Australian Government
Australian Accounting Standards Board

XRB EXTERNAL REPORTING BOARD
NZ ACCOUNTING STANDARDS BOARD

Staff Paper

Project:	**Reduced Disclosure Requirements (Tier 2) Principles**	**Meeting:**	AASB October 2015 (M148)
Topic:	**Sweep Issues – Presentation of Financial Statements**	**Agenda Item:**	15.1
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Introduction and objective of this paper

1 The objective of this paper is to determine how the RDR decision-making framework should be applied to AASB 101/NZ IAS 1 *Presentation of Financial Statements*, AASB 107/NZ IAS 7 *Statement of Cash Flows* and AASB 108/NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Specifically this paper addresses:

(a) whether there should be any reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 for Tier 2 entities (Issue 1(a));

(b) whether Tier 1 and Tier 2 entities should have the same presentation requirements in relation to the primary financial statements[1] (Issue 1(b)); and

(c) the statement that will appear in the RDR Appendix to each Standard cross-referencing to relevant paragraphs in AASB 101/NZ IAS 1 and AASB 108/NZ IAS 8 (Issue 2).

2 This paper is structured as follows:

(a) summary of staff recommendations (paragraph 3);

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1 Statement of Financial Position, Statement of Profit or Loss and Other Comprehensive Income, Statement of Cash Flows and Statement of Changes in Equity.

(b) application of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 by Tier 2 entities (paragraphs 4-11);

(c) presentation of primary financial statements (paragraphs 12-22); and

(d) cross-referencing to AASB 101/NZ IAS 1 and AASB 108/NZ IAS 8 (paragraphs 23-26).

Summary of staff recommendations

3 The staff recommend the following:

(a) Issue 1(a): there should be a reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8;

(b) Issue 1(b):

(i) Tier 1 and Tier 2 entities should have the same presentation requirements in relation to the primary financial statements;

(ii) presentation requirements be described as:

Presentation requirements are requirements that specify, for the current and the comparative period, the broad structure of financial statements including the basis of classification of items. In addition, requirements addressing additional line items, disaggregation and subclassification of line items on the face of the primary financial statements are considered to be presentation requirements. Specifications relating to additional line items and disaggregation to be disclosed in the notes are treated as matters of disclosure.

(c) Issue 2: the following text be added the beginning of the RDR Appendix of each Standard:

In applying this Standard, Tier 2 entities should consider the requirements addressing accounting policies, significant judgements and sources of estimation uncertainty in AASB 101/NZ IAS 1 Presentation of Financial Statements*, paragraphs 117-133 and AASB 108/NZ IAS 8* Accounting Policies, Changes in Accounting Estimates and Errors *paragraphs 28-31 and 39-40.*

Issue 1: Application of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 by Tier 2 entities

<u>Background</u>

4 In September 2015, the Boards[2] tentatively decided that the RDR decision-making framework should start with the disclosures required for Tier 1 entities and reduce them to identify the disclosures that Tier 2 entities are required to make[3].

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2 The AASB and New Zealand Accounting Standards Board (NZASB)

5 In addition, the Boards directed staff to bring back to the October meetings consideration of how the RDR decision-making framework should be applied to AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8, including whether:

(a) there should be any reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8; and

(b) the presentation on the face of the primary financial statements should be the same for Tier 1 and Tier 2 entities.

6 Staff note that, in 2010, when the initial Tier 2 reporting requirements were determined, the AASB did not specifically consider the interaction between the Tier 2 disclosure requirements of AASB 101, AASB 107 and AASB 108 and the requirement for entities preparing special purpose financial statements (SPFS) in accordance with Part 2M.3 of the *Corporations Act (2001)*. Entities preparing financial reports in accordance with Part 2M.3 of the *Corporations Act (2001)* (including those preparing SPFS) are required to comply with all of the requirements of AASB 101, 107 and 108. However, Tier 2 entities (preparing general purpose financial statements) have a number of disclosure reductions within these Standards.

7 Further, application of the current Tier 2 Disclosure Principles[4] do not result in the same line items and subclassifications on the face of the primary financial statements of Tier 1 and Tier 2 entities. The reason for this difference is how the current principles distinguish presentation from disclosure:

> Presentation requirements are limited to requirements that specify the broad structure of financial statements including the basis of classification of items. Specifications relating to subclassifications or line items to be shown on the face of financial statements, or in the notes, are treated as matters of disclosure (paragraph 9).

8 Staff also note that the current Conceptual Framework Exposure Draft[5] does not distinguish between presentation and disclosure. The definition provided is:

> The terms used to describe how information about assets, liabilities, equity, income and expenses is provided in financial statements.

<u>Staff Analysis – Issue 1(a) Reduction in disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8</u>

9 In considering if a reduction in the disclosures of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 should be permitted, staff note that:

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3 http://www.aasb.gov.au/admin/file/content102/c3/M147_Action_Alert_Sept_2015.pdf (accessed 30 September 2015)

4 http://www.aasb.gov.au/Work-In-Progress/Reduced-Disclosure-Requirements/Tier-2-Disclosure-Principles.aspx

5 http://www.aasb.gov.au/admin/file/content105/c9/ACCED264_06-15.pdf

(a) the current Tier 2 Disclosure Principles do not require disclosure in AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 to be consistent with Tier 1 entities on the basis that Tier 2 entities do not have public accountability. The current project to revise the Reduced Disclosure Requirements Framework is not reconsidering the basis for determining whether an entity is Tier 1 or Tier 2 (that is, on the basis of public accountability).

(b) there are two differential reporting frameworks, one for GPFS entities and one for SPFS entities. The current project to revise the Reduced Disclosure Requirements Framework is not reconsidering differential reporting[6].

10 Advantages of Tier 2 entities having no reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 include:

(a) Tier 2 disclosures for these Standards will be consistent with Tier 1 entities; and

(b) entities preparing GPFS will be required to disclose the same information as SPFS entities reporting in accordance with Chapter 2M.3 of the *Corporations Act (2001)*

11 Disadvantages of Tier 2 entities having no reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 (i.e., required to apply AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 in full) include:

(a) potentially a significant additional cost burden for Tier 2 entities; and

(b) may lead to cluttering the financial statements with information that is not relevant to users for understanding the activities of Tier 2 entities.

Staff Recommendation

12 Staff consider, on balance, that the disadvantages of Tier 2 entities having no reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 (i.e. required to apply AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 in full) outweigh the advantages. Accordingly, staff recommend that there should be a reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 for Tier 2 entities.

Question 1 to the Boards

Do Board members agree with the staff recommendation that there should be a reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 for Tier 2 entities?

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6 A forthcoming AASB Research Report will address the suitability of special purpose financial reporting for entities that publicly lodge financial statements.

Staff analysis – Issue 1(b): Presentation of face of the primary financial statements

Note that if the Boards disagree with the staff recommendation in Question 1 (i.e., the Boards decide that there should be no reduction in the disclosure requirements of AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8), paragraphs 13-23 (below) do not need to be considered by the Boards.

13 Staff note that application of Reduced Disclosure Requirements Principles is not intended to amend the presentation (sometimes used interchangeably with classification) requirements of Tier 1 and is concerned only with reducing the disclosure burden. Sometimes judgement is required as to whether a particular requirement relates to presentation or disclosure.

14 Staff are of the view that, for the purposes of the Reduced Disclosure Requirements, the face of the primary financial statements is a matter of presentation, rather than disclosure. Staff consider it to be important to ensure the requirements relating to the face of the primary financial statements are consistent in presentation for all entities preparing general purpose financial statements (both Tier 1 and Tier 2 entities) to allow stakeholders to compare the primary financial statements of entities.

15 In addition, staff do not consider the cost of preparing the presentation requirements of primary financial statements to be incrementally significant for Tier 2 entities[7].

16 In analysing this issue, staff also considered the extent to which information on the face of the financial statements should be classified as presentation requirements. Staff are of the view that the presentation requirements of the financial statements should relate to the current and the comparative periods only. That is, information relating to presenting a third balance sheet should be excluded from being considered as presentation for a Tier 2 entity. This view is on the basis that staff are of the view that AASB 108/NZ IAS 8 disclosures (paragraphs 28-29 and 49) adequately address the disclosures regarding changes in accounting policy, retrospective restatement or reclassification.

Staff Recommendation

17 Staff recommend that the application of the revised Reduced Disclosure Requirements Framework result in entities presenting the same information on the face of the primary financial statements in relation to current and comparative periods. That is, Tier 1 and Tier 2 entities should have the same presentation requirements in relation to the primary financial statements in relation to current and comparative periods.

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7 The additional disclosures required (as compared to currently applicable Tier 2 disclosure requirements), as a result of the change in description of presentation, are:
– gains and losses arising from the derecognition of financial assets measured at amortised cost (paragraph 82(aa)
– presentation of line items … that reconcile any subtotals presented in accordance with paragraph 85 with the subtotals or totals required in Australian Accounting Standards for such statement(s) (paragraph 85B)

> **Question 2 to the Boards**
>
> Do Board members agree with the staff recommendation that the application of the revised Reduced Disclosure Requirements Framework result in entities presenting the same information on the face of the primary financial statements in relation to current and comparative periods?

18 If the Boards agree with the staff recommendation in paragraph 17 above, staff have identified two options to achieve consistent presentation:

Option 1: Amend the current description of presentation in the Tier 2 Disclosure Principles

19 Under option 1, the current description of presentation would be modified such that:

(a) requirements relating to line items, disaggregation and subclassifications on the face of the financial statements to be classified as presentation rather than disclosure; and

(b) the description of presentation requirements be limited to the current and the comparative periods only[8].

20 Staff recommend the following revised description if Option 1 is preferred by the Boards:

Presentation requirements are requirements that specify<u>, for the current and the comparative period,</u> the broad structure of financial statements including the basis of classification of items. <u>In addition, requirements addressing additional line items, disaggregation and subclassification of line items on the face of the primary financial statements are considered to be presentation requirements.</u> Specifications relating to ~~subclassifications or line items to be shown on the face of financial statements, or in the notes,~~ <u>additional line items and disaggregation to be disclosed in the notes</u> are treated as matters of disclosure.

Option 2: Retain current description of presentation and exclude AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8 from the presentation principles

21 Under option 2, the current description of presentation is retained; however, the presentation principle would not be applied for AASB 101/NZ IAS 1, AASB 107/NZ IAS 7 and AASB 108/NZ IAS 8.

Staff Recommendation

22 Staff recommend amending the current description of presentation in the Tier 2 Disclosure Principles (option 1) on the basis that this option more accurately reflects the view that such items are presentation, rather than disclosure requirements.

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[8] Staff note that, as a result, Tier 2 entities would likely continue to be excluded from the requirement in paragraphs 10(f), 40A and 40B(c) to present a third balance sheet.

Question 3 to the Boards
Do Board members agree with the staff recommendation to amend the description of presentation as outlined in paragraph 20 above?

Issue 2: Cross-referencing to AASB 101/NZ IAS 1 and AASB 108/NZ IAS 8

Background

23 In September 2015, the Boards directed staff to articulate in the RDR decision making framework the principle that the disclosures in relation to significant judgements and estimates and accounting policies required for Tier 2 entities located in AASB 101/NZ IAS 1 and AASB 108/NZ IAS 8 should be used to evaluate the need for entities to make similar disclosures in other Standards and as a consequence the related paragraphs in individual Standards be excluded for Tier 2 entities.

Staff Analysis

24 Staff have identified the following relevant disclosure requirements in relation to significant judgements and estimates and accounting policies:

(a) AASB 101/NZ IAS 1:

(i) disclosure of accounting policies (paragraphs 117-121);

(ii) judgements (paragraphs 122-124);

(iii) sources of estimation uncertainty (paragraphs 125-133).

(b) AASB 108/NZ IAS 8:

(i) accounting policy disclosures (paragraphs 28-31); and

(ii) Changes in accounting estimates (paragraphs 39-40)

25 Extracts of the paragraphs noted above can be found in Appendix A to this paper.

Staff Recommendation:

26 Staff recommend the following text be added to the beginning of the RDR Appendix of each Standard.

In applying this Standard, Tier 2 entities should consider the requirements addressing accounting policies, significant judgements and sources of estimation uncertainty in AASB 101/NZ IAS 1 Presentation of Financial Statements*, paragraphs 117-133 and AASB 108/NZ IAS 8* Accounting Policies, Changes in Accounting Estimates and Errors *paragraphs 28-31 and 39-40.*

Question 4 to the Boards
Do Board members agree with the proposed text outlined in paragraph 27 above?

Appendix A – Extracts of AASB 101 and AASB 108/NZ IAS 8

Outlined below are paragraphs taken from AASB 101 and AASB 108/NZ IAS 8. These paragraphs are generic paragraphs that could replace the application of certain paragraphs in the Standards.

Extracts from AASB 101/NZ IAS 1:

1 Disclosure of accounting policies (paragraphs 117-121)

117 An entity shall disclose its significant accounting policies comprising:

(a) the measurement basis (or bases) used in preparing the financial statements; and

(b) the other accounting policies used that are relevant to an understanding of the financial statements.

118 It is important for an entity to inform users of the measurement basis or bases used in the financial statements (for example, historical cost, current cost, net realisable value, fair value or recoverable amount) because the basis on which an entity prepares the financial statements significantly affects users' analysis. When an entity uses more than one measurement basis in the financial statements, for example when particular classes of assets are revalued, it is sufficient to provide an indication of the categories of assets and liabilities to which each measurement basis is applied.

119 In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position. Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in Australian Accounting Standards. An example is disclosure of whether an entity applies the fair value or cost model to its investment property (see AASB 140 *Investment Property*). Some Australian Accounting Standards specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. For example, AASB 116 requires disclosure of the measurement bases used for classes of property, plant and equipment.

121 An accounting policy may be significant because of the nature of the entity's operations even if amounts for current and prior periods are not material. It is also appropriate to disclose each significant accounting policy that is not specifically required by Australian Accounting Standards but the entity selects and applies in accordance with AASB 108/NZ IAS 8.

2 Judgements (paragraphs 122-124):

122 An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

123 In the process of applying the entity's accounting policies, management makes various judgements, apart from those involving estimations, that can significantly affect the amounts it recognises in the financial statements. For example, management makes judgements in determining:

(a) [deleted]

(b) when substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to other entities;

(c) whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; and

(d) whether the contractual terms of a financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

124 Some of the disclosures made in accordance with paragraph 122 are required by other Australian Accounting Standards. For example, AASB 12 *Disclosure of Interests in Other Entities* requires an entity to disclose the judgements it has made in determining whether it controls another entity. AASB 140 *Investment Property* requires disclosure of the criteria developed by the entity to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business, when classification of the property is difficult.

3 Sources of estimation uncertainty (paragraphs 125-133)

125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period.

126 Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. For example, in the absence of recently observed market prices, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the effect of technological obsolescence on inventories, provisions subject to the future outcome of litigation in progress, and long-term employee benefit liabilities such as pension obligations. These estimates involve assumptions about such items as the risk adjustment to cash flows or discount rates, future changes in salaries and future changes in prices affecting other costs.

127 The assumptions and other sources of estimation uncertainty disclosed in accordance with paragraph 125 relate to the estimates that require management's most difficult, subjective or complex judgements. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increases, those judgements become more subjective and complex, and the potential for a consequential material adjustment to the carrying amounts of assets and liabilities normally increases accordingly.

128 The disclosures in paragraph 125 are not required for assets and liabilities with a significant risk that their carrying amounts might change materially within the next financial year if, at the end of the reporting period, they are measured at fair value based on a quoted price in an active market for an identical asset or liability. Such fair values might change materially within the next financial year but these changes would not arise from assumptions or other sources of estimation uncertainty at the end of the reporting period.

129 An entity presents the disclosures in paragraph 125 in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other sources of estimation uncertainty. The nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures an entity makes are:

(a) the nature of the assumption or other estimation uncertainty;

(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;

(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and

(d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

130 This Standard does not require an entity to disclose budget information or forecasts in making the disclosures in paragraph 125.

131 Sometimes it is impracticable to disclose the extent of the possible effects of an assumption or another source of estimation uncertainty at the end of the reporting period. In such cases, the entity discloses that it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year that are different from the assumption could require a material adjustment to the carrying amount of the asset or liability affected. In all cases, the entity discloses the nature and carrying amount of the specific asset or liability (or class of assets or liabilities) affected by the assumption.

132 The disclosures in paragraph 122 of particular judgements that management made in the process of applying the entity's accounting policies do not relate to the disclosures of sources of estimation uncertainty in paragraph 125.

133 Other Australian Accounting Standards require the disclosure of some of the assumptions that would otherwise be required in accordance with paragraph 125. For example, AASB 137 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. AASB 13 *Fair Value Measurement* requires disclosure of significant assumptions (including the valuation technique(s) and inputs) the entity uses when measuring the fair values of assets and liabilities that are carried at fair value.

Extracts from AASB 108/NZ IAS 8:

4 Accounting Policy disclosures:

28 When initial application of an Australian Accounting Standard has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the Australian Accounting Standard;

(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;

(c) the nature of the change in accounting policy;

(d) when applicable, a description of the transitional provisions;

(e) when applicable, the transitional provisions that might have an effect on future periods;

(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if AASB 133 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;

(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(h) if retrospective application required by paragraph 19(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

29 When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if AASB 133 applies to the entity, for basic and diluted earnings per share;

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

30 When an entity has not applied a new Australian Accounting Standard that has been issued but is not yet effective, the entity shall disclose:

(a) this fact; and

(b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Australian Accounting Standard will have on the entity's financial statements in the period of initial application.

31 In complying with paragraph 30, an entity considers disclosing:

(a) the title of the new Australian Accounting Standard;

(b) the nature of the impending change or changes in accounting policy;

(c) the date by which application of the Australian Accounting Standard is required;

(d) the date as at which it plans to apply the Australian Accounting Standard initially; and

(e) either:

(i) a discussion of the impact that initial application of the Australian Accounting Standard is expected to have on the entity's financial statements; or

(ii) if that impact is not known or reasonably estimable, a statement to that effect.

5 Changes in accounting estimates

39 An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.

40 If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.