Paper#: K160

APPLICATION OF THE REPORTING ENTITY CONCEPT IN AUSTRALIA

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ABSTRACT

Our aim is to document empirically the financial reporting choices, more specifically the application of the *reporting entity* concept, by for-profit private and not-for-profit entities in Australia. For decades, the reporting entity concept has been the foundation of differential reporting in Australia – a primary factor determining whether particular organisations across Australia should produce full GAAP-based financial reports. In recent years, the application of the concept, as originally set out in Statement of Accounting Concepts (SAC) 1, has come under increasing criticism on several grounds – most notably, that it does not yield the reporting outcomes originally intended by regulators. Our results show that the factors identified in SAC 1 as being indicative of the existence of a reporting entity, do not systematically explain its application. This suggests that factors in SAC 1, which also proxy for demand for financial information, do not explain the reporting practices of these entities. Our findings have relevance for researchers seeking to gain a better understanding of the factors affecting the accounting and reporting choices of these entities and for regulators interested in the means by which these choices might be more effectively regulated in future.

Keywords: Reporting entity, differential reporting, SAC 1, for-profit private companies, not-for-profit entities

1. Introduction

We explore the reporting practices of for-profit private and not-for-profit entities lodging financial statements with the Australian Securities and Investments Commission (ASIC). More specifically, we examine the factors affecting the decision by these organisations to apply the *reporting entity* concept. Despite their economic and social importance, relatively little is known about these entities [i]. To empirically document these practices, we draw a random sample of 1,546 entity reports and operationalise the criteria set out in Statement of Accounting Concepts 1 (SAC 1) as being indicative of the existence of a reporting entity. Our results indicate that the principles-based criteria in SAC 1, designed to guide the application of the concept does not systematically explain reporting practices observed by these entities.

The reporting entity concept has, for over two decades, been the foundation of the differential reporting regime existing in Australia. A primary implication of the concept is that those entities considered to be reporting entities have been, *prima facie*, required to produce full GAAP-based, or 'general purpose' financial reports. Those entities not considered to be reporting entities are typically exposed to lesser standards of reporting, referred to in some regions as 'little GAAP' (Collis et al. 2004)[ii].

Our study is motivated by the ongoing interest of central rule-making agencies and accounting associations worldwide in understanding the financial reporting practices of private and/or small companies (Schipper, 2010). For example, both FASB and the AICPA have over an extended period, examined various issues relating to the application of U.S. GAAP to private and/or small companies (e.g. AICPA 1976, 1981, 1996, 2005; FASB 1981, 1983; FASB/AICPA 2006). As an example, in its widely cited 2005 *Taskforce* report, the AICPA examined two specific questions in relation to private company reporting, namely; (i) whether the financial statements prepared in accordance with GAAP meet the needs of the constituents of those reporting; and (ii) whether the costs of providing GAAP financial statements for these entities is justified relative to the benefits they provide to users. The IASB also has recently sought to address this issue (IASB, 2010) and it remains on the agenda of the Australian Accounting Standards Board (2010a, 2010b, 2010c, 2010d) and regulators in the UK, New Zealand and Hong Kong (HKSA, 2004) (see also Kamnikar, Kamnikar and Burrowes, 2012).

Under Australian accounting regulations, entities are required to self determine whether they meet the definition of a reporting entity (AARF/AASB, 1990; Langfield-Smith, 1991; Australian Securities Commission, 1992). As discussed further in later sections, the classification rests primarily on whether there are potential users who are dependent on general purpose financial reports as their primary information source in making and evaluating decisions regarding the allocation of scarce resources. A number of broad criteria are set out in SAC 1 to assist the identification of reporting entities which relate to the separation of ownership and management, the economic and political importance of the entities and their financial characteristics. According to SAC 1, the greater the separation of ownership and management and the more economically, politically and financially significant an entity is, the more likely there will be dependant users relying on the financial statements as their primary information source, suggesting classification as a reporting entity. The criteria set out in SAC 1 remains however, indicative only. Despite significant debate, regulators have typically avoided imposing quantitative rules to structure the application of the concept (Hoogervorst, 2012)[iii]. As a consequence, the decision remains largely a matter of judgement for the entities involved.

Little empirical insight is available into the reporting choices made by these entities and more specifically, the factors driving the decision to classify as a reporting entity. Valuable

insights are available into the difficulty of applying principles-based concepts such as the reporting entity (Walker, 2007). Other work has enhanced the general understanding of the usefulness of GAAP based financial statements for constituents of private and/or not-for-profit entities (e.g. AICPA 2005) and the usefulness[iv] of GAAP-based reports produced by these entities for the decisions made by interested parties (Allee and Yohn, 2009; Bharath et al., 2008). A theme identified in the findings of this work is that when GAAP statements are prepared they appear to provide useful information to users (AICPA, 2005). We are not aware however of previous work which sheds light on the factors affecting the decision to produce those reports.

The conventional rationale for the application of the reporting entity concept is two-fold. First, it is designed to enable the provision of information that is useful for the decisions made by users of financial statements. The implicit assumption is that the user needs of larger, more economically and socially significant entities may be different. Second and related, the concept is designed to enable those organisations to be relieved of the costs of compliance when those costs exceed the benefits of reporting (Langfield-Smith, 1991; Brailsford and Ramsay, 1993).

The factors affecting the application of the reporting entity concept are likely to be complex. If financial reports are viewed as economic goods, the quality varying with demand for the information, and where the information needs of users of financial reports are appropriately served by a lower level of information disclosure, then in equilibrium, organisations are more likely to self classify as a non-reporting entity (Ball and Shivakumar, 2005). At the same time, proponents of principles-based regulations argue that a higher quality of reporting is likely when reports are prepared in line with high-level principles which focus on outcomes, compared to reports prepared according to detailed rules which focus more on process (FSAC, 2004). If this view holds, and if the content of SAC 1 is consistently applied, the indicative factors identified therein should have explanatory potential for the reporting choices observed.

Overall our results indicate that measures which proxy for the factors identified in SAC 1 as indicative of the existence of a reporting entity, do not systematically explain the application of the concept. In other words, the decision whether an entity classifies itself as a reporting entity appears to be driven by factors other than those identified in SAC 1. While our results show there are statistically significant differences[v] on some of the indicative factors identified in SAC 1, a number of anecdotes reported in the paper corroborate the extent of variation in the application of the reporting entity concept by entities[vi].

2. Literature and background

Currently in Australia, approximately 22,000 entities lodge financial statements annually with ASIC in accordance with the *Corporations Act 2001*. ASIC defines five categories of entities: (1) Large for-profit private entities (a private company satisfying at least two of the three size criteria); (2) Small proprietary companies lodging at the direction of ASIC or at the request of shareholders; (3) Foreign-controlled entities which ASIC categorises as ‘Small Proprietary companies controlled by a foreign company’; (4) Unlisted public companies other than those limited by guarantee - which include a range of entities such as insurance companies and finance companies; and (5) Public companies limited by guarantee - which mainly comprise clubs, institutes and societies.

In 2005, ASIC conducted an internal review of an unspecified sample of reports lodged by for-profit private and not-for-profit entities and identified inconsistent application of the reporting entity concept (ASIC, 2005). ASIC concluded a number of entities that self-classified as non-reporting entities should have been classified as reporting entities. The implication is that some of the entities preparing Special Purpose Financial Reports[vii] (SPFRs) might more appropriately have prepared General Purpose Financial Reports (GPFRs). Entities lodging GPFRs follow Australian Accounting standards and thus the financial reports are consistent with those prepared by firms operating on the capital market, whereas entities lodging SPFRs, while also consistent with the basis on which GPFRs are prepared[viii], have limited disclosure requirements and thus produce reports with significantly less financial information. ASIC's assertions have not been subject to empirical verification.

Previous research in this area suggests that members of the accounting profession in Australia adopt different approaches to implementing principles-based regulations such as the reporting entity (Walker, 2007). Entities face complex incentives in determining the format and content of financial reports. Primarily, entities have a responsibility to produce information that complies with appropriate regulations and which provides information that is useful for decision making. At the same time, disclosing additional information as required by GPFRs is likely to be costly and may act as a disincentive for entities to consider themselves as reporting entities (AASB 2010d, para BC71; FASC 2006). There is considerable variation in approaches taken by regulators in relation to the reporting practices of private and not-for-profit entities across international jurisdictions (IASB, 2010). These factors, taken together, provide significant motivation to develop a greater understanding of the reporting practices of these entities.

In response to these concerns, the AASB released in February 2010, ED 192 *Revised Differential Reporting Framework*, recommending a revised approach to reporting for these entities. However, following feedback from constituents, the AASB subsequently issued AASB 1053 which limited changes to the current reporting framework to the introduction of a second tier of reporting requirements, involving reduced disclosure for some entities producing GPFRs (Potter et al., 2013). The AASB then commissioned the authors of the present study to investigate the financial reporting practices by for-profit private companies and not-for-profit entities in Australia to inform future regulatory developments for these entities. This paper draws on the evidence used in the investigation to provide evidence on the reporting practices of for-profit private companies and not-for-profit entities in Australia.

The next section provides a review of the reporting entity concept followed by an examination of the application of the reporting entity concept for a sample of for profit and not-for-profit entities lodging accounts with ASIC. The final section contains a discussion of the results and conclusions.

2.1 The Reporting Entity Concept

Differential reporting has been a feature of the Australian financial statement reporting environment for decades and has been incorporated in Australian Accounting Standards since 1990. For-profit private and not-for-profit entities currently lodge with ASIC either a GPFR or a SPFR. Entities lodging GPFRs are required to apply all accounting standards[ix] and thus their financial reports are consistent with those prepared by entities with seasoned equity, whereas entities lodging SPFRs have limited disclosure requirements.

While the reporting entity requirements applicable to SPFRs have varied in the past, for the period covered by the study, ASIC's reporting guidance (RG 85) is relevant. According to RG 85, entities preparing SPFRs under the *Corporations Act 2001* should adopt accrual accounting and apply recognition and measurement underpinning accounting standards, but are subject to limited disclosure requirements (ASIC 2005, para. 2). There are five accounting standards which apply to all entities preparing financial reports in accordance with Part 2M.3 of the *Corporations Act* which must be followed by entities preparing SPFRs. Three of these standards are concerned primarily with disclosure issues, that is, AASB 101, *Presentation of Financial Statements*; AASB 107, *Cash Flow Statements*; and AASB 108, *Accounting Policies, Changes in Accounting Estimates and Errors*. The two remaining standards are concerned with the substantive issues of the financial reports: AASB 1048, *Interpretation of Standards* [x], and AASB 1031, *Materiality*.

At the heart of Australia's differential reporting regime is the *reporting entity* concept. Indeed the differential reporting regime primarily relies on a principles-based requirement that reporting entities (i.e., entities that have potential users who are dependent on information useful for making and evaluating decisions about resource allocations) should prepare GPFRs (Walker, 2007). While initially introduced in the early 1990s to enable smaller entities to reduce the costs of complying with GAAP, whether the reporting entity concept should continue to apply in Australia has been the subject of considerable debate (AASB, 2010b). To inform such discussions, we seek to document empirically whether and how, the reporting entity concept is being consistently applied as a means of understanding the likelihood that the concept is delivering the reporting outcomes originally intended by regulators. This objective leads to our primary research question:

> *"To what extent do the factors proposed in SAC 1 as being indicative of a reporting entity, adequately determine whether an entity produces a general purpose financial report?"*

The remainder of this section explains the definition of the reporting entity concept as outlined in SAC 1 and endorsed via APES 205 *Conformity with Accounting Standards*. This section assists us with developing our hypotheses, which is then followed by an analysis of the application of the reporting entity concept across the five categories of entities lodging annual financial statements with ASIC. As a basis for the analysis, we identify and test the factors as outlined in SAC 1 (paragraphs 19-22) as suggesting the existence of a reporting entity to understand the application of the reporting entity concept by entities in the sample.

SAC 1 and the reporting entity concept - SAC 1 states that "reporting entities shall prepare general purpose financial reports. Such reports shall be prepared in accordance with Statements of Accounting Concepts and Accounting Standards" (para. 41). APES 205 states that only entities which are regarded as 'reporting entities' are required to comply with all SACs and Accounting Standards[xi]. Entities not regarded as reporting entities should prepare SPFRs, unless a non-reporting entity voluntarily elects to prepare a GPFR.

SAC 1 sets out the criteria for identifying a reporting entity, which is based on whether it is reasonable to expect the existence of external users who are dependent on GPFRs as their primary source of information for making and evaluating resource allocation decisions. Examples of entities typically considered to be reporting entities are provided in various regulations, policy statements and accounting standards such as AASB 1025 *Application of the Reporting Entity Concept and Other Amendments* (1992) and include various types of

companies (e.g., companies whose securities are publicly listed), trusts which raise funds from the public; government-controlled entities and government departments (see Walker, 2007). Where regulation exists which is specific to any of the five categories of entities lodging accounts with ASIC and which shapes reporting practices, further discussion is provided in the results section of the paper.

Existence of a reporting entity – SAC 1 acknowledges the subjectivity involved in applying the reporting entity concept and identifies a number of indicative factors which assist in determining the likelihood of the existence of users who are dependent on general purpose financial reports:

1. ***Separation of management from economic interest*** – Entities that demonstrate a greater spread of ownership/membership are more likely to have users who are dependent on general purpose financial reports (SAC 1 (para. 20));
2. ***Economic or political importance/influence*** – Reporting entities are also more likely to have a greater impact on the welfare of external parties. Examples of such entities include organisations with dominant positions in their respective market place, employer/employee associations and public sector entities which have regulatory power (SAC 1 (para.21));
3. ***Financial characteristics*** – SAC 1 also identifies financial characteristics as one set of indicators of the existence of a reporting entity. While noted as indicative only, such characteristics include size (e.g. value of sales or assets, or number of employees or customers) and the entity's relative level of indebtedness to external parties (SAC 1 (para.22)).

To summarise, an entity is regarded as a 'reporting entity' whenever it is reasonable to expect the existence of users who are dependent on financial reports as their primary source of information for making and evaluating scarce resource allocation decisions (SAC 1, para. 40). Factors outlined in SAC 1, which assist in determining the existence of a reporting entity, are indicative only. The criteria identified in SAC 1 also is consistent with an established body of research literature, which is often described as focussing on 'contracting' issues. According to this literature, those entities for which there is a greater demand for financial information for external monitoring of performance and accountability, will make different reporting choices and produce higher quality reports (see for example, Allee and Yohn, 2009; Ball and Shivakumar, 2005; Bharath et al., 2008; Watts 2003a, 2003b). An inference from this literature is that in our sample, we should observe an association between the factors outlined in SAC 1 and the decision to produce GPFRs. Accordingly, the above discussion of the SAC 1 indicative factors can be summarised in the following three hypotheses:

H1: Companies lodging GPFRs will be significantly larger, as measured by trading revenue, total assets and number of employees, than companies lodging SPFRs;

H2: Companies lodging GPFRs will demonstrate greater separation of management, as measured by the total number of members, than companies lodging SPFRs;

H3: Companies lodging GPFRs will have significantly higher levels of indebtedness, as measured by the total dollar value of total liabilities and the total value owing to creditors, than companies lodging SPFRs.

3. METHOD

This study provides an analysis of the characteristics of firms preparing GPFRs and SPFRs to assess the application of the reporting entity concept. Specifically, the analysis compares the characteristics (indicative factors) outlined in SAC 1 (paragraphs 19-22) in order to gauge whether these factors explain an organisations' assessment of their reporting entity status. A number of financial characteristics and related factors which proxy for the separation of management from economic interest are tested empirically to examine the application of the reporting entity concept. Our evidence in respect of social and political importance is more circumstantial and discussed in the context of the analysis.

3.1 Sample Selection and Data

This study presents data based on random samples of entities drawn from each of the five categories of entities lodging financial reports with ASIC. A random sample of 1,546 entities was drawn from 2008-09 population counts provided by ASIC (see Table 1). The data analysed in this study was hand collected from PDF copies of company lodgements obtained from ASIC in April 2011. The data years subject to analysis were the most recently available annual report years – with most report years ending in 2009 and 2010. It should be noted that because the analysis in this study covers the years up to 2010, it does not examine the impact of changes in the reporting patterns following the issue of AASB 1053 in 2010.

INSERT TABLE 1

As shown in Table 1, there were 6,339 large proprietary entities lodging financial reports with the ASIC in 2010-11 and an initial random[xii] sample of 357 entities was drawn from this group. To augment missing company lodgements and gaps in company year observations, we obtained additional company lodgement data in September 2012 and as a result our final random sample for large proprietary companies was 394. Under the *Corporations Act 2001* a proprietary company is defined as one that is limited by share capital, has less than 20 non-employee shareholders and has not raised money from the public. These proprietary companies are regarded as 'large' if they satisfy two or more of the following size tests: (i) consolidated revenue of $25 million or more; (ii) consolidated gross assets of $12.5 million or more; (iii) 50 or more employees of the group. The *Corporations Act 2001* requires all large proprietary companies, unless grandfathered[xiii], to lodge a directors' report and an audited financial report with ASIC.

As shown in Table 1, there were 2,797 foreign-owned entities registered with ASIC. Under Part 5B.2 of the *Corporations Act 2001*, a foreign company (i.e., a company incorporated or unincorporated body formed in an external territory of Australia or outside Australia) wishing to carry on business in Australia must be registered and these entities are required to lodge financial statements with ASIC. Section 9 and 292(2)(b) of Part 2M of the *Corporations Act*, as well as the 'control test' in AASB 127 *Consolidated and Separate Financial Statements*, are used to determine whether a proprietary company is considered to be 'controlled' by a foreign-owned company. A random sample of 340 foreign owned entities was drawn for this group of entities.

Under the requirements of Section 294(1) Part 2M.3 of the *Corporations Act* 2001, ASIC or shareholders with 5 per cent or more of the voting capital may direct a small proprietary company to comply with requirements under Divisions 2 to 6 of the Act and prepare and lodge a financial report with ASIC. The rationale for this requirement is to ensure that all shareholders in these small entities have 'adequate access to financial information without

imposing an unreasonable burden on small companies' (Australian Commonwealth Treasury, 2006, p.3). In addition, ASIC might direct a company to lodge an audited financial report because of a dispute between shareholders or the entity might have committed a 'strict liability offence' such as abrogation of directors' duties. In 2010-11, there were 186 small proprietary companies directed by ASIC to produce a financial report. A random sample of 95 small proprietary companies was drawn for this group.

Unlisted public entities include companies limited only by shares, a small number of 'no-liability' (mining) public companies and public companies limited by both shares and by guarantee. They differ from proprietary companies in their capacity to have more than 50 non-employee members and to offer shares to the public. In a sense, this suggests unlisted public companies may have broadly similar legislative obligations under the *Corporations Act 2001* as a listed public company. However, in contrast to a listed public company, the shares of unlisted public companies are not included on the official list of a securities exchange. All unlisted public companies registered under the *Corporations Act 2001* must have at least 3 directors, 2 of whom must be Australian residents. There were 3,985 (see Table 1) unlisted public companies required to submit an audited financial report with the corporate regulator in the financial year 2010-11.

The rationale for unlisted public companies producing audited financial reports is that these entities have the ability to offer shares and raise capital from the general public. The *Corporations Act 2001* seeks to ensure that investors or shareholders with smaller holdings should have access to audited financial information for decision-making purposes (Australian Commonwealth Treasury, 2006). Similar to the other types of entities in our sample and despite their definition as 'public', these companies can choose to produce either a GPFR or a SPFR depending on their reporting entity status. A random sample of 347 entities was drawn for this group.

Public companies limited by guarantee must comply with the broader legislation that applies to all public companies. Charitable or not-for-profit organisations that register a company structure with ASIC (i.e., create a legal entity that is separate from its members) are examples of 'public companies limited by guarantee'. These companies must include the words 'Limited' or 'Ltd' after their name, unless they are eligible for an exemption from this requirement from the corporate regulator. Common examples of companies in this group are sports and recreation-related organisations, community service organisations, education-related institutions, and religious organisations (Australian Commonwealth Treasury, 2007).

Under the *Corporations Act 2001*, public companies limited by guarantee do not have the power to issue shares to members but instead each member guarantees to pay a nominal amount specified in the company's constitution in the event that the company goes into liquidation. In other words, the liability of the company's members is limited to the amount that members have contributed to the assets of the company in case of liquidation. Unlisted public companies tend to be significantly larger than limited-by-guarantee companies and because of their share capital structure they are more likely to have a profit motive compared to limited by guarantee companies (Australian Commonwealth Treasury, 2007). There were 8,404 public companies limited by guarantee that lodged audited financial reports with ASIC in the financial year 2010-11 and a random sample of 370 companies was drawn from this group. A summary of the descriptive statistics for the five groups of entities is presented in Table 2.

INSERT TABLE 2

3.2 Empirical Models and Measures

Two logistic regression models are specified in this paper, which test the expectation that companies lodging a GPFR will be significantly larger, have greater separation of management from economic interest, and have higher levels of indebtedness. The first set of six models predicts discrete outcomes of large proprietary companies lodging a GPFR on the basis of the following three sets of reporting entity indicative characteristics: (i) size of company, which is proxied by the natural logarithm of trading revenue (*lnTrading*); the natural logarithm of total assets (*lnAssets*), and natural logarithm of employees (*lnEmployees*); (ii) separation of management from economic interest, which is proxied by the binary variable more than 1 member (*Mem_Dum*), and; (iii) levels of indebtedness, which is proxied by the natural logarithm of creditors (*lnCreditors*) and natural logarithm of total liabilities (*lnLiabilities*).

$$\ln\left[\frac{P}{1-P}\right]GPFR = \beta_0 + \beta_1 X_{\ln Trading} + \beta_2 X_{Mem\_Dum} + \beta_3 X_{\ln Total\_Liabilities} + u \quad (1)$$

$$\ln\left[\frac{P}{1-P}\right]GPFR = \beta_0 + \beta_1 X_{Total\_Assets} + \beta_2 X_{Mem\_Dum} + \beta_3 X_{\ln Total\_Liabilities} + u \quad (2)$$

$$\ln\left[\frac{P}{1-P}\right]GPFR = \beta_0 + \beta_1 X_{\ln Employees} + \beta_2 X_{Mem\_Dum} + \beta_3 X_{\ln Total\_Liabilities} + u \quad (3)$$

$$\ln\left[\frac{P}{1-P}\right]GPFR = \beta_0 + \beta_1 X_{\ln Trading} + \beta_2 X_{Mem\_Dum} + \beta_3 X_{\ln Creditors} + u \quad (4)$$

$$\ln\left[\frac{P}{1-P}\right]GPFR = \beta_0 + \beta_1 X_{\ln Total\_Assets} + \beta_2 X_{Mem\_Dum} + \beta_3 X_{\ln Creditors} + u \quad (5)$$

$$\ln\left[\frac{P}{1-P}\right]GPFR = \beta_0 + \beta_1 X_{\ln Employees} + \beta_2 X_{Mem\_Dum} + \beta_3 X_{\ln Creditors} + u \quad (6)$$

where

GPFR is a binary variable, where 1 = the entity has lodged a GPFR with ASIC, 0 = the entity has lodged a SPFR with ASIC;

LnTrading is measured by the entities' total consolidated revenue and a transformed measure (using the natural log) is included in the logistic regression analysis;

LnAssets is measured by the entities' total current and non-current consolidated assets and a transformed measure (using the natural log) is included in the model;

LnEmployees is the total consolidated number of employees employed by the entity and a transformed measure (using the natural log) is included in the model;

Mem_Dum is a binary variable, where 1 = more than 1 member (i.e., shareholder) in the company, 0 = less than or equal to 1 member. This measure proxies for the separation of management from economic interest';

LnCreditors is the total dollar value the entity owes to its suppliers and a transformed measure (using the natural log) is included in the model, and;

LnLiabilities is the total dollar value of the entity's current and non-current liabilities and transformed measure (using the natural log) is included in the model.

The second set of logistic regression analyses were used to predict the discrete outcomes of small, foreign-owned, unlisted public, and limited by guarantee companies lodging a GPFR on the basis of the following two sets of indicative characteristics: (i) size of company, proxied by the natural logarithm of trading revenue (*lnTrading*) and the natural logarithm of total assets (*lnAssets*), and; (ii) levels of indebtedness, proxied by the natural logarithm of creditors (*lnCREDITORS*) and the natural logarithm of total liabilities (*lnLIABILITIES*). Number of employees (*LnEmployees*) and the separation of management from economic interest proxy, more than 1 member (*Mem_Dum*), were excluded from the logistic regression analyses for these four groups of companies as data for these variables are not required by ASIC and thus not disclosed in Form 388.

$$\ln\left[\frac{P}{1-P}\right] GPFR = \beta_0 + \beta_1 X_{\ln Trading} + \beta_2 X_{\ln Total\_Liabilities} + u \quad (7)$$

$$\ln\left[\frac{P}{1-P}\right] GPFR = \beta_0 + \beta_1 X_{\ln Total\_Assets} + \beta_2 X_{\ln Total\_Liabilities} + u \quad (8)$$

$$\ln\left[\frac{P}{1-P}\right] GPFR = \beta_0 + \beta_1 X_{\ln Trading} + \beta_2 X_{\ln Creditors} + u \quad (9)$$

$$\ln\left[\frac{P}{1-P}\right] GPFR = \beta_0 + \beta_1 X_{\ln Total\_Assets} + \beta_2 X_{\ln Creditors} + u \quad (10)$$

All four variables specified in equation (2) are as defined earlier in equation (1).

4. RESULTS

This section presents descriptive and univariate mean difference results comparing entities that lodge GPFRs and SPFRs with ASIC. The descriptive analysis outlines the frequency distributions of companies producing GPFRs and SPFRs among the five groups of reporting entities, while univariate independent samples *t*-tests examine mean differences on a number of indicative factors outlined in SAC 1 that proxy for the existence of a reporting entity.

4.1. Distribution of Entities Producing GPFRs and SPFRs

The overwhelming majority (i.e., around 81 per cent) of large proprietary, foreign-owned and small proprietary entities lodge SPFRs with ASIC, whereas around 68 per cent of unlisted public companies other than those limited by guarantee and public companies limited by guarantee produce GPFRs. Specifically, Table 3 shows that approximately 80 per cent of large proprietary entities produce SPFRs, while a similar portion (84 per cent) of foreign-owned companies lodge SPFRs with ASIC. Approximately 76 per cent of the small proprietary companies in the sample lodge SPFRs, while in contrast, a higher portion (around 70 per cent) of unlisted public companies lodge GPFRs. Based on our sample of public companies limited by guarantee, about 66 per cent of entities produce GPFRs.

INSERT TABLE 3

If the application of the reporting entity concept adequately distinguishes those entities for which the demand for information is highest, we would expect to see a higher proportion of firms across the five categories producing GPFRs than was actually observed. We were also surprised that a third of public companies prepared SPFRs, particularly as by definition a public company potentially has dependent users and face a greater demand for financial information. Similarly, the finding that 16 (20) per cent of foreign owned (large) entities prepare GPFRs appears to be relatively low, particularly given the size of some entities in the sample [xiv]. In order to better understand these firms' decisions regarding their reporting entity status, the next section compares the characteristics of firms preparing GPFRs and SPFRs.

4.2. Univariate Analysis of Entities Producing GPFRs and SPFRs

Indicative factors (characteristics) outlined in SAC 1 that proxy for the existence of a reporting entity, namely, trading revenue, total assets, and number of employees (i.e., proxy for size of firm), number of members or shareholders (i.e., a proxy for the separation of management from economic interest), and creditors and total liabilities (i.e., a proxy for the level of indebtedness of the firm) were compared between entities lodging a SPFR and a GPFR. The univariate analysis used independent samples *t*-tests (adjusted for unequal variances) and two-sample Wilcoxon rank-sum (Mann-Whitney) tests to examine mean and median differences on the indicative factors between the two groups. Independent samples t-tests are adjusted for unequal variances because of extreme values observed on the indicative factors. The expectation is that if entities in the sample are applying factors identified in SAC 1, there should be statistically significant differences in the mean (median) values across the sample.

Large Proprietary Entities **-** Results presented in Table 4 show that firms preparing GPFRs are significantly larger than firms preparing SPFRs as measured by trading revenue, total assets and number of employees. By way of additional analysis (not reported), because trading revenue and total assets are significantly skewed, we normalise these variables by using natural logarithmic procedures (i.e., to reduce the standard deviation) and to provide corroboration of the t-test and the Wilcoxon rank-sum test results. Results from this additional analysis confirm that firms preparing GPFRs are, on average, larger than firms preparing SPFRs.

INSERT TABLE 4

It is expected that the proxy used for the 'separation of management from economic interest', that is, number of members (shareholders) will show that with multiple members/shareholders there is potential for agency conflict, suggesting a greater demand for high quality financial reporting, possibly leading to a higher likelihood that GPFRs will be prepared. When there is only one member/shareholder, the likelihood of agency conflict is lower, suggesting a possible higher incidence of SPFRs being prepared. Results demonstrate non-significant differences between entities lodging GPFRs and SPFRs for both mean values, suggesting that the widening of separation between management and ownership/members does not impact the decision to classify as a reporting entity and lodge GPFRs. By implication, entities producing SPFRs are equally likely to have a greater spread of ownership/management and users who are dependent on information for making and evaluating resource allocation decisions. It is noteworthy that entities lodging GPFRs have significantly more directors (Mean = 5) compared with entities lodging SPFRs (Mean = 3), which suggests larger boards are more likely to require the preparation of GPFRs, probably as a result of superior corporate governance and financial reporting procedures.

According to SAC 1, another indicator of whether there is existence of users who are dependent on GPFRs is the entities' level of indebtedness. In other words, greater levels of indebtedness can indicate greater demand for financial information in making and evaluating lending decisions (Minnis, 2011; Ball and Shivakumar, 2005; Watts, 2003a) We use the total dollar value owing to creditors and the dollar value of total liabilities to proxy for the firm's 'indebtedness', which show significant mean and median differences among large proprietary firms between the GPFRs and SPFRs groups. These univariate results suggest that the type of financial statement differs with larger companies and with greater levels of indebtedness.

Foreign-Owned, Small Proprietary, Unlisted Public, and Public Companies Limited by Guarantee – Univariate results presented in Table 4 demonstrate that the decisions by these four groups of entities to classify as a reporting entity and lodge GPFRs are generally not dependent on the indicative factors outlined in SAC 1 relating to size and indebtedness. Foreign-owned, small proprietary and unlisted public companies lodging SPFRs are not significantly smaller than GOFRs firms based on trading revenue or indebtedness. In other words, the factors identified in SAC 1 which proxy for the existence of dependant users do not seem to impact the decision to produce GPFRs for these entities.

However, results for the public companies limited by guarantee cohort show variables that proxy for size (i.e., trading revenue and total assets), separation of management from economic interest (i.e., number of members), and indebtedness (i.e., creditors and liabilities) demonstrate that larger entities with greater separation of ownership from management and higher levels of debt are more likely to lodge GPFRs than SPFRs.

4.3. Logistic Regressions of Entities Producing GPFRs and SPFRs

Separate logistic regression models were estimated for the five groups of entities in our sample, to determine whether an entity is more likely to lodge a GPFR on the basis of six key variables that make up the reporting entity test as outlined in SAC 1 for large proprietary companies and on four variables for the other four groups of companies[xv]. The six indicative characteristics assessed were: (i) natural logarithm of trading revenue (*LnTrading)*; (ii) natural logarithm of total assets (*LnAssets*); (iii) natural logarithm of employees (*lnemployees*); (iv) more than 1 member (*Mem_Dum*); (v) natural logarithm of creditors (*LnCreditors*); and (vi) natural logarithm of total liabilities (*LnLiabilities*).

All logistic regression models are controlled for non-independently and identically distributed disturbance variances by estimating robust standard errors of the variance-covariance estimates (VCE) using the Huber-White sandwich estimator which, essentially, estimates conditionally heteroskedastic errors of the regression model. As some of the SAC 1 characteristics are highly correlated, suggesting possible multicollinearity concerns, we conduct six separate logistic regression models on the large proprietary company cohort using various combinations of size and indebtedness factors and four separate logistic regression models on the foreign-owned, small proprietary, unlisted public, and public companies limited by guarantee groups.

An examination of the results of the six logistic regression models for the large proprietary company cohort indicates that the predictors, as a set, adequately distinguish demand for GPFRs and SPFRs [$\chi^2 = 10.15$, df =3, $p < .05$; $\chi^2 = 16.13$, df =3, $p < .001$; $\chi^2 = 25.93$, df =3, $p < .000$; $\chi^2 = 8.40$, df =3, $p < .05$; $\chi^2 = 18.04$, df =3, $p < .001$; $\chi^2 = 16.30$, df =3, $p < .001$, respectively, for models 1 to 6], and these predictors account on average for around 7 per cent of the variance in the six models (Pseudo-R^2 ranging from .0448 to .1004). According to the

Wald criterion, *LnTrading and LnEmployees* are non-significant predictors of the decision to produce GPFRs, whereas *LnAssets*, *LnCreditors*, *LnLiabilities*[xvi] and *Mem_Dum* show to be statistically significant predictors of the preparation of GPFRs in some of the combinations of size and indebtedness factors. Notwithstanding this statistically significant result, it is important to distinguish between statistical significance and economic importance in this study (see footnote 6). Accordingly, while the models show that they significantly distinguish between companies lodging GPFRs and SPFRs, the models not only explain reporting choice around 7 per cent of the time but it is difficult to see how many of the companies lodging SPFRs were not classified as reporting entities, based on their trading revenue, total assets and number of employees (i.e., approximately 71 per cent have trading revenue of more than $25 million; 84.3 per cent have total assets that exceed $12.5 million, and; 76.1 per cent have more than 50 employees).

INSERT TABLE 5

The logistic regression results suggest that lodgement of GPFRs by large proprietary companies is not systematically dependent on size, but does seem dependent on 'separation of management from economic interest' (i.e., more than 1 member/shareholder) and level of indebtedness, suggesting that entities with more than one member/shareholder and higher levels of indebtedness are more likely to lodge GPFRs, probably in response to greater agency conflict. While around 20 per cent of large proprietary companies have classified themselves as reporting entities and univariate results show significant differences across a number of dimensions measuring 'size', 'separation of management from economic interest', and 'indebtedness', our multivariate logistic regression results show that only level of members/shareholders and in some instances indebtedness is associated with the decision by large proprietary firms to classify as a reporting entity and produce GPFRs. The existence of less powerful stakeholders such as employees and creditors do not appear to have any influence in the firm's decision as to whether to classify as a reporting entity. Differences observed between the univariate and multivariate techniques used in this study can be explained by the fact that univariate results concentrate on individual variables without relying on equating other data into the calculations. However, multivariate techniques examine multiple variables simultaneously by combining numerous variables to consider a broader impact from the data as well as controlling for the unique contribution of each indicative factor on the choice between GPFRs and SPFRs.

Logistic regression analyses were also undertaken to understand more fully the decision by foreign-owned, small, unlisted public, and public companies limited by guarantee to lodge GPFRs. Variables used in these four models are the natural logarithm of trading revenue (*LnTrading*), the natural logarithm of total assets (*LnAssets*), the natural logarithm of creditors (*LnCreditors*), and the natural logarithm of total liabilities (*LnLiabilities*). Variables measuring number of employees and number of shareholders are excluded because this information is not required by ASIC and because there are too few observations for the number of members' variable, respectively.

An examination of the results of the logistic regression models for foreign-owned, small proprietary, and unlisted public companies indicate that the predictors, as a set, do not distinguish demand for general and special purpose financial reports [see Table 5, Panels A and B, which show non-significant model chi-square results for these three groups]. Taken together, the results suggest the lodgement of GPFRs by these entities do not appear to depend on the indicative factors outlined in SAC 1. However, an assessment of the logistic regression model for the public company limited by guarantee cohort indicates that the predictors, as a set,

adequately distinguish demand for GPFRs and SPFRs [χ^2 = 20.88, df =2, p < .000; χ^2 = 23.27, df =2, p < .000; χ^2 = 22.10, df =2, p < .000; χ^2 = 25.73, df =2, p < .000, respectively]. According to the Wald criterion, lnTRADING (z = 1.78, p < .010), lnTOTAL_ASSETS (z = 2.20, p < .05), lnTOTAL_LIABILITIES (z = 2.18, p < .05) and lnCREDITORS (z = 3.31, p = .005 and z = 2.33, p < .01) are significant predictors, suggesting that both size and indebtedness appear to influence whether public companies limited by guarantee are classified as reporting entities and produce GPFRs. However, the model for the public company limited by guarantee cohort explains on average reporting choice 13.1 per cent of the time in the four models. The remaining logistic regression results suggest that lodgement of GPFRs by these entities is not dependent on any other of the indicative factors outlined in SAC 1.

In summary, the results indicate that the factors identified in SAC 1 as indicative of the existence of a reporting entity, do not systematically explain the application of the concept. Instead, for the companies in the sample, the decision to classify as a reporting entity generally appears to be driven by factors other than those identified in SAC 1.

The next section provides additional analysis on the large proprietary company group to enhance understanding of the extent of variation with which the reporting entity concept is applied.

4.4. Piecewise Logistic Regression Models on Large Proprietary Companies

Piecewise logistic regression models using b-spline smoothing techniques are specified on the large proprietary company cohort to determine whether an entity is more likely to lodge a GPFR on the basis of key indicative SAC 1 factors[xvii]. Linear b-spline smoothing is applied on the three variables which proxy for size and on the two variables which proxy for indebtedness, allowing a piecewise linear model to be assessed on the likelihood of lodging a GPFR.

There are several reasons for using linear b-spline smoothing procedures on the large proprietary company cohort. First, preliminary tests show that the size and indebtedness proxies all exhibit different incremental slopes when regressed on GPFR, indicating that these piecewise functions are not a continuous (i.e., non-linear) function of GPFR. Accordingly, linear b-spline smoothing procedures were used to create continuous regression functions by connecting various piecewise linear segments in the above-mentioned explanatory variables. Second, approximately 80 per cent of the large proprietary company sample lodge SPFRs with ASIC and thus it makes intuitive sense to compare the two lodgement groups over different ranges of firm size and indebtedness characteristics. Third, linear b-spline smoothing procedures control for non-independently and identically distributed disturbance variances (i.e., heteroskedasticity) in the regression model. Fourth, b-spline procedures are beneficial for skewed data as it restricts tails to linearity by providing a conservative estimate for the tail regions thus reducing the influence of extreme outliers [xviii] (see de Boor, 1978).

We use piecewise linear splines with three internal knots for the untransformed size proxies (i.e., size variables not subject to natural logarithmic transformations), that is, trading revenue at $25 million, $50 million, and $100 million; total assets at $12.5 million, $25 million, and $50 million, and; employees at 50, 100, and 500. Similarly, three internal knots are used for the untransformed indebtedness proxies, that is, creditors at $5 million, $10 million, and $25 million, and; total liabilities at $12.5 million, $25 million, and $50 million.

The piecewise logistic regression results provide corroboration to the results reported earlier (see section 4.3) and suggest that lodgement of GPFRs is not dependent on size, but is dependent on 'separation of management from economic interest' (i.e., more than 1 member/shareholder), suggesting that entities with more than one member/shareholder are more likely to lodge GPFRs, probably in response to greater agency conflict. Interestingly, results for total liabilities and creditors show that lower levels of indebtedness are associated with a lower likelihood of lodging a GPFR, whereas there is no statistically significant likelihood associated with higher levels of indebtedness, that is, greater than $50 million for total liabilities and greater than $25 million for creditors (see Table 6). On average, around 7.5 per cent of the variance is accounted for by the various combinations of explanatory variables in the six models (Pseudo-R^2 ranging from .0646 to .0873).

INSERT TABLE 6

The next section provides a number of anecdotes to enhance understanding of the extent of variation with which the reporting entity concept is applied.

4.5. Anecdotes of Entities Producing GPFRs and SPFRs

While empirical tests are helpful to shed light on drivers of the decision to implement the reporting entity concept, they do not fully allow an appreciation of the variation in reporting choices made. Accordingly, we augment our analysis by providing some insights through anecdotes which highlight the unpredictable application of the reporting entity concept.

Large Proprietary Entities **-** These anecdotes provide a sample of the variation observed.

(i) A management services company stated their sole business purpose was to provide administration services and staff to the wider group. The company had $100 million in assets, $16 million in trade creditors and 55 employees who were charged out to the group. This entity was not classified as a reporting entity and thus produced a SPFR;

(ii) In the sample there were 4 aged care providers, all of whom collected bonds from residents living in the entities' facilities. Three of the four companies were classified as reporting entities and produced GPFRs and one of the four indicated they were not a reporting entity and produced a SPFR. The non-reporting entity had over $23 million in resident bonds (liabilities), employed 111 staff and had $1,044,827 in trade creditors;

(iii) One example was noted of a global financial services firm producing a SPFR, whose stated activities suggest the probable impact on the welfare of external parties. In the large proprietary sample, this entity had the second largest amount of "Trade and other payables", which included $475b owed to other persons. This same company reported in note 18 that it had unsecured external borrowings (which included client segregated funds of $208b) of $2,197b. Two other entities in the same industry and with similar financial profiles produced GPFRs;

(iv) One company who indicated they only had one shareholder and 500 employees, had self-classified as a non-reporting entity. The same company reported "Trade Payables" of $244b - one of the largest amounts for companies producing a SPFR;

(v) A global engineering company was noted that it had produced a SPFR, having only one member but 4,488 employees. This company reported "Trade Payables" worth

$96b (2009) and "Amount due to customers under engineering contracts" of $160b (2009). In the Balance Sheet, the total amount of Current Trade Payables (which includes the two amounts mentioned previously) is $292b, which is one of the largest for firms producing a SPFR.

Foreign-Owned Entities **-** The following anecdotes highlight the unpredictable application of the reporting entity concept among foreign-owned entities.

(i) One example was noted of an entity which manufactures and sells aggregate, concrete, concrete pipe and concrete precast products in Australia. This entity also is commonly regarded as one of the few largest firms in its industry globally, but it classified itself as a non-reporting entity and produced a SPFR. This entity reported revenues of $1.9b and $1.7b over the 2008 and 2009 years.

(ii) In the sample there were four financial service companies who all had revenues of less than $10 million. Two of the four companies were classified as reporting entities and produced GPFRs and two indicated they were not a reporting entity and produced SPFRs. One of the non-reporting entities had over $6 million in revenues and over $150 million in assets;

(iii) Consistent with other samples, there is a discrepancy with how similar sized companies are classified. In the sample, ten companies had revenues over $100 million and assets over $50 million. Four of these companies were classified as reporting entities and produced GPFRs and six companies indicated they were not reporting entities and produced SPFRs.

Unlisted public companies **-** The following are some anecdotes from the unlisted public company cohort.

(i) One example was noted of a mining company, involved in ore and copper-gold exploration, which reported revenues of $1.8b and $1.5b over the 2007 and 2008 years and disclosed assets values of $3.3b and $2.8b over the same period. This entity had classified itself as a non-reporting entity and produced SPFRs;

(ii) In the sample there were five financial services companies who all had revenues of less than $1 million. Three of the five companies were classified as reporting entities and thus produced GPFRs, while two of the five indicated they were not reporting entities and thus produced SPFRs. One of the non-reporting entities had over $12 million in assets.

(iii) In the sample, five companies had revenues ranging between $130 million - $200 million and assets ranging between $26 million - $600 million. Two of these companies were classified as reporting entities and produced GPFRs, while three companies indicated they were not reporting entities and produced SPFR. One of the non-reporting entities had revenues of $183 million and assets of $600 million.

Public companies limited by guarantee **-** The following anecdotes highlight variation observed in the public company limited by guarantee group.

(i) In the sample there were six sport and recreation clubs who all had revenues less than $500,000. Three of the six companies were classified as reporting entities and produced GPFRs and three indicated they were not a reporting entity and produced SPFRs;

(ii) In the sample, nine companies had revenues of less than $1 million. Three of these companies were classified as reporting entities and produced GPFRs and six companies indicated they were not reporting entities and produced SPFRs. One of the non-reporting entities had revenues of $759,664 and assets of $17.4 million in comparison to one of the reporting entities that had revenues of $355,257 and assets of $356,641.

5. DISCUSSION AND CONCLUSIONS

This study provides large-scale empirical evidence on the reporting practices of for-profit private companies and not-for-profit entities in Australia. The five categories of entities lodging financial reports with ASIC are: (1) Large for-profit private entities; (2) Small proprietary companies lodging at the direction of ASIC or at the request of shareholders; (3) Foreign controlled entities; (4) Unlisted public companies other than those limited by guarantee, and; (5) Public companies limited by guarantee.

The proportion of firms classifying themselves as reporting entities and thus preparing GPFRs are as follows: 20 per cent large; 16 per cent foreign owned; 24 per cent small proprietary; 70 per cent unlisted public companies, and; 66 per cent unlisted public companies limited by guarantee. The proportion of firms preparing GPFRs across the five categories is lower than was expected. In particular, we were surprised that a third of public companies prepared SPFRs, particularly as by definition it is 'reasonable' to expect that a public company has the existence of users who are dependent on the entity's financial statements for information. Similarly, the finding that 16 per cent of foreign-owned and 20 per cent of large entities prepare GPFRs is lower than our *ex ante* expectation.

In order to better understand these firms' decisions regarding their reporting entity status, we compare whether there are systematic differences between firms preparing GPFRs and SPFRs based around the indicative factors identified in SAC 1, size, levels of indebtedness, and a proxy for agency conflict (number of shareholders). Univariate results show that while firms preparing GPFRs in the large proprietary entity cohort are significantly larger in trading revenue, total assets, and number of employees compared with firms preparing SPFRs, logistic regression results do not show systematic differences on these size variable proxies, suggesting that size is not a definitive indicative factor of reporting entity choice among the large proprietary firms. Differences on trading revenue and total assets were not observed when comparing firms preparing GPFRs and SPFRs for the foreign owned, small proprietary and unlisted public company cohorts in both the univariate and logistic regression results. Whereas firms preparing GPFRs in the public company limited by guarantee cohort show they are significantly larger in trading revenue compared with firms preparing SPFRs in the univariate results, but not in the logistic regression results.

Our proxies for the firm's level of 'indebtedness', creditors and total liabilities, show significant mean and median differences between firms preparing GPFRs and SPFRs among the large proprietary and public companies limited by guarantee cohorts, but non-significant mean and median results are observed among the foreign owned, small proprietary and unlisted public company groups. However, logistic regression results demonstrate that the only significant result for 'indebtedness' is on 'total liabilities' and 'creditors' in the public company limited by guarantee cohort. This result suggests that firms' assessment of their reporting entity status, particularly among the for-profit company groups, is not influenced by the level of indebtedness. Further, anecdotal evidence suggests that neither creditors or employees influence the firms' decision as to their reporting entity status.

Confined to the large proprietary company cohort because of limited data availability, results for number of members, our proxy for the separation of management from economic interest demonstrate non-significant mean and median differences between entities lodging GPFRs and SPFRs. However, a transformed binary variable of number of members which categorises members into two groups (i.e., 1 = more than one member; 0 = less than and equal to one member) loads significantly in the regression model, suggesting that the widening of separation between management and ownership does have some impact on the decision by large proprietary companies to classify as a reporting entity. By implication, entities producing SPFRs are equally likely to have a greater spread of ownership/management and users who are dependent on information for making and evaluating resource allocation decisions.

In summary, both logistic regression and piecewise regression results indicate that measures which proxy for the factors identified in SAC 1 as indicative of the existence of a reporting entity, do not systematically and adequately explain the application of the concept. A number of anecdotes provide corroboration of the extent of variation with which the reporting entity concept is applied.

The results appear to support ASIC's concerns expressed in Regulatory Guide 85 (2005) concerning the inconsistent application of the reporting entity concept. More importantly, as all financial report lodgements with ASIC are required to be audited, our empirical investigation suggests variation in the attitudes of auditors toward the application of the reporting entity concept, providing some support to the suggestion that the benefits of principles-based regulations may be oversold (Walker, 2007).

Subjectivity associated with the principles-based approach to company's determination of their reporting entity status creates a problem for monitoring compliance. The finding of no systematic differences between firms preparing GPFRs and SPFRs based around the indicative factors identified in SAC 1, highlights the subjective nature of the reporting entity concept. In the absence of systematic patterns of disclosure or quantitative tests for the application of the reporting entity concept, it is difficult to know how regulators might enforce compliance in future. Only time will tell whether policy makers will re-consider the relevance of the reporting entity concept, or alternatively whether tighter tests are contemplated to standardise its application. Developing an appropriate regulatory solution to address this balance will be complex (Benston et al. 2006; Schipper, 2003).

From this study, there are a number of interesting avenues for further research. One such avenue is to develop an enhanced understanding of the implications of the reporting choice made by firms on the quality of information reported. There is a well developed literature which positions financial reports as economic goods whose quality is a function of user demand (e.g. Ball, Kothari and Robin, 2000; Ball, Robin and Wu, 2003; Ball and Shivakumar, 2005). If the reporting entity concept is applied as intended by regulators, those entities for which there is greater demand for financial information should produce full GAAP-based financial statements, which in turn should be of higher quality. Any future work which seeks to document empirically the quality of the financial reports of these entities will inform future deliberations by regulators.

Second and related, there is opportunity to explore more deeply the costs and benefits associated with producing full-GAAP based financial statements for these entities. *Prima facie*, there is a presumption that the preparation of full GAAP-based financial reports will lead to an improvement in the measurement of the economic performance of the entities involved. Proponents of this view argue that accrual-based reports enable greater efficiencies in both the

allocation of scarce economic resources and in the contracting relationships formed by the entities involved (Ball, 2006). Notwithstanding these claimed benefits, the usefulness and economic benefits of applying existing GAAP to these smaller entities continues to be debated vigorously (see, for example, FASC 2006). Research which addresses such issues will enhance the existing understanding of the reporting practices of these socially and economically important entities.

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Table 1: For-profit private and not-for-profit entities lodging financial reports with ASIC in 2010-11 and 2008-09

Type of Entity	**Population 2010-11**	**Population 2008-09**	**Sample 2008-09**
Large proprietary companies (non-disclosing entities)	6,339	5,097	394[a]
Small proprietary companies controlled by a foreign company	2,797	2,237	340
Small proprietary companies - financial report requested by ASIC	186	131	95
Unlisted public companies other than those limited by guarantee	3,985	3,884	347
Public companies limited by guarantee (i.e., large clubs)	8,404	9,673	370
Total:	**21,711**	**21,022**	**1,546**

[a] Our initial sample for the large proprietary group was 357 entities. Due to additional data provided by ASIC to alleviate missing company lodgements and gaps in company year observations, our sample was increased by 37 companies.

Table 2. Summary Statistics for the Five Groups of Entities

Large Proprietary	N	Mean $million	Median $million	SD $million	Skewness	Kurtosis	Min $million	Max $million
Trading	336	$162.0	$45.9	$589.0	9.707665	107.8854	0	$7,480.0
Total Assets	372	$341.0	$39.7	$1,530.0	9.244323	100.7384	0	$20,100.0
Employees	333	321.2	102	802.8	6.107729	49.5714	0	7879
Members	334	2.9	1	5.7	6.566147	52.63986	0	58
Creditors	342	$84.6	$8.9	$318.0	7.467432	68.82485	0	$3,670.0
Liabilities	372	$221.0	$24.0	$879.0	7.797708	72.62271	0	$9,730.0
Foreign-Owned								
Trading	211	$25.3	$5.6	$134.0	12.80538	175.9596	0	$1,880.0
Total Assets	317	$32.3	$4.5	$139.0	11.61856	166.7227	0	$2,130.0
Employees	4	1.3	1	1.3	0.652024	2.096953	0	3
Members	33	13.7	0	37.3	3.263687	12.54603	0	164
Creditors	267	$7.4	$0.899	$30.2	9.806802	113.4847	-$1.8	$390.0
Liabilities	317	$15.2	$2.1	$50.5	6.584861	51.8674	-$5.9	$474.0
Small Proprietary								
Trading	81	$39.0	$2.2	$176.0	7.231339	57.70807	0	$1,470.0
Total Assets	91	$74.8	$2.4	$327.0	5.841023	37.73222	0	2$,370.0
Employees	11	21.1	0	31.8	0.958719	2.218994	0	80
Members	1	4	4	.	.	.	4	4
Creditors	85	$28.1	$0.184	$236.0	9.046611	82.89838	0	$2,180.0
Liabilities	91	$60.3	$1.03	$313.0	6.52604	44.94131	0	$2,370.0
Unlisted Public								
Trading	230	$210.0	$2.0	$1,590.0	11.71206	149.5831	-$17.0	$21,500.0
Total Assets	319	$390.0	$4.0	$2,060.0	9.253415	104.0227	0	$26.7
Employees	0	.	.	.	.	.	.	.
Members	0	.	.	.	.	.	.	.
Creditors	280	$116.0	$0.804	$572.0	6.469509	48.21831	0	$5,310.0
Liabilities	319	$305.0	$1.2	$1,860.0	10.28335	122.267	0	$24,900.0
Limited By Guarantee								
Trading	212	$3.3	$0.328	$15.6	9.333235	97.03379	0	$180.0
Total Assets	353	$7.8	$0.616	$40.6	11.2763	148.3151	0	$599.0
Employees	8	50.6	4	89.4	1.61564	4.147198	0	250
Members	143	731.4	29	1919.1	3.839735	18.61505	0	12464
Creditors	317	$0.851	$0.070	$3.6	9.439491	102.7543	0	$42.0
Liabilities	353	$3.3	$0.117	$18.8	10.45765	127.1911	0	$265.0

Table 3. Distribution of Entities Lodging GPFR versus SPFR with ASIC

	Large Proprietary Companies		Foreign-Owned Companies		Small Proprietary Companies		Unlisted Public Companies		Limited by Guarantee Companies		Row Totals	
	Freq.	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**	**Freq.**	**Percent**
GPFR	79	20.1	53	15.6	23	24.2	242	69.7	239	66.0	636	41.4
SPFR	315	79.9	287	84.4	72	75.8	105	30.3	123	34.0	902	58.6
Total	394	100.0	340	100.0	95	100.0	347	100.0	362*	100.0	1,538*	100.0

*We were unable to determine the type of report lodged for eight limited by guarantee companies. In addition, for two of these entities financial statement data were missing.

Table 4. Univariate Tests on Indicative Factors

		Large Proprietary Companies		Foreign-Owned Companies		Small Proprietary Companies		Unlisted Public Companies		Limited by Guarantee Companies	
		GPFR $million	**SPFR $million**	**GPFR $million**	**SPFR $million**	**GPFR $million**	**SPFR $million**	**GPFR $million**	**SPFR $million**	**GPFR $million**	**SPFR $million**
Trading	**Mean**	$312	$125***	$20.9	$23.3	$7.8	$48.1	$231	$54.4	$4.8	$0.313**
	Median	$64.5	$43.5***	$3.6	$5.8	$1.1	$3.4	$2.4	$0.361**	$0.666	$0.037***
Total Assets	**Mean**	$821	$199**	$36.1	$31	$4.6	$94.4*	$461	$162	$8.2	$6.7
	Median	$78.1	$34.1***	$3.7	$4.3	$1.3	$4.8	$3.3	$2.4	$1.3	$0.113***
Employees	**Mean**	592	243***	-	-	-	-	-	-	-	-
	Median	146	103**	-	-	-	-	-	-	-	-
Members	**Mean**	4	3	23	5	-	-	-	-	928	102***
	Median	1	1	3	0*	-	-	-	-	68	9
Creditors	**Mean**	$168	$58.4***	$10.7	$6	$1.9	$34.6	$128	$38.2*	$0.953	$0.638
	Median	$26.8	$8.3***	$0.720	$0.910	$0.150	$0.234	$0.679	$0.281	$0.124	$0.007***
Liabilities	**Mean**	$476.1	$143***	$21.2	$12.4	$2.7	$76.4*	$384	$69.9*	$3.8	$2.3
	Median	$46.1	$19.4***	$2.5	$2.1	$0.311	$3.1*	$1.1	$0.588	$0.272	0.013**

t-tests are adjusted for unequal variances and two-sample Wilcoxon rank-sum (Mann-Whitney) tests on median differences are also conducted. Variables that proxy for 'size' and 'indebtedness' were normalised by using natural logarithmic (not reported in Table 2) procedures to provide corroboration of the *t*-test and the Wilcoxon rank-sum test results.

*, **, ***, significant at the thresholds of 5%, 1% and 0.1%, respectively.

Table 5. Logistic Regression Results on SAC1 Indicative Factors

Panel A	Large Proprietary Companies	Foreign-Owned Companies	Small Proprietary Companies	Unlisted Public Companies	Limited by Guarantee Companies
LnTrading	1.082613	.9518536	. .7512221	1.016243	1.182084
	(0.66)	(-0.36)	(-1.11)	(0.24)	(1.78)*
Mem_Dum	1.808579	-	-	-	-
	(1.89)*				
LnTotal_Liabilities	1.31421	1.036143	1.017469	1.01861	1.293926
	(2.45)**	(0.27)	(0.09)	(0.29)	(2.18)**
Constant	.0004539	.2714124	19.25787	1.790412	.0190697
	(-3.39)***	(-0.73)	(1.40)	(0.74)	(-3.46)***
N	291	220	68	204	184
Wald χ^2	10.15**	0.13	3.84	0.45	20.88***
Psuedo-R^2	0.0574	0.0007	0.0495	0.0019	0.1379
LnTotal_Assets	1.34982	1.113944	1.056536	1.03442	1.277201
	(1.81)*	(1.45)	(-1.42)	(0.40)	(2.20)**
Mem_Dum	1.751415	-	-	-	-
	(1.86)*				
LnTotal_Liabilities	1.083938	.9652582	.7646949	1.005813	1.122397
	(0.57)	(-0.42)	(1.64)	(0.08)	(1.34)
Constant	.0002379	.059106	6.161114	1.435325	.0238224
	(-4.60)***	(-2.39)**	(1.27)	(0.56)	(-3.68)***
N	330	308	88	305	309
Wald χ^2	16.13***	2.24	6.93**	1.00	23.27***
Psuedo-R^2	0.0665	0.0070	0.0619	0.0028	0.1022
LnEmployees	1.074273	-	-	-	-
	(0.69)				
Mem_Dum	2.060196	-	-	-	-
	(2.18)**				
LnTotal_Liabilities	1.556757	-	-	-	-
	(4.39)***				
Constant	.0000591	-	-	-	-
	(-5.60)***				
N	270	-	-	-	-
Wald χ^2	25.93***	-	-	-	-
Psuedo-R^2	0.1004	-	-	-	-

The regression coefficients are the odds ratios associated with the probability of lodging a GPFR and the associated *z*-values are shown in parentheses.

*, **, ***, significant at the thresholds of 10%, 5%, and 1%, respectively.

Table 5 (continued). Logistic Regression Results on SAC1 Indicative Factors

Panel B	Large Proprietary Companies	Foreign-Owned Companies	Small Proprietary Companies	Unlisted Public Companies	Limited by Guarantee Companies
LnTrading	1.180059	.9392423	.6954004	1.060919	1.141477
	(1.06)	(-0.48)	(-1.57)	(0.85)	(1.47)
Mem_Dum	1.760015	-	-	-	-
	(1.86)*				
LnCreditors	1.177187	1.014482	1.143885	.9643775	1.480273
	(1.61)	(0.13)	(0.73)	(-0.55)	(3.31)***
Constant	.0008062	.4748016	12.80645	2.053993	.0086283
	(-2.83)***	(-0.42)	(1.12)	(0.93)	(-3.69)***
N	279	215	63	201	175
Wald χ^2	8.40**	0.25	2.94	0.73	22.10***
Psuedo-R^2	0.0448	0.0014	0.0465	0.0029	0.1641
LnTotal_Assets	1.546785	1.064728	.823804	1.056495	1.203718
	(3.23)***	(0.88)	(-1.36)	(0.74)	(1.60)
Mem_Dum	1.874772	-	-	-	-
	(2.06)**				
LnCreditors	.994476	1.035674	1.037959	1.016322	1.276171
	(-0.06)	(0.55)	(0.27)	(0.25)	(2.33)**
Constant	.0000926	.0472966	3.282564	.9038874	.0150742
	(-4.77)***	(-2.54)**	(0.79)	(-0.14)	(-3.79)***
N	302	288	78	287	289
Wald χ^2	18.04***	1.50	2.87	2.53	25.73***
Psuedo-R^2	0.0784	0.0065	0.0235	0.0079	0.1197
LnEmployees	1.142856	-	-	-	-
	(1.21)				
Mem_Dum	1.682036	-	-	-	-
	(1.62)				
LnCreditors	1.393523	-	-	-	-
	(3.23)***				
Constant	.0004921	-	-	-	-
	(-4.48)***				
N	257	-	-	-	-
Wald χ^2	16.30***	-	-	-	-
Psuedo-R^2	0.0745	-	-	-	-

The regression coefficients are the odds ratios associated with the probability of lodging a GPFR and the associated *z*-values are shown in parentheses.
*, **, ***, significant at the thresholds of 10%, 5%, and 1%, respectively.

Table 6. Piecewise Logistic B-Spline Regression Results on SAC1 Indicative Factors

Panel A	**Large Proprietary Companies**	**Panel B**	**Large Proprietary Companies**	**Panel C**	**Large Proprietary Companies**
Trading1	.7105423	**Total_Assets1**	.4884276	**Employees1**	.6166599
	(-0.77)		(-0.95)		(-1.13)
Trading2	.7823625	**Total_Assets2**	1.191702	**Employees2**	.5417767
	(-0.57)		(0.29)		(-1.15)
Trading3	.7492247	**Total_Assets3**	.6270041	**Employees3**	.5175122
	(-0.63)		(-0.88)		(-1.56)
Mem_Dum	1.836794	**Mem_Dum**	1.684971	**Mem_Dum**	1.785038
	(2.01)**		(1.80)*		(1.96)**
Total_Liabilities1	.3665983	**Total_Liabilities1**	.3750198	**Total_Liabilities1**	.3608369
	(-2.30)**		(-1.59)		(-2.64)***
Total_Liabilities2	.2226827	**Total_Liabilities2**	.2500522	**Total_Liabilities2**	. .2221344
	(-2.83)***		(-2.16)**		(-2.97)***
Total_Liabilities3	.5792046	**Total_Liabilities3**	.779426	**Total_Liabilities3**	.6957493
	(-1.31)		(-0.52)		(-0.91)
Constant	. 4770345	**Constant**	.4258289	**Constant**	.6226368
	(-2.71)***		(-3.82)**		(-1.39)
N	301	**N**	334	**N**	326
Wald χ^2	20.46***	**Wald χ^2**	23.35***	**Wald χ^2**	23.33***
Psuedo-R^2	0.0646	**Psuedo-R^2**	0.0671	**Psuedo-R^2**	0.0688

The regression coefficients are the odds ratios associated with the probability of lodging a GPFR and the associated *z*-values are shown in parentheses.
*, **, ***, significant at the thresholds of 10%, 5%, and 1%, respectively.

Table 6 (continued). Piecewise Logistic B-Spline Regression Results on SAC1 Indicative Factors

Panel D	**Large Proprietary Companies**	**Panel E**	**Large Proprietary Companies**	**Panel F**	**Large Proprietary Companies**
Trading1	.5943761	**Total_Assets1**	.1675252	**Employees1**	.5121838
	(-1.06)		(-2.17)**		(-1.47)
Trading2	.6091874	**Total_Assets2**	.6248345	**Employees2**	.3565462
	(-1.10)		(-0.96)		(-1.90)*
Trading3	.640453	**Total_Assets3**	.5144387	**Employees3**	.4318588
	(-0.97)		(-1.43)		(-1.93)*
Mem_Dum	1.868278	**Mem_Dum**	1.797659	**Mem_Dum**	1.96524
	(2.04)**		(1.96)*		(2.21)**
Creditors1	.5036568	**Creditors1**	.6283472	**Creditors1**	.4209516
	(-1.56)		(-1.01)		(-2.32)**
Creditors2	.2605645	**Creditors2**	.3779114	**Creditors2**	.274126
	(-2.49)**		(-1.78)*		(-2.66)***
Creditors3	.246373	**Creditors3**	.2943341	**Creditors3**	.2252022
	(-2.91)***		(-2.39)**		(-3.13)***
Constant	.5841388	**Constant**	.5330851	**Constant**	.8950394
	(-1.92)*		(-2.66)***		(-0.30)
N	286	**N**	306	**N**	298
Wald χ^2	23.06***	**Wald χ^2**	28.75***	**Wald χ^2**	26.96***
Psuedo-R^2	0.0752	**Psuedo-R^2**	0.0873	**Psuedo-R^2**	0.0842

The regression coefficients are the odds ratios associated with the probability of lodging a GPFR and the associated *z*-values are shown in parentheses.
*, **, ***, significant at the thresholds of 10%, 5%, and 1%, respectively.

NOTES

[i] For example, there are approximately two million small-to-medium size private businesses in Australia, representing around 99 per cent of all actively trading businesses and employing approximately 60 per cent of all private sector employment (Commonwealth of Australia, 2011). Similarly, in the US there are approximately 29 million private and not-for-profit companies, representing about 99 per cent of all employer firms, employing more than 50% of all private sector employees (Allee and Yohn, 2009). Accordingly, accounting regulators identify the importance of entities in the sector for job creation, entrepreneurialism, and the overall vitality of the nation's economy (FASB/AICPA, 2006).

[ii] Examples of exceptions include entities categorised as 'disclosing entities', cooperatives and charitable organisations, which all have their financial reporting obligations shaped by various regulations and legislation.

[iii] It is noted that the case for providing additional rules to shape the implementation of a principles-based standards is generally complex. According to Schipper (2003) for example, while the inclusion of scope exceptions and alternative treatments can assist in meeting constituent concerns and avoid conflicts with other regulations, the impact on the comparability, relevance and reliability of the information is not yet clear (see also Nelson, 2003; Benston et al. 2006).

[iv] For example, Allee and Yohn (2009) use logistic regression analyses to compare the characteristics of privately held small businesses in the US that choose to produce and use financial statements with those that do not. They find that size of firm, firm growth, and limited liability organizational form are associated with demand for financial statements, providing corroboration of the usefulness of GAAP-based financial statements for these entities.

[v] In this study it is important to distinguish between statistical significance and economic importance (see Ziliak and McCloskey, 2004; McCloskey and Ziliak, 1996). For example, our results reveal that approximately 71 per cent of large proprietary companies lodging a special purpose financial report have trading revenue of more than $25 million; 84.3 per cent have total assets that exceed $12.5 million, and; 76.1 per cent have more than 50 employees.

[vi] The results also appear to support ASIC's concerns expressed in Regulatory Guide 85 (2005) concerning the inconsistent application of the reporting entity concept. An implication is that there is fundamental variation in the understanding of the essence and application of the reporting entity concept among practitioners.

[vii] SAC 1, paragraph 33, by implication explains that a SPFR is a financial report other than a general purpose financial report (AARF/AASB, 1990). Deegan (2012) defines a SPFR more specifically as "a financial statement designed to meet the needs of a specific group or to satisfy a specific purpose" (p.5).

[viii] For the reports examined in the study, both GPFRs and SPFRs were required to be prepared based in line with recognition and measurement approaches and techniques embedded throughout accounting standards.

[ix] Australian Accounting Standards incorporate International Financial Reporting Standards.

[x] AASB 1048 is the means by which interpretations are made applicable under the Corporations Act 2001. The Interpretations apply to particular types of entities only to the extent stipulated in those interpretations.

[xi] In interpreting the results relating to the application of the reporting entity concept, it is noted that the concept is not mandatory for preparers of financial reports, but applies only to members of the professional accounting bodies in Australia under the 'professional standard' APES 205 *Conformity with Accounting Standards*.

[xii] Due to data constraints, we were unable to stratify the sample beyond entity type. While the sample is generalisable across the five types of entities characterised in this study, the possibility exists that it may not be generalisable across entities of all sizes and industries.

[xiii] 'Grandfathered' is a legal term used to describe a situation in which an old regulation continues to apply to some existing situation. In this case, a 'grandfathered' proprietary company is a company that was formerly granted an exemption from lodging an audited financial report based on criteria in s319(4) of the *Corporations Act*, that is, the company continues to meet the 'exempt proprietary company' definition at all times since 30 June 1994; the company was 'large' at end of first financial year ending after 9 December 1995; the company had the financial report audited for 1993 and each subsequent year; the company lodged notice within 4 months of the end of the first financial year ending after 9 December 1995.

[xiv] The alternative view is that since principles-based regulations may not yield consistent reporting choices, particularly where the responsibility for compliance continues to rest with report preparers, the result should not be surprising at all (Walker, 2007).

[xv] As data for two variables, number of employees (Employees) and more than 1 member (Mem_Dum), were unavailable in Form 388 for the four groups of companies, these two variables were excluded from the analyses.

[xvi] *LnLiabilities* was replaced with *Gearing*, that is, a variable measuring total liabilities/total assets. Using any combination of size factors, the variable *Gearing* did not significantly distinguish demand for general and special purpose financial reports.

[xvii] Piecewise logistic regressions are not conducted on the foreign-owned, small proprietary and unlisted public company groups because these models do not distinguish demand for general and special purpose financial reports. As the public company limited by guarantee group shows that size and indebtedness are linear functions of GPFR, it is unnecessary to conduct a piecewise logistic regression on this group of companies.

[xviii] The size and indebtedness proxies exhibit statistically significant skewness due to extreme outlier values in all the variables.