Disclosure of subsidiary information

KPMG submission

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Executive summary

As a leading professional services firm, KPMG Australia (KPMG) is committed to meeting the requirements of all our stakeholders – not only the organisations we audit and advise, but also employees, governments, regulators and the wider community. We strive to contribute to the debate that is shaping the Australian economy and welcome the opportunity to respond to Treasury's disclosure of subsidiary information consultation.

Financial statements may not be the most appropriate place for the proposed disclosure of subsidiary tax residency information. Given the direction of tax transparency reporting in Australia, it would seem to make more sense for the disclosure of tax residency information to be included as part of the proposed new public country-by-country reporting framework.

As an overall comment, we have concerns on whether placing this information in the financial statements is the appropriate place for this information. Financial statements generally focus on information that the users of financial statements find useful in understanding an entity's financial position, performance and cash flows. By necessity, information in financial statements is based on a materiality concept – otherwise the financial statements could be hundreds of pages long. Users would not be able to 'see the woods from the trees.'

If the financial statements needed to include information for each entity held within the group, then this would easily add multiple pages to most listed entity financial statements. The information present would also lack the necessary context around the purpose or usefulness of the information (for example, merely listing entities that have a non-Australian tax residency would not provide any context that the entity could be dormant or immaterial to the wider group or the level of taxes paid).

Given the direction of tax transparency reporting in Australia is that of the Global Reporting Initiative standard GRI 207 - as set out in the public country-by-country (CbC) draft legislation released on 6 April 2023 – we suggest Treasury consider whether the disclosure of tax residency information would be more appropriate to include as part of the proposed new public CbC reporting framework (with the additional disclosure limited to Australian public companies). In the event the public CbC reporting framework does not apply to an organisation (because annual global income is less than A$1 billion), we would suggest in such cases the tax residency of entities be disclosed through some type of statement as part of the tax return process or a tax transparency report.

If you would like to discuss the contents of this submission further, please do not hesitate to reach out to Michael Voogt, Jenny Wong or Alia Lum.

Yours sincerely,

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Background

About KPMG

KPMG is a global organisation of independent professional firms, providing a full range of services to organisations across a wide range of industries, governments and not-for-profit sectors. We operate in 146 countries and territories and have more than 227,000 people working in member firms around the world. In Australia, KPMG has a long tradition of professionalism and integrity combined with our dynamic approach to advising clients in a digital-driven world.

Section 1:
KPMG recommendations

RECOMMENDATION 1:

KPMG recommends the disclosure of tax residency information be included as part of the proposed new public CbC reporting framework (with the additional disclosure limited to Australian public companies) instead of the financial reports of the consolidated group governed by the Corporations Act 2001. In the event the public CbC reporting framework does not apply to an organisation, we would suggest the tax residency of entities be disclosed through some type of statement as part of the tax return process or a tax transparency report.

RECOMMENDATION 2:

The exposure draft is unclear in relation to whether the information needs to be presented both in half-year and full year financial statements for an entity. KPMG considers that requiring this information for half-year statements would not be practical, given the condensed nature of these statements.

RECOMMENDATION 3:

KPMG recommends greater clarity be provided on whether the exposure draft is intended to apply to companies limited by guarantee, no liability companies, and registered foreign companies. Treasury should also consider how branches fit into these requirements, given they may not be considered ‘subsidiaries’ under Australian Accounting Standards.

RECOMMENDATION 4:

Given the disclosure of subsidiary information is proposed for inclusion in the Corporations Act rather than Australian Accounting Standards, consideration will need to be given to reframing statutory audit opinions in Australia. This issue will require consideration by the Auditing and Assurance Standards Board (AUASB).

RECOMMENDATION 5:

KPMG considers it would not be reasonable to impose a requirement for a director’s judgement to be stated as ‘correct’. In our view, there should be liaison on this issue with the AUASB as to the impact on the audit report if this requirement was implemented.

RECOMMENDATION 6:

KPMG recommends the wording in Section 295(3A)(v) is made clearer to avoid different interpretations. One suggestion is to refer to ‘consolidated group’ instead of ‘public company’.

Section 2:
KPMG insights

Specific comments

We set out below some additional issues arising from the Disclosure of Subsidiary Exposure Draft (ED) legislation that would be worthwhile for Treasury to address.

PUBLIC COUNTRY-BY-COUNTRY DRAFT LEGISLATION

Treasury recently released Exposure Draft legislation: *Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Multinational tax transparency – tax changes* (Public CbC ED) on new tax transparency measures for multinational entities to prepare for public release certain tax information on a country-by-country basis and a statement on their approach to taxation. The approach in applying the public CbC tax disclosure rules in Australia under the proposals in the exposure draft broadly follows that of the GRI 207 standard. The way the current legislation is drafted is that it draws on the key tax data components of GRI 207-4 to be reported on a CbC basis (see proposed 3D(6) of the Taxation Administration Act 1953). One element that is in the GRI 207-4 standard and not in the current Public CbC ED is the requirement to disclose "all tax jurisdictions where the entities included in the organisation's audited consolidated financial statements, or in the financial information filed on public record, are resident for tax purposes." The GRI 207-4 standard requires the determination of 'tax residency' of entities and the reporting of tax data of those jurisdictions where the entities included in the audited consolidated financial statements are residents for tax purposes.

Given Australia's new public CbC framework is seeking to closely align with GRI 207-4, it would be a consistent approach to require tax residency to be disclosed under the public CbC framework instead of the financial reports of the consolidated group governed by the Corporations Act 2001.

Disclosing the tax residency of entities as part of the public CbC reporting would ensure all the relevant tax related information is in the one tax transparency report of the organisation, providing external stakeholders with a more complete and holistic context of an organisation's disclosure of its tax affairs.

From a compliance perspective, reporting tax related information in the same reporting cycle of public CbC tax reporting instead of a separate annual reporting process would streamline the resources required and process for pulling this information together to meet the disclosure requirements.

The additional requirement to disclose tax residency should be limited to Australian public companies to align with the previous announced scope of this measure. We do acknowledge that the public CbC would generally apply to multinational groups with annual global income of A$1 billion or over, and the Disclosure of subsidiary information exposure draft is intended to apply broader scope of entities including those multinational enterprises with an annual global income less than A$1 billion. We would suggest in those cases the tax residency of entities be disclosed through some type of statement as part of the tax return process or a tax transparency report.

FINANCIAL STATEMENTS MEANING

The drafted requirement in Section 295(3A) of the exposure draft is for a company's 'financial statements.' Section 295 and section 303 of the Corporations Act define the meaning of 'financial statements.' The exposure draft is unclear in relation to whether the information needs to be presented both in half-year and full year financial statements for an entity. If it is required to be presented in both half-year and full year statements, KPMG considers this would not be in line with the approach for half-year financial statements.

Half-year financial statements are condensed and refer back to the full year financial statements for details of significant accounting policies. The level of disclosure in half-year financial statements is significantly reduced from the full year financial statements. Half-year disclosure requirements are set out in AASB 134 Interim Financial Reporting.

PUBLIC COMPANIES

The requirement in the exposure draft is for public companies. Under the Corporations Act public companies are companies other than proprietary companies.

It is unclear on whether the exposure draft is to be applied to companies limited by guarantee, no liability companies, and registered foreign companies. If the intention is for the proposals in the exposure draft to apply to these entities, this policy intention needs to be clarified in the proposed law.

Another issue that arises is how branches fit into these requirements, given that technically they may not be considered 'subsidiaries' under Australian Accounting Standards.

AASB 1054 v. CORPORATIONS ACT

If the information 'must' be presented in financial statements, a question arises as to whether consideration has been given to the requirement to disclose in AASB 1054 Australian Additional Disclosures instead of the Corporations Act. We note that other Australian-specific disclosure requirements (for example, franking credit information) is prescribed in AASB 1054 for disclosure.

The inclusion in Australian Accounting Standards would assist with any audit report requirements (discussed below).

AUSTRALIAN ACCOUNTING STANDARDS v. CORPORATIONS ACT

By including the proposed disclosure requirements in the Corporations Act, this has implications for the statutory audit opinion illustrated and required by Australian Auditing Standards. The current audit opinion is framed in the context of subject matter being 'in accordance with the Corporations Act 2001, including:

- giving a true and fair view of the Group's financial position as at 30 June 2022 and of its financial performance for the year ended on that date; and
- complying with Australian Accounting Standards and the Corporations Regulations 2001'

Given this disclosure is proposed for inclusion in the Corporations Act rather than Australian Accounting Standards, consideration will need to be given to reframing statutory audit opinions in Australia, which is not as simple as adding another bullet point to cover the specific disclosure.

This issue will require consideration by the Auditing and Assurance Standards Board (AUASB).

TRUE AND CORRECT

The proposed section 295(4)(d) of the Corporations Act 2021 in the exposure draft states the directors must provide a director's opinion on whether the consolidated entity statement required under (3A) is 'true and correct'. It is unclear what 'correct' means. It is not a term that is used in Auditing Standards, which uses the phrase 'true and fair'. It is also not a term that is used in the Corporations Act, which also uses the term 'true and fair view'. Elsewhere in the directors' declaration, the directors state there is 'reasonable grounds to believe'.

KPMG considers it would not be reasonable to impose a requirement on a director's judgement to be stated as 'correct'. The determination of tax residency will not always be clear cut, particularly given we are still awaiting amendments to the law on the definition of corporate residency following the Board of Taxation's review.[1] The previous government proposed amendments to the existing legislation to clarify the position so that a foreign incorporated company only will be treated as an Australian tax resident if it has a 'significant economic connection to Australia'. Following the change of government, it remains unclear whether this proposal will proceed. If the measure is enacted as originally announced, this test will be satisfied where both the company's core commercial activities are undertaken in Australia and its central management and control is in Australia. The measure, if enacted as proposed, will have effect from the first income year after the enabling legislation is enacted; however, taxpayers will have the option of applying the new law from 15 March 2017.

[1] https://taxboard.gov.au/consultation/corporate-tax-residency-review

Given this context, it is questionable whether directors would be able to opine that the tax residency of a subsidiary is 'true and correct'.

In our view, there should be liaison with the AUASB as to the impact on the audit report. Auditors would need to consider what type of audit report they can give on 'correct' if this legislation is enacted as is. In some circumstances, the auditor may not be able to provide a report as an audit statement about 'correct' may not be in the form of an opinion. This will result in increased complexity around financial statements and the responsibilities of an auditor reporting on them.

PART OF CONSOLIDATED ENTITY

KPMG considers that the meaning of 'each entity that was, at the end of the financial year, part of the consolidated entity' is unclear. This would include subsidiaries as defined by AASB 10. The Corporations Act or Australian Accounting Standards do not define 'part of' and as such, it is unclear whether an associate entity, an interest in a joint operation, or an interest in an entity that is accounted at fair value (under IFRS 9 Financial Instruments) be included within this scope of the consolidated entity. The language in Australian Accounting Standard is a reference to 'subsidiaries.'

WORDING OF PROPOSED SECTION 295(3A)(a)(v)

The wording in proposed Section 295(3A)(a) of the Corporations Act 2001 will result in all direct and indirect subsidiaries being included on the list of entities in the consolidated entity.

The way that Section 295(3A)(v) is currently drafted requires an interpretation of the words 'held by the public company'. There are two possible readings of this phrase:

– *Literal reading* – which would mean information required by (v) is only provided for direct (body corporate) subsidiaries.

This means indirect subsidiaries would be left blank or not applicable – and potentially would be confusing to the financial statement users)

– *Context reading* – which would mean the inclusion of information required by (v) for all direct and indirect (body corporate) subsidiaries.

This would mean seem to be the intended meaning of the drafting.

Either way, as a matter of 'good drafting', KPMG recommends that the requirement be made clearer to avoid different interpretations. One suggestion is to refer to 'consolidated group' instead of 'public company'.

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