Australian Government
Australian Accounting Standards Board

13 July 2010

An update on the Differential Reporting Project

The first stage is now complete

To conclude the first stage of revisions to the differential reporting framework, AASB 1053 *Application of Tiers of Australian Accounting Standards* and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements* were issued on 30 June 2010. See paragraph 9 below regarding application dates.

Background to issuance of Stage 1 Standards

1. The AASB issued ED 192 *Revised Differential Reporting Framework* and its related Consultation Paper *Differential Financial Reporting – Reduced Disclosure Requirements* on 26 February 2010. The closing date for comment for both documents is 23 April 2010.

2. Public Roundtable discussions were held on 5 May 2010 in Sydney and 7 May 2010 in Melbourne.

3. The Board began redeliberating its ED 192 proposals for a revised differential reporting framework at the April 2010 meeting in the light of feedback received from its constituents through comment letters and Roundtable discussions.

4. At the May 2010 meeting, the Board decided that revisions to the differential reporting framework should be made in two stages. In the first stage, the Reduced Disclosure Requirements should be introduced as a second Tier of reporting requirements for preparing general purpose financial statements. The Board noted that the aim of this stage is to attend to the immediate reporting needs of entities that currently apply full IFRSs as adopted in Australia but find the disclosures under full IFRSs as adopted in Australia burdensome.

5. In the second stage the other proposals of ED 192, including clarification of the meaning of general purpose financial statements and the change of application focus of AASB Standards from 'reporting entity' to 'general purpose financial statements', will be further considered.

6. Consistent with the Board's decision at its June 2010 meetings, as part of the first stage, AASB 1053 *Application of Tiers of Australian Accounting Standards* was made and*:*

   (a) identifies the following type of entities would be required to apply full IFRSs as adopted in Australia (Tier 1) in preparing general purpose financial statements:

      (i) for-profit private sector entities that have public accountability; and

(ii) the Australian Government and State, Territory and Local Governments.

Further, subject to AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, GGSs of the Australian Government and State and Territory Governments shall apply Tier 1 reporting requirements in preparing financial statements.

(b) requires the following types of entities, as a minimum, to apply the Reduced Reporting Requirements (Tier 2) in preparing general purpose financial statements:

(i) for-profit private sector entities that do not have public accountability;

(ii) all not-for-profit private sector entities; and

(iii) public sector entities other than those in (a)(ii) and (a)(iii).

These types of entities may elect to apply Tier 1 reporting requirements in preparing general purpose financial statements.

7. The Board confirmed that IASB's *IFRS for SMEs* is not presently a suitable set of requirements for a second tier of requirements for general purpose financial statements in Australia. However, it was noted the AASB will continue to monitor further changes in the *IFRS for SMEs* and that it is open to the possibility of adopting the *IFRS for SMEs* in future should the changes in that Standard make it practicable in an integrated public sector/private sector reporting environment.

8. The Board also decided that under the first stage of revisions to the differential reporting framework, the reporting entity concept will continue to be used for differential reporting purposes.

9. The Board decided that any mandatory application of the second Tier should be annual reporting periods beginning on or after 1 July 2013. Entities may apply the second Tier requirements to annual reporting periods beginning on or after 1 July 2009 but before 1 July 2013.

Next steps

10. The Board decided that, in progressing the second stage of revisions to the differential reporting framework, further research should be carried out on the impact of the ED 192 proposals on those entities currently preparing special purpose financial statements. The Board will consider the results of such research in due time.

Previous deliberations

11. The AASB published Invitation to Comment (ITC) 12 in May 2007 containing the IASB's ED of A Proposed IFRS for Small and Medium-sized Entities (SMEs) and the AASB's proposals for a revised differential reporting regime in Australia.

12. The Board received considerable feedback on its proposals in response to ITC 12 and via Roundtable discussions conducted during the exposure period. The Board began redeliberating ITC 12 proposals in the light of comments received in November 2007. The following reflects a summary of the Board's progress.

Change of application focus

Initial proposals

13. ITC 12 proposed that the application of AASB Standards should no longer depend on whether entities are reporting entities, rather the focus of application would be general purpose financial statements. Accordingly, it was proposed that all entities that prepare general purpose financial statements (GPFSs) would apply either full IFRSs (as adopted in Australia) or an IFRS for SMEs (as adopted in Australia), based on criteria that establish which set of these Standards would apply.

Board decisions on redeliberation

14. The Board decided that an Exposure Draft should propose a shift of application focus from the reporting entity to GPFSs on the grounds that:

    (a) Australia has adopted IFRSs, which apply to GPFSs, rather than reporting entities;

    (b) the reporting entity concept is not used internationally for the purpose of determining the application of accounting standards but it is applied in determining the boundaries of the entity being reported on; and

    (c) under the current differential reporting regime, various interpretations have been developed around the reporting entity concept that give rise to inconsistent outcomes. One interpretation is that non-reporting entities lodging financial statements with a regulator should apply the recognition and measurement requirements in the Standards, but need only apply some of the presentation and disclosure requirements. Another interpretation is that entities can selectively apply recognition, measurement and disclosure requirements in the Standards.

General purpose financial statements

Initial proposals

15. ITC 12 proposed that, under a revised differential reporting regime, all financial statements that are on a public register, such as those prepared and lodged with the Australian Securities and Investments Commission (ASIC) under the *Corporations Act 2001*, or otherwise made available to the public at large, such as those tabled in a Parliament, would be regarded as GPFSs.

16. In addition, ITC 12 proposed that, notwithstanding a company being exempt from lodging under the Corporations Act, if it is required under that Act to prepare financial statements in accordance with Australian Accounting Standards, its financial statements are regarded as GPFSs.

Board decisions on redeliberation

17. The Board decided that an Exposure Draft should propose that financial statements are general purpose if:

(a) satisfy the following two conditions:

(i) they are publicly available, whether under a legal mandate or voluntarily and

(ii) they are either:

(A) prepared in accordance with Australian Accounting Standards under a legal mandate or held out to be so prepared; or

(B) required to be GPFSs under a legal mandate or held out to be GPFSs.

(b) they are held out as having been prepared in accordance with Australian Accounting Standards or held out as being GPFSs to any party are GPFSs.

18. The Board decided to propose in an Exposure Draft that:

(a) 'preparation in accordance with Accounting Standards' means the application of all Accounting Standards and not a subset of them; and

(b) the phrase 'Accounting Standards' is taken to be a reference to full IFRSs (as adopted in Australia and any other reporting requirements that are devised by the AASB for the preparation of GPFSs.

Differential reporting
Initial proposals

For-profit entities

19. ITC 12 proposed the following in respect of for-profit entities that prepare GPFSs:

(a) publicly accountable for-profit entities as defined by the IASB would apply full IFRSs (as adopted in Australia);

(b) for-profit entities that do not satisfy the definition of a publicly accountable entity, but are viewed as being 'important' from a public interest perspective because of their large size, also would apply full IFRSs. 'Important', entities are those that exceed either of the nominated size thresholds (Revenue $500m, Assets $250m); and

(c) other for-profit entities that are not publicly accountable or not otherwise included in (b) above, would apply the IFRS for SMEs (as adopted in Australia). Such entities could choose to apply full IFRSs (as adopted in Australia).

Not-for-profit entities

20. ITC 12 proposed the following in respect of not-for-profit (NFP) private and public sector entities that prepare GPFSs:

    (a) NFP entities exceeding either of the nominated size thresholds (Revenue $25m Assets $12.5m) apply full IFRSs (as adopted in Australia); and

    (b) NFP entities that fall under the nominated size thresholds would apply the IFRS for SMEs (as adopted in Australia). Such entities could also choose to apply the full set of IFRSs (as adopted in Australia).

21. ITC 12 sought constituents' views about the need for a third tier of simpler reporting requirements for smaller NFP entities because they might find the adoption of the forthcoming IFRS for SMEs burdensome on cost-benefit grounds.

Board decisions on redeliberation

22. The Board decided to propose in an Exposure Draft that:

    (a) a revised differential reporting framework would consist of two tiers of reporting requirements for preparing GPFSs:

        Tier 1: Full IFRSs as adopted in Australia; and

        Tier 2: A Reduced Disclosure Regime

    (b) a Reduced Disclosure Regime (RDR) that retains the full IFRS recognition and measurement requirements and substantially reduced disclosures corresponding to those requirements;

    (c) publicly accountable for-profit private sector entities should apply Tier 1, and non-publicly accountable for-profit private sector entities have a choice of applying Tier 1 or Tier 2;

    (d) not-for-profit private sector entities should have a choice of applying Tier 1 or Tier 2;

    (e) public sector entities should have a choice of applying Tier 1 or Tier 2, except :

        (i) Federal, State and Territory Governments;

        (ii) Local Governments; and

        (iii) Universities;

        should apply Tier 1.

Further consultation

Consultation Paper

23. Based on its decisions on redeliberating ITC 12 proposals and its reconsideration of the IFRS for SMEs issued in July 2009, the AASB issued a draft Consultation Paper titled *Differential Financial Reporting – Reduced Disclosure Requirements* on 4 December 2009. The Consultation Paper proposes a Reduced Disclosure Regime (RDR) as a second tier of GPFS

reporting requirements instead of the *IFRS for SMEs* that was proposed under ITC 12. The RDR involves recognition and measurement requirements of full IFRSs, as already adopted in Australia, with disclosures substantially reduced compared with those that would be required under full IFRSs as adopted in Australia.

The draft Consultation Paper was finalised and formally issued in February 2010.

24. The AASB Consultation Paper includes background material on the RDR. It sets out why the proposed RDR is considered more appropriate, at least at this time, than the IFRS for SMEs for the Australian environment on cost-benefit and user needs grounds and in view of the transaction neutrality policy applicable between the private and public sectors in Australian Accounting Standards. However, the proposed RDR applies the principles used by the IASB, when preparing the IFRS for SMEs, in determining the proposed reductions in disclosures.

ED 192

25. The AASB posted a draft Exposure Draft *Revised Differential Reporting Framework* on its website in December 2009. The draft set out the elements of the proposed revised differential reporting framework. Staff papers setting out draft proposed disclosures and analyses showing how the draft proposed disclosures were determined by applying the principles used by the IASB in determining disclosures under the IFRS for SMEs.

26. The draft Exposure Draft was amended and formally issued as ED 192 at the same time as the Consultation Paper in February 2009**.** Both documents have the closing date for comment of 23 April 2010. ED 192 notes that the Exposure Draft and the Consultation Paper are complementary and should be read together and that specific questions on the Exposure Draft and the Consultation Paper are included in the Exposure Draft.

In adopting this particular consultation process the AASB Consultation Paper notes:

> *"In releasing this Consultation Paper, the AASB is taking the approach of exposing a proposed Reduced Disclosure Regime for comment and an Exposure Draft showing how the regime is intended to apply. If the proposed regime is adopted, the AASB would hope to be able to issue a final pronouncement before the end of June 2010 and to allow early adoption. It is the prospect of early application that is driving this consultation approach. However, it must be stressed that the AASB is open to alternative views. If the consultation process leads to an alternative approach, it may be that more due process will be needed and a different time scale adopted."*

Other pertinent issues
Public accountability

27. The Board noted that the notion of public accountability as defined by the IASB has a for-profit context and is not applicable to the NFP sector where entities are involved in pursuing a wide variety of objectives.

28. The Board also considered the option of using a modified definition of public accountability in the NFP sector context. The Board noted that such a definition would not provide a robust basis for identifying entities falling under different reporting tiers since NFP private sector entities, with the likely exception of smaller member-based entities, are generally seen as being publicly accountable in the general sense of the term. A similar argument is made in relation to NFP public sector entities noting that these entities are levying or using public funds and are all generally regarded as publicly accountable.

29. Moreover, a modified notion of public accountability to cater for the NFP sector would probably give rise to the same level of subjectivity as the concept of reporting entity currently being used for differential reporting purposes and there are disparate views among commentators about whether such a notion can effectively be used to identify entities falling under different reporting tiers in the NFP sector.

30. The Board also noted that some commentators believe the level of public accountability for each entity within the charitable sector depends on a number of entity-specific factors, which reduce its usefulness as a stand-alone criterion for differential reporting purposes in the NFP sector.

31. Accordingly, the Board decided that the notion of public accountability, whether as defined by the IASB or in a modified form, would not provide a robust basis for identifying entities falling under different tiers of reporting requirements in the NFP sector.

Use of size thresholds

32. The Board decided that size thresholds do not provide a robust basis for differential reporting purposes on the grounds that they involve complexities and that the disadvantages of using size thresholds would exceed any advantages that may arise from their use. The Board noted that:

- keeping size thresholds up-to-date would entail additional maintenance and monitoring costs;
- there is no consensus of views among respondents about the use of size thresholds as a basis for identifying entities falling under different tiers of reporting requirements in the NFP sector. There are also differences of view between commentators as to the amounts of the appropriate thresholds;
- particularly in the public sector, unless jurisdiction specific thresholds are prescribed, it would lead to similar entities applying different requirements across different State and Territory jurisdictions because of the size differences between these jurisdictions; and
- problems may arise at the whole of government level if public sector entities were to apply different reporting requirements, possibly resulting in different accounting outcomes that would need to be adjusted on consolidation.

The need for a third tier

33. The Board decided there is no need for a third tier of reporting requirements considering that:

    (a) the federal government is considering whether to alleviate the reporting burden of small companies limited by guarantee; and

    (b) there was no convergence of views amongst respondents about the requirements of a third tier and the way entities applying those requirements should be identified.

34. The Board noted that many NFP entities in the private sector are established as companies limited by guarantee under the Corporations Act or as associations under relevant Associations Acts in each State. Moreover, many non-trading cooperatives are regulated by State or Territory Acts. It is expected that, in cases where the proposed alternative reporting requirements are regarded as burdensome for small entities, regulators may step in and fill the gap either by exempting certain small entities from reporting or devising the minimum requirements they regard as appropriate for such entities.

Special treatment of charities

35. Some respondents to ITC 12 argued that the disclosures required by full IFRSs or included in the proposed IFRS for SMEs do not satisfy the information needs of users of financial statements of charities on the grounds that these Standards have a for-profit focus.

36. The Board decided that, as a general policy, there should not be sub-classification of different types of entities in the NFP sector other than between private and public sector entities for differential reporting purposes (in line with ITC 12). The Board noted that:

    (a) in a transaction-neutral reporting environment, a sub-classification should not be relevant as far as the recognition and measurement of transactions are concerned; and

    (b) a choice of reporting requirements would provide different levels of disclosures appropriate for entities with different levels of activities.

37. The Board noted that this does not rule out specific projects directed at specific aspects of reporting by particular types of NFP entities. A separate project has been actioned that deals with disclosures that might be required of charities.

The role of the reporting entity concept

38. Currently the reporting entity concept is used conceptually to identify when any entity should prepare GPFSs and to discern the borders of that entity. It is also employed operationally in application clauses of standards for differential reporting purposes in Australia. Currently reporting entities must apply all Australian Accounting Standards and non-reporting entities may apply a

subset of them[1]. Under the proposed differential reporting regime outlined in ED 192, the reporting entity concept would no longer be used to operationalise differential reporting and the focus of application of Australian Accounting Standards would move from ‘reporting entity’ to GPFSs.

39. At its May 2010 meeting, the Board decided to defer the decision about the change of application focus of Standards from reporting entity to GPFSs to the second stage of implementing the project, pending further research.

1 AASB 101, AASB 107 *Statement of Cash Flows*, and AASB 108 *Accounting Policies,* Changes *in Accounting Estimates and Errors* apply to each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act regardless of whether the entity is a reporting entity.