

Differential Reporting Project: Board Decisions and Tentative Basis for Conclusions

For-profit entities

ITC 12 proposals

1. ITC 12 proposed the following in respect of for-profit entities that prepare general purpose financial statements (GPFSS):
 - (a) publicly accountable for-profit entities would apply full IFRSs;
 - (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; and
 - (c) other for-profit entities that are not publicly accountable or not otherwise included in (b) above, would apply the IFRS for SMEs. Such entities could choose to apply full IFRSs.
2. ITC 12 regarded as 'important', entities that exceed either of the following size thresholds:
 - Consolidated Revenue for the financial year of the entity and the entities it controls (if any) \$500m.
 - Consolidated Assets at financial year end of the entity and the entities it controls (if any) \$250m.
3. A publicly accountable for-profit entity would have the same definition as that proposed in the ED of A Proposed IFRS for SMEs:

"An entity has public accountability if:

 - (a) it has issued (or is in the process of issuing) debt or equity instruments in a public market; or
 - (b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment bank." (Glossary to the ED)

Board decisions and basis for conclusions

4. The Board received considerable feedback on its proposals in response to ITC 12 and via Roundtable discussions conducted during the exposure period. The Board considered differential reporting in respect of for-profit Corporations Act entities that are required to apply Accounting Standards and tentatively decided that a two-tier differential reporting regime is appropriate.
 - (a) The first tier, which is applicable to the GPFSSs of publicly accountable entities, would consist of full IFRSs.
 - (b) The second tier, which is applicable to the GPFSSs of non-publicly accountable entities, would include a choice to apply:

- (i) either the IFRS for SMEs, or
- (ii) an alternative regime involving full IFRSs recognition and measurement requirements plus limited specified disclosures to be determined by the Board.

Non-publicly accountable entities could also choose to apply full IFRSs.

5. The tentatively agreed two-tier differential reporting regime applicable to the GPFs of for-profit entities were similar to the respective ITC 12 proposals in the following ways:
 - (a) using the notion of publicly accountable entity as defined by the IASB ED of A Proposed IFRS for SMEs; and
 - (b) making publicly accountable entities subject to the requirements of full IFRSs as adopted in Australia.
6. The tentatively agreed two-tier differential reporting regime differs from the ITC 12 proposals in the following ways:
 - (a) not having 'important' entities in tier 1; and
 - (b) adding an alternative regime of full IFRS recognition and measurement requirements plus limited specified disclosures to be determined by the Board.
7. In its submission to the IASB, the Board commented that wholly-owned subsidiaries of publicly accountable entities could be allowed to apply the same recognition and measurement policies as their IFRS compliant parent but limited specified disclosures. Some constituents argued that a lower level of disclosures compared to IFRSs or the IASB ED would be justified since, in the case of wholly-owned subsidiaries, users are largely internal.
8. The Board considered that the IFRS for SMEs provides a less onerous set of requirements that can be utilised in formulating a revised differential reporting regime for Australia. However, the Board noted that a final decision on the structure of the second tier should await the outcome of the IASB's SMEs project on the grounds that the second alternative in tier 2 may not be needed if the forthcoming IFRS for SMEs is a truly stand-alone document and contains fewer disclosures than proposed in the IASB ED.
9. The Board changed its view on having 'important' entities in tier 1 on the grounds that:
 - (a) using public accountability as defined by the IASB would put financial reporting by the for-profit sector in Australia in line with international requirements;
 - (b) large non-publicly accountable entities would still be preparing quality GPFs under the requirements of the second tier;
 - (c) it is consistent with the Board's revised view that it should provide different tiers of reporting requirements for preparing GPFs and the onus would be on other regulators or legislators to provide criteria identifying entities falling under each tier. The only exception to this rule is the use of public

accountability as a basis for differential reporting in the for-profit sector to help ensure consistency with international practice so that, listed entities and deposit takers would apply full IFRSs; and

- (d) keeping size thresholds that identify important entities up-to-date would entail additional maintenance and monitoring costs.

Not-for-profit entities

ITC 12 proposals

10. ITC 12 proposed the following in respect of both private sector and public sector not-for-profit (NFP) entities that prepare GPFSs:
- (a) NFP entities exceeding either of nominated size thresholds 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).
11. The nominated size thresholds for NFP entities in ITC 12 were:
- Consolidated revenue for the financial year of the entity and the entities it controls (if any) \$25m.
 - Consolidated assets at the end of the financial year of the entity and the entities it controls (if any) \$12.5m.
12. ITC 12 noted that there may be a need for a third tier of simpler reporting requirements for smaller NFP entities since they might find the adoption of the forthcoming IFRS for SMEs burdensome on cost-benefit grounds. ITC 12 sought constituents' views about:
- (a) the need for a third tier;
 - (b) requirements under that tier; and
 - (c) the way entities falling under that tier might be identified.

Board decisions and basis for conclusions

13. The Board received considerable feedback from constituents with an interest in NFPs.
14. The Board decided that NFP private sector entities should all have the choice of applying any of the following alternatives (that is, a one-tier approach):
- (i) full IFRSs (as adopted in Australia); or
 - (ii) the IFRS for SMEs (as adopted in Australia); or
 - (iii) a regime of full IFRS recognition and measurement requirements with limited specified disclosures to be determined by the Board.
15. The Board decided that NFP public sector entities would follow a two-tier reporting system as follows:

- Tier 1: financial reporting at federal, state and territory levels would apply full IFRSs (as adopted in Australia)
- Tier 2: all other public sector entities would have the choice of applying one of the following:
 - (i) full IFRSs (as adopted in Australia); or
 - (ii) the IFRS for SMEs (as adopted in Australia); or
 - (iii) a regime of full IFRS recognition and measurement requirements with limited specified disclosures to be determined by the Board.

Subdivision within NFP sector

16. ITC 12 tentatively assumed a subdivision of NFP entities between private and public sectors. The Board subsequently further considered the issue of possible subclassifications of different types of NFP entities within the NFP sector for differential reporting purposes. The Board noted commentators' views on ITC 14 *Proposed Definition and Guidance for Not-for Profit Entities* that NFP entities can generally be identified as being in one of three categories based on the nature of their operations and sources of funding:

- (a) charities;
- (b) member-based entities; and
- (c) public sector entities.

and that there may be a need for a fourth 'other' category to cater for entities such as schools and religious organisations. The Board noted the significant disparities in the size of entities within each of the above categories.

17. Some respondents to ITC 12 argued that the disclosures required by full IFRSs or proposed in the IASB ED do not satisfy the information needs of users of financial statements of charities. These Standards, it was noted, have a for-profit focus while the nature of charities' activities is such that not all disclosures in these Standards are pertinent to the needs of users of the financial statements of charities. Moreover, there are disclosures that relate to the nature of operations of charities and specific issues of public interest which are not required by these Standards and that may be within the scope of financial reporting. It is argued that the stakeholders of charities are interested in the accountability of the entity in achieving objectives stated in the charity's mission statement using funds provided by those stakeholders. They noted that donors, grantors and contributors who provide resources in the form of money or voluntary services and the public at large (which include the beneficiaries of charitable activity) are all interested in the accountability of charities.
18. The Board noted that a similar view exists in regard to all NFP entities. This view links accountability to the primary reason for existence of each NFP entity and provides that disclosure of particular performance-related information would help inform a wide range of stakeholders about the way the NFP entity is utilising its resources in achieving its purpose.
19. The Board decided that there should not be subclassification of different types of entities in the NFP sector other than between private and public entities for differential reporting purposes (in line with ITC 12). The Board noted that:

- (a) in a transaction-neutral reporting environment, a subclassification should not make a reporting difference 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.
20. The Board noted that this does not rule out specific projects directed at particular types of NFP entities and decided that a separate project proposal should provide insight into whether disclosures in addition to those required by IASB Standards as adopted in Australia should be required of charities. However, the Board also noted that much of the information relating to the extent to which a NFP entity has achieved its 'purpose' set out in its mission statement may not be of an accounting nature.

Public accountability

21. The Board considered whether the notion of public accountability as defined by the IASB is applicable to the NFP sector. It noted that, although there are some who argue that the deposit taking attribute of the IASB definition of public accountability may cover some NFP entities on the grounds that they hold funds in a fiduciary capacity, the IASB definition has a for-profit context and is not applicable to the NFP sector where entities are involved in a wide variety of activities.
22. 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 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. 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.
23. The Board also noted that some commentators believe that 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. It has been argued that the degree of public accountability of a charity has a direct relationship to the following.

Sources of funds. For example, if the sources of funds are public donations or government grants, then a high degree of public accountability is expected. Voluntary labour may be regarded as a form of donation and, therefore, a higher degree of public accountability might be expected when significant voluntary labour is involved. Generally the level of public accountability is high where public funds are involved such as when community or social activities are carried out on behalf of government. However, when the source of funds is an individual or a corporation, a much lower degree of public accountability is expected on the basis that the individual or corporations involved can probably access the financial information they need. A moderate level of public accountability may be envisaged when the sources of funds are grants from foundations or sponsors.

Number of stakeholders in the entity. The wider the spectrum of stakeholders, the higher the expected level of public accountability.

Scale of operations and geographical coverage. Generally charities active at the national or international level are seen as being publicly accountable at a high level.

24. 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 to identify entities falling under different tiers of reporting requirements in the NFP sector.

Use of size thresholds

25. The Board considered the use of size thresholds as a basis for identifying entities falling under different tiers of reporting requirements in the NFP sector. Some commentators preferred the use of size thresholds in comparison to the use of a modified notion of public accountability as the basis for identifying reporting tiers on the grounds that it is not subjective and would provide consistency in identifying entities that fall under various tiers. However, other commentators were concerned about using size thresholds citing the following reasons:
- (a) size thresholds are arbitrary;
 - (b) size thresholds will become outdated overtime; and
 - (c) 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.
26. There were also differences of view between commentators as to the amounts of the appropriate thresholds. Some thought the thresholds proposed in ITC 12 are too low and should be raised to be comparable to proposed 'important' entity thresholds in the for-profit sector. Others thought the proposed thresholds are too high, which would mean that too few NFP entities would apply full IFRS requirements. Yet others thought that the ratio of thresholds (revenue twice the assets) is not appropriate for many asset-rich entities in the NFP sector.
27. ITC 12 argued that size thresholds reflect the degree of public interest in the activities of the entity. This means that entities falling below the proposed thresholds attract less public interest than those exceeding the thresholds. The similarity of thresholds between NFP private sector and public sector entities also involved an assumption that both types of entities are subject to similar levels of public interest.
28. Respondents' comments on the questions surrounding the comparability of thresholds between the private and public sector NFP entities and their difference from those devised for 'important' entities in the for-profit sector did not reflect any convergence of views. Some respondents thought that public sector NFP entities are inherently of greater public interest than private sector NFP entities. Others thought that the thresholds should take account of the fact that the funds at the disposal of public sector NFP entities are generally materially larger than those at the disposal of private sector NFP entities. Some expressed the view that public interest would not differ between for-profit and NFP sectors. Others expressed the view that entities within the public sector are all of public interest and size thresholds give a misleading perception of an increase in public interest proportional to an increase in the size of entity.

29. Another issue of concern is the problems that 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.
30. The Board concluded that size thresholds do not provide a robust basis for differential reporting purposes because of the complexities involved and that the disadvantages of using size thresholds would exceed any advantages that may arise from their use. The Board also noted that keeping size thresholds up-to-date would entail additional maintenance and monitoring costs.

The issue of a third tier

31. The Board noted that a reason for contemplating the need for a third tier in ITC 12 was that there is generally no NFP equivalent to the outright exemption from reporting that exists in the for-profit corporate sector.
32. The Board also noted that while there is some support from respondents to ITC 12 for creating a third tier, there are different views about the requirements of such a tier and the way entities applying those requirements should be identified. The Board also considered the views expressed by respondents to the Discussion Paper published by Treasury in June 2007 titled *Financial Reporting by Unlisted Public Companies* in relation to the creation of a third tier of reporting requirements for companies limited by guarantee.
33. 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 Incorporated Associations Acts in each State. Moreover, many non-trading cooperatives are regulated by State or Territory Acts.
34. The Board decided that there is no need for a third tier of reporting requirements considering that:
 - (a) the Treasury intends to alleviate the reporting burden of small companies limited by guarantee through future provisions in the Corporations Act; and
 - (b) based on its recent deliberations there would be the choice of a regime involving full IFRS recognition and measurement requirements but limited specified disclosures.
35. The Board noted that an advantage of a differential reporting regime that uses IASB Standards as 'foundation' reporting requirements is the low cost of maintenance and cross-border comparability. It was also noted 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 (as is the case for small proprietary companies), or devising the minimum requirements they regard as appropriate for such entities (as is expected to be the case for small companies limited by guarantee).

The availability of IFRS for SMEs as a choice

36. The Board noted that the IFRS for SMEs is expected to be adopted by many overseas jurisdictions and it would be inappropriate to deprive Australian entities from using the IFRS for SMEs as adopted in Australia for the following reasons:
- (a) consistency with the IASB approach in regard to for-profit entities;
 - (b) consistency with the Board's transaction neutrality policy;
 - (c) an Australian subsidiary of a foreign company should have the choice of applying the IFRS for SMEs if other subsidiaries of the company operating in other jurisdictions have the choice, or are required, to follow the IFRS for SMEs; and
 - (d) the reporting requirements of the IFRS for SMEs are less onerous compared with those of full IFRSs, providing a suitable choice in cases where other regulators, legislators and stakeholders regard a less onerous regime as being more appropriate for some NFP entities that are currently applying full IFRSs.

Change of application focus

37. The Board decided that there needs to be 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 should apply the recognition and measurement requirements in 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.
38. Many constituents view the different outcomes noted in 37(c) above as a point of strength rather than weakness of using the reporting entity concept for differential reporting purposes. They consider that, provided professional judgement is exercised, the various different outcomes are appropriate to different circumstances.
39. ITC 12 identified two views about who should determine application of accounting standards:
- View 1: application of accounting standards is most appropriately dealt with as a matter of government policy, and this is the approach in many jurisdictions outside Australia.
- View 2: the AASB should play a role in determining the application of its Standards. Under the existing reporting regime, the AASB plays a key role in determining the application of its Standards.

40. The legislation plays an important role in the application of Standards under the current reporting regime in the form of exemptions. For example, small proprietary companies are exempted from financial reporting under the Corporations Act and some associations enjoy similar exemptions under State and Territory Incorporated Associations Acts. The change in focus of application of Standards from the reporting entity to GPFs provides the Board with the opportunity to continue to share the responsibilities associated with the application of Standards with other regulators and legislators.

The revised reporting framework

41. The revised framework relies on other regulators, legislators or stakeholders in:
- (a) determining entities that should legally report or otherwise are exempted from financial reporting; and
 - (b) identifying the reporting requirements to be applied by the entity in preparing GPFs where a choice is allowed by the AASB.

Compared with the current reporting framework, other regulators, legislators or stakeholders have an enhanced role in determining the application of Standards under the revised framework.

42. The significant role assigned to the 'reporting mandate' in the revised framework arises from its ability to facilitate the application of different reporting requirements in an effective and efficient manner. The AASB noted that, except for the cases where a clear-cut and timeless application criterion can be used by the Board, because of the complexities involved in determining application of different reporting requirements to entities of different sizes and with varying levels of economic, social and political significance across different economic sectors, the application issue would best be dealt with by jurisdictional authorities and stakeholders. In particular, comments received in relation to the use of the ITC 12 proposals for differential reporting in the NFP sector indicates constituents' concerns about possible inconsistencies in identifying entities applying different tiers of reporting requirements in Federal, State and Territory jurisdictions.
43. Under the revised framework, the Board would:
- (a) define and clarify the concept of GPFs; and
 - (b) promulgate different tiers/choices of reporting requirements for use by entities in preparing their GPFs.
44. Under the revised framework, the Board would have a role in identifying the following types of entities that apply different tiers of reporting requirements.
- (a) for-profit entities if not otherwise exempted by legislation; and
 - (b) whole-of-government entities and government departments at the Federal, State and Territory levels.
45. The revised framework would define the AASB's role in a manner similar to the role IASB plays internationally. Like the IASB, the AASB would undertake to provide a basis for identifying for-profit entities that should follow full IFRSs. Accordingly

publicly accountable entities as identified by the IASB would apply full IFRSs in preparing and presenting GPFSSs. Non-publicly accountable entities could apply full IFRSs as a choice but would also be allowed to apply the IFRS for SMEs. In the Australian context, the IFRS for SMEs may be one of two alternatives available to non-publicly accountable entities, the other being a regime involving full IFRS recognition and measurement requirements plus limited specified disclosures to be determined by the AASB. However, as noted above, the need for this second alternative would depend on the final content of the IASB's IFRS for SMEs.

46. In the not-for-profit private sector, the AASB's role would be limited to the provision of different choices of reporting requirements and the onus would be on other regulators or legislators and stakeholders to determine those entities in their jurisdictions that should apply one or other set of reporting requirements.

General purpose financial statements

47. ITC 12 proposed that, under a revised financial reporting regime, all financial reports that are on a public register, such as those prepared and lodged with the Australian Securities and Investments Commission (ASIC) under the Corporations Act, or otherwise made available to the public at large, such as those tabled in a Parliament, would be regarded as GPFSSs.
48. 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 a financial report in accordance with Australian Accounting Standards, its financial statements are regarded as GPFSSs. An example of entities that would be affected by this proposal would be large proprietary companies that are exempted from lodging their financial reports with the ASIC under the grandfathering provision in section 1408(6) of the Corporations Act. If a grandfathered large proprietary company prepares a financial report in accordance with Australian Accounting Standards under the requirements of the Corporations Act, then its financial report would be regarded as a general purpose financial report.

Board decisions

49. The Board received considerable feedback from constituents on these proposals. The Board decided that financial statements lodged with the ASIC under the Corporations Act are GPFSSs on the grounds that:
 - (a) the legislator's decision in requiring lodgement is with a view to protecting 'public interest' and is not for a purely regulatory objective. Tests of 'economic significance' underlying the lodging of financial statements by large proprietary companies is evidence that legislators have considered public interest as a basis for requiring lodgement; and
 - (b) the financial statements on the ASIC's public register are accessible by the public, and users' access is with a view to relying on information contained in the financial statements to make resource allocation decisions. Such users often cannot command specific information from the entity and would rely on publicly available financial information for decision making purposes.
50. Based on the Board's recent decisions, full IFRSs will not be the only basis for preparing GPFSSs. Where a choice of reporting requirements is provided, the entities

can also use the IFRS for SMEs (as adopted in Australia) or a regime involving full IFRS recognition and measurement requirements with limited specified disclosures as the basis for preparing GPFSSs.

51. The Board will continue its deliberations of ITC 12 proposals in regard to GPFSSs in the light of comments received at its future meetings. Among issues to be discussed are:
 - (a) the relationship between lodgement on a public register and the general purpose nature of financial statements in the case of entities other than those that are required to lodge with the ASIC; and
 - (b) the nature of the financial statements of grandfathered companies prepared in accordance with Australian Accounting Standards.
52. The attached chart depicts the revised differential reporting regime based on the Board's decisions to date.

Attachment: Revised differential reporting regime based on the Board's decisions to date

