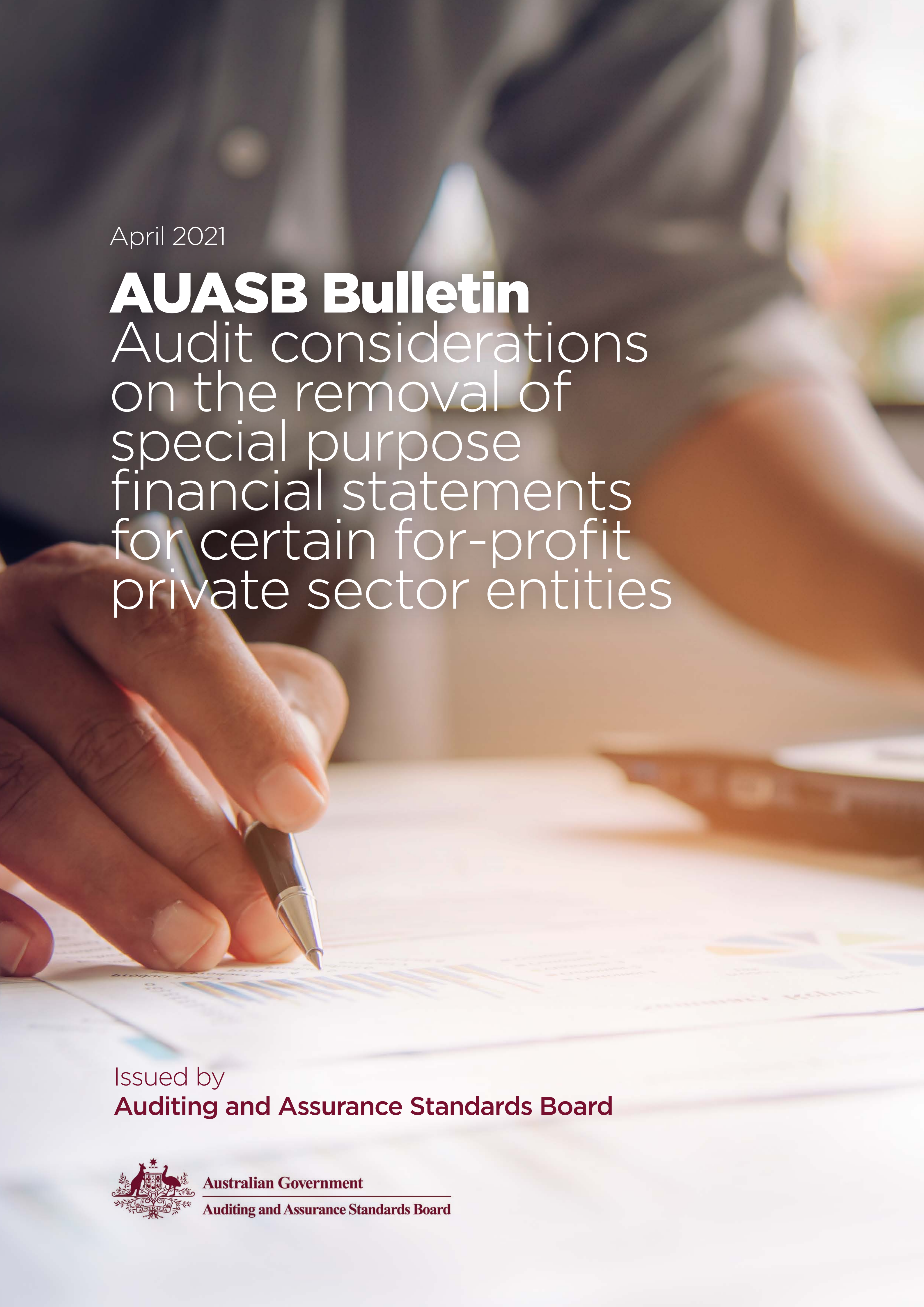

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AUASB Bulletin
Audit considerations on the removal of special purpose financial statements for certain for-profit private sector entities

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The Auditing and Assurance Standards Board (AUASB) is an independent, Non-corporate Commonwealth entity of the Australian Government, responsible for developing, issuing and maintaining auditing and assurance standards.

Sound public interest-oriented auditing and assurance standards are necessary to reinforce the credibility of the auditing and assurance processes for those who use financial and other information. The AUASB standards are legally enforceable for audits or reviews of financial reports required under the *Corporations Act 2001*. For more information about the AUASB see the AUASB Website.

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Table of contents

Introduction and purpose

The Australian Accounting Standards Board (AASB) has issued amendments to the Australian Financial Reporting Framework (FRF) which will:

- Remove the ability for certain for-profit private sector entities to prepare special purpose financial statements (SPFS) for the purposes of fulfilling their annual reporting obligations to stakeholders; and
- Replace the Tier 2 Reduced Disclosure Requirements (RDR) general purpose financial statements (GPFS) with a new Tier 2 Simplified Disclosure (Tier 2 SD) Standard (AASB 1060)[1].

The purpose of this bulletin is to assist auditors by providing guidance on these matters when performing upcoming audits of entities that are affected by any of these changes.

Background

1. What are the changes to the FRF?

The AASB have issued the following Australian Accounting Standards (AAS):

Pronouncement	Impact
AASB 2020-2[2]	From 1 July 2021 certain for-profit private sector entities[3] will no longer be permitted to prepare SPFS for the purposes of their annual reporting to stakeholders. Entities affected include those required by legislation to prepare financial statements that comply with AAS or accounting standards, and other entities that are required only by their constituting document or another document to prepare financial statements that comply with AAS. The standard also includes optional relief on the first-time adoption of the Tier 1 or Tier 2 reporting requirements. Refer to Key Facts AASB 2020-2 *Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (Key Facts AASB 2020-2) issued by the AASB for full details on the types of for-profit private sector entities who can no longer prepare SPFS post 1 July 2021.
AASB 1060[4]	Introduces a new Tier 2 GPFS Simplified Disclosure (Tier 2 SD) framework to replace the current Tier 2 RDR financial statements.

[1] Also applicable for not-for-profit entities.

[2] AASB 2020-2 *Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities*

[3] Refer to AASB 2020-2 for further detail on the for-profit sector entities who can no longer prepare SPFS.

[4] Refer to AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Entities*

2. What is the effective date of the changes?

The mandatory effective date of the changes to the FRF is annual periods beginning on or after 1 July 2021 (i.e. 30 June 2022 year ends onwards), however there is significant transitional relief for entities who early adopt and therefore many entities may elect to transition from SPFS to the new Tier 2 SD early i.e. the upcoming 30 June 2021 or 31 December 2021 reporting periods.

3. What transitional relief is available for entities who are required to transition from SPFS to Tier 2 GPFS?

The transitional relief available under the AAS depends on the date of adoption. The audit work performed thereon may be affected by the options chosen.

Early adoption

To encourage early transition from SPFS to Tier 2 SD there is significant transitional relief for adoptions in annual reporting periods beginning on or after 1 July 2020 but before 1 July 2021 as follows:

- Relief from restating comparative information in the year of transition (relevant for entities not currently complying with recognition and measurement (R&M) requirements in their SPFS); and
- Entities that have complied with all R&M requirements in previous SPFS have relief from presenting comparative information for those incremental disclosures that they had not previously made.

Early adoption or adoption on the mandatory date

Entities who adopt Tier 2 SD no later than the first year it becomes mandatory i.e. for annual reporting periods beginning on or after 1 July 2021 but before 1 July 2022 are not required to distinguish the correction of prior period errors from changes in accounting policies in the year of transition in the financial statement disclosures.

Refer to Key Facts AASB 2020-2 and AASB 1054 Appendix C, Chart 1 First-time Adoption of Tier 1 or Tier 2 Reporting Requirements which provide a summary of the transitional relief.

Management's responsibilities

4. What are management's responsibilities in relation to the changes to the FRF?

Management and those charged with governance are responsible for the preparation of the financial statements in accordance with the applicable FRF. Entities which have previously prepared SPFS will need to assess if they can continue to do so or will they need to change their FRF to GPFS. If the entity is required to prepare GPFS, the following will need to be considered:

- **Which** general purpose Tier is appropriate i.e. Tier 1 (full IFRS) or Tier 2 SD (AASB 1060 - simplified disclosures)?
- **When** will they transition i.e. early adoption prior to annual reporting periods beginning on or after 1 July 2021 or adoption on the mandatory date?
- **How** will they transition, i.e. use the full retrospective approach in AASB 108 or the exceptions available in AASB 1?
- **What** transition relief is available to them i.e. depending on adoption date, may be eligible for relief from restatement of comparatives / disclosure relief from distinguishing between correction of errors and changes in accounting policy?

Auditor's responsibilities

5. Is the FRF to be used by management in preparation of the financial report acceptable?

The overall objective of the auditor is to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to express an opinion on whether the financial report is prepared, in all material respects, in accordance with an applicable FRF[5].

Assessing the acceptability of the FRF is integral to the auditor's responsibilities. In July 2019 the AUASB issued a bulletin[6] to remind auditors of the relevant requirements when considering the FRF:

- ASA 210[7] requires the auditor, as a precondition to accepting the engagement, to determine whether the FRF that is to be applied in the preparation of the financial report is acceptable and obtain acknowledgement from management that they understand their responsibility to prepare the financial report in accordance with this FRF; and
- ASA 700[8] requires auditors to evaluate whether the financial report adequately refers to or describes the applicable FRF.

When determining the acceptability of the FRF, auditors of entities who have previously prepared SPFS need to consider if they agree with management's assessment as to whether SPFS are permitted or not.

If management determine that the entity is no longer entitled to prepare SPFS, the auditor assesses the application of the new general purpose FRF used to prepare the financial report, including if considered material, the relevant adaptions for first year of adoption available from transitional relief in AASB 20202-2. (refer question 3).

Where management determines that the entity can continue to prepare SPFS, the auditor would also be required to assess whether this is in accordance with AASB 2020-2 ie. that the FRF is acceptable. The existing specific obligations for the auditor in ASA 800[9] remain relevant in relation to assessing the acceptability of the special purpose FRF.

If the auditor determines that it is not acceptable to continue to prepare SPFS and therefore the FRF is not acceptable, ASA 210 paragraph 8 requires the auditor to not accept the engagement. However, if this is not possible, ASA 210 paragraph 20 requires the auditor to evaluate the effect of the misleading nature of the financial report on the auditor's report and include appropriate reference to this matter in the audit engagement letter.

[5] ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards paragraph 11.*

[6] AUASB Bulletin *Auditor's Responsibilities and the Financial Reporting Framework*

[7] ASA 210 *Agreeing the Terms of Audit Engagements, paragraph 6(a) & (b)(i)*

[8] ASA 700 *Forming an Opinion and Reporting on a Financial Report, paragraph 15*

[9] ASA 800 *Special Considerations – Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks*

6. Does the auditor need to re-issue the engagement letter?

ASA 210 requires the auditor to agree the terms of the audit engagement, including the identification of the FRF for the preparation of the financial report, to be recorded in an engagement letter or other suitable form of written agreement. Therefore, if the FRF is changing from SPFS to GPFS this should be confirmed in writing by management by either re-issuing the engagement letter or in a suitable written form such as an addendum to the existing written agreement.

7. What are the auditor's responsibilities in relation to comparative information on the year of transition from SPFS to GPFS?

ASA 710[10] provides requirements and guidance on the auditor's responsibilities in relation to corresponding figures (referred to as comparative information in the Accounting Standards and in this bulletin). The objective is to obtain sufficient appropriate audit evidence about whether the comparative information has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable FRF. Therefore, the auditor's objective is to assess whether the comparative information has been prepared and presented in accordance with the transitional relief (refer question 3).

ASA 710 includes the following requirements in relation to comparative information:

- paragraph 7 (a) requires the auditor to evaluate whether the comparative information agrees to the prior period audited Financial Report;
- paragraph 7 (b) requires the auditor to evaluate whether the accounting policies reflected in the comparative information are consistent with those applied in the current period, or, if there have been changes, whether these have been properly accounted for and adequately presented and disclosed.

AASB 2020-2 allows entities who elect to early adopt AASB 1060 (i.e. for reporting periods beginning before 1 July 2021) to not restate comparative information and present the comparative financial statements (statement of financial position, statement of profit and loss and other comprehensive income, statement of changes in equity and statement of cash flows), and the related notes based on the previously audited SPFS. In this scenario, auditors agree the comparative information to the previously audited SPFS (note if this is an initial audit engagement, auditors will also need to comply with ASA 510[11]).

For entities who are required, or elect, to restate and present comparative information in accordance with all R & M requirements in the accounting standards using either AASB 1[12] or AASB 108[13], the auditor obtains sufficient and appropriate audit evidence on the comparative information in accordance with ASA 710, when forming an opinion on whether the financial report has been prepared in all material respects in accordance with the FRF.

If the auditor concludes the comparative information is not in accordance with the FRF, in all material respects, the auditor considers this when forming their opinion on whether the financial report as a whole is free from material misstatement.

[10] ASA 710 *Comparative Information – Corresponding Figures and Comparative Financial Reports*
[11] ASA 510 *Initial Audit Engagements – Opening Balances*
[12] AASB 1 *First-time Adoption of Australian Accounting Standards*
[13] AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*

8. **What are the auditor's responsibilities in relation to adjustments and disclosures required when transitioning from SPFS to GPFS, including any identified prior period errors?**

The auditor's obligation is to obtain sufficient and appropriate audit evidence on transition adjustments and disclosures required by AASB 2020-2 when forming their opinion on whether the financial report, as a whole, is free from material misstatement. When fulfilling this obligation auditors consider the materiality of the transitional adjustments and disclosures required by AASB 2020-2 auditors, in accordance with ASA 320[14].

AASB 2020-2 allows entities who elect to early adopt AASB 1060 (i.e. for reporting periods beginning before 1 July 2021) to not disclose restated comparative information in the financial statements. Entities will need to prepare an opening balance sheet (1 July 2020) using all R&M requirements in the new accounting standards when determining the adjustments to opening retained earnings. Auditors apply ASA 510 when assessing the opening balances.

With an objective to facilitate a timely transition from SPFS to GPFS Tier 2 the AASB have provided relief to entities from distinguishing the correction of errors from changes in accounting policies on transition in the note disclosures, provided the entity prepares GPFS in a period beginning prior to 1 July 2022.

All adjustments to retained earnings on transition from SPFS to GPFS need to be disclosed, but entities do not need to identify whether an adjustment relates to the correction of an error in prior year financial statements or a change in accounting policy, and therefore do not include the additional disclosures that would otherwise be required where a material prior period error has been corrected in the current period.

Assessing whether an adjustment on transition from SPFS to GPFS is a change in accounting policy or an error in the prior period financial statements is dependent on the basis of preparation of the previous SPFS. For example:

- If the basis of preparation stated full compliance with R & M requirements however upon transition it was discovered this was not correct, any adjustments to achieve compliance are considered an error.
- If however, the basis of preparation was silent on compliance with R & M and instead listed compliance with specific AAS then any adjustments required to achieve compliance with R & M requirements other than those in the AAS listed, would be considered a change in accounting policy.
- Companies preparing financial statements under the *Corporations Act 2001* (The Act) are required to comply with specified accounting standards (being AASB 101 *Presentation of Financial Statements,* AASB 107 *Statement of Cash Flows,* AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors,* AASB 1048 *Interpretation of Standards* and AASB 1054 *Australian Additional Disclosures*), and non-compliance with any of these standards would be considered an error.

If the auditor becomes aware of a material misstatement in the previously audited SPFS the auditor must consider their responsibilities such as:

- ASA 560[15] has relevant requirements when an error is identified in a financial report after it has been issued. Auditors consider the materiality of the error, and the level of reliance on the financial report and auditor's report when determining the appropriate course of action.

[14] ASA 320 *Materiality in Planning and Performing an Audit*
[15] ASA 560 *Subsequent Events*

- ASA 710 paragraph 12 requires the auditor to modify the auditor's report in the current year if a material error exists in the comparative information which has not been restated or appropriate disclosures have not been made. Auditors consider the disclosure requirements in ASA 2020-2 when assessing whether appropriate disclosures have been made.
- Section 311 of the Act requires auditors conducting audits for the purposes of the Act, to notify ASIC of significant (and in some instances non-significant) contraventions of the Act. Refer to Regulatory Guide 34: *Auditor's obligations: reporting to ASIC* (RG 34) for further information. RG 34 details that failure to comply with accounting standards is likely to be a significant contravention (see RG 34.80 to RG 34.82).

Auditors use professional judgement and consider the materiality of the prior period misstatements when determining the appropriate course of action. ASA 450[16] includes requirements and guidance when determining whether misstatements are material, individually or in aggregate which include considering the size and nature of the misstatement, and the overall effect on the financial report as a whole.

Auditors also assess whether the financial statements achieve fair presentation[17 18]. The disclosure requirements in AASB 2020-2 are the minimum and in the majority of circumstances compliance is expected to achieve fair presentation. However, auditors may consider a prior year error, that is not distinguished from a change in accounting policy, could be obscuring a matter reasonably expected to influence the economic decisions of the users, and in the absence of separate reporting could potentially result in a material misstatement. In these instances, the auditor may request additional disclosures be made to achieve fair presentation.

9. What is the impact on the auditor's report?

Auditor's reports on the first GPFS

When forming an opinion on the first GPFS after transitioning from a SPFS, the auditor considers whether the financial report is prepared, in all material respects, in accordance with the applicable FRF. In this year, the applicable FRF includes the specific requirements in AASB 2020-2 and AASB 1060 (Tier 2 SD).

There is no requirement to include an emphasis of matter (EOM) in the auditor's report, however auditors may consider an EOM appropriate, as in their judgement, specific disclosures exist (such as the basis of preparation or adjustments on transition) which are fundamental to the user's understanding of the financial report and therefore meet the definition of an EOM in accordance with ASA 706.

Auditors are also reminded to ensure the relevant sections of the auditor's report appropriately refers to the new FRF used to prepare the financial report, and against which the auditor assesses fair presentation.

Auditor's reports on SPFS

For entities that continue to prepare SPFS, auditors must assess if this is acceptable (refer question 5). Where it remains acceptable, auditors continue to include an EOM drawing user's attention to the basis of preparation and that it is a special purpose framework as required by ASA 800.

[16] ASA 450 *Evaluation of Misstatements Identified during the Audit*

[17] ASA 700 *Forming an Opinion and Reporting on a Financial Report, paragraph 14*

[18] *Corporations Act 2001 s 297 also requires a true and fair view*