Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**IFRS for SMEs disclosures – new Tier 2 framework**	**Meeting**	AASB February 2019 (M169)
Topic:	**Staff Paper**	**Agenda Item:**	7.1
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What is the proposal?

1 The objective of this project is to assess whether it would be feasible to adapt the disclosure requirements in the *International Financial Reporting Standard for Small and Medium Sized Entities* (IFRS for SMEs standard) for use by for-profit entities that are not publicly accountable entities, while retaining the recognition and measurement requirements from full IFRS Standards. If the assessment is positive, it might result in a new Tier 2 disclosure standard for Australian entities to replace the current RDR framework).

2 The aim is to have two key outputs from this project:

(a) a new Tier 2 disclosure standard for Australian entities that might replace the current RDR disclosures; and

(b) a document that could assist the IASB in their IFRS for SMEs for Subsidiaries project[1].

Objective of this paper

3 The objective of this paper is to ask the Board to:

(a) **decide** whether to progress developing a separate IFRS for SMEs-based disclosure standard to be exposed as a new Tier 2 GPFS framework (still full recognition and measurement with reduced disclosure);

(b) **provide feedback** on the proposed methodology followed by staff in performing the analysis and comparison of recognition, measurement (R&M) and disclosure requirements in IFRS for SMEs standard and full IFRS (paragraph 27-35 of this staff paper); and

(c) **agree** on the next steps.

1 The objective of the IASB project is to assess whether it would be feasible to permit subsidiaries that meet the definition of a small and medium-sized entity (SME) to use the recognition and measurement requirements in IFRS Standards and the disclosure requirements in the IFRS for SMEs Standard. See link to the project site

4 A draft analysis and comparison of R&M requirements in IFRS for SMEs standard and full IFRS (see agenda paper 7.2) is included in the supplementary folder. Staff has only covered 37 sections in IFRS for SMEs standard and AASB interpretations are not yet covered. The Board members are encouraged to review the draft analysis and comparison of R&M requirements in IFRS for SMEs standard and full IFRS and provide preliminary views/feedback on staff's assessments of R&M differences and related recommendations.

Why should the Board consider this agenda item at today's meeting?

5 Feedback from roundtables, surveys and submissions to ITC 39[2] has been that stakeholders consider the disclosure requirements in current Reduced Disclosure Requirements (RDR) too much and the disclosures proposed in the Specified Disclosure Requirements (SDR) too little in some instances and want something in-between. Assuming the Board agrees with the staff recommendation in agenda item 4.1 to proceed with Phase 2 of the adoption of the IASB's revised conceptual framework in Australia, a new Tier 2 GPFS framework will need to be developed in response to the feedback received.

6 The IASB added a project on SMEs that are subsidiaries to their research pipeline after the 2015 agenda consultation. This project is currently identified as being subject to feasibility assessment. Staff propose sharing the analysis undertaken in this paper with the IASB, to help with this assessment. Should the IASB agree that the approach proposed by staff is workable, and move the project to their active agenda, this would mean that the IASB would ultimately take ownership for developing and maintaining the disclosure standard. It would not only remove the need for the AASB to maintain a separate Tier 2 disclosure standard, but also provide comparability and consistency for subsidiary reporting globally.

7 The project satisfies the AASB strategic objectives of developing standards that meet the needs of external report users but retain transaction neutrality, and of actively influencing the IASB standards by demonstrating thought leadership and enhancing key international relationships.[3]

8 Staff would like to get in principle approval from the Board to proceed with the project, and obtain preliminary feedback on the methodology being used, so an exposure draft can be developed for tabling at the next meeting.

Linkage to the other parts of the Conceptual Framework project

9 This paper links to the Phase 2 approach of ITC 39. The objective of Phase 2 approach is to maintain IFRS as a base for all other entities[4], by having one conceptual framework, remove SPFS and provide a new GPFS Tier 2 alternative.

10 This paper evaluates the feasibility of developing a new GPFS Tier 2 framework for for-profit entities that are not publicly accountable entities which would use the recognition and measurement requirements from full IFRS Standards and the disclosure requirements in the IFRS for SMEs Standard.

Structure of paper

This staff paper is set out as follows:

(a) Background

(b) Why should the AASB develop a separate disclosure standard using IFRS for SMEs Standard as a base?

(c) Advantages and disadvantages of the proposed option

2 See Agenda Paper 4.1 of this Board meeting for more information.
3 See AASB and AUASB Strategy, 2017-2021
4 for-profit private sector entities that do not have public accountability

(d) Key methodology and steps

(e) Staff recommendations

(f) What are the next steps?

Attachments

Agenda Paper 7.2	(WORKING DRAFT) Detailed comparison of R&M requirements in IFRS for SMEs Standard and full IFRS and analysis on impact of disclosures – *(included in the supplementary folder for the Board's preliminary feedback)*
Agenda Paper 7.3	(WORKING DRAFT) Draft ED 2XX – FOR NOTING ONLY

Background

11 Participants at the Phase 2 roundtables in September 2018[5] indicated that a Tier 2 disclosure framework in between SDR and RDR would be appropriate:

(a) Almost all (96%) of attendees strongly agreed that Tier 2 GPFS should fully comply with R&M requirements in Australian Accounting Standards (AAS) to facilitate transparent, comparable, consistent financial statements;

(b) Majority of the participants commented that SDR is too much in some ways but falls short in many other ways; and

(c) Almost half (45%) of participants preferred RDR with further reductions in disclosures and improvements to the usability of the framework.

12 The following feedback was received from the respondents to the AASB's For-profit User and Preparer Survey[6]:

(a) On average 93% of primary users and over 95% of other users said comparability, transparency, comprehensibility and consistency are what is most important to them when reading financial statements. Comparability of R&M was rated 88% in importance to primary users and 100% by other users;

(b) 45% of primary users preferred a combination of GPFS-SDR and GPFS-RDR for the Tier 2 GPFS framework; and

(c) Many respondents said that SDR lacked disclosures on commitments, contingencies and liquidity, which are all necessary to understand the entity's financials.

13 The 36 submissions received by the AASB in relation to the Phase 2 proposals in ITC 39 had similar comments[7]:

(a) 75% of respondents to the Phase 2 submissions support a Tier 2 GPFS framework that requires full compliance with R&M; and

(b) the majority of respondents prefer something in between GPFS-RDR and GPFS-SDR and that GPFS-SDR does not meet user needs.

14 The current Tier 2 disclosure requirements in Australia and New Zealand are essentially the same and are based on the approach developed by the AASB in 2010. That approach:

5 see agenda item 9.1 of AASB meeting held on 13 November 2018
6 See report on For-profit User and Preparer Survey Results issued in December 2018
7 See Agenda Paper 4.1 of this Board meeting for more information

(a) draws on the disclosure requirements in the IFRS for SMEs Standard when Tier 2 recognition and measurement requirements are the same as those under the IFRS for SMEs Standard; and

(b) applies the 'user needs' and 'cost-benefit' principles applied by the IASB in developing its IFRS for SMEs Standard when Tier 2 recognition and measurement requirements are not the same as those available under the IFRS for SMEs Standard.[8]

15 Shading is used in the existing standards to identify those full IFRS disclosures that can be removed based on the approach described in paragraph 14.

16 Subsequently, a post implementation review of the current Tier 2 framework was carried out by the AASB which identified:

(a) that the existing Tier 2 disclosure requirements determined using the approach described in paragraph 14 has d not delivered the outcome expected; and

(b) a need to refine the principles used in determining the level of RDR to achieve an appropriate balance between the benefits of financial information to the users and the costs to the preparers of providing that information.[9]

17 In response to the findings of the post implementation review, the AASB issued ED 277 *Reduced Disclosure Requirements for Tier 2 Entities* in May 2016 as a joint project with the New Zealand Accounting Standards Board (NZASB). ED 277 proposed adopting an RDR decision-making framework, together with accompanying operational guidance. This framework was then applied to the disclosure requirements in Australian Accounting Standards/New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) to identify which of those disclosure requirements should be reduced for Tier 2 entities in each jurisdiction.

18 The framework was based on Key Disclosure Areas (KDAs)[10] which were meant to result in information that meets user needs. Judgement was required when applying this framework, and the overarching principles of user needs and cost-benefit were considered when determining the disclosures that relevant Tier 2 entities in each jurisdiction should make. However, after reviewing the comment letters received on ED 277, the Board decided to conduct further outreach and consultation on the proposals in ED 277 at its August 2017 meeting[11]. Any further work or outreach on ED 277 was put on hold with the commencement of the Conceptual Framework project.

19 Considering the feedback received from constituents in relation to the adoption of the IASB's revised conceptual framework, there does not appear to be much support to reconsider the proposals in ED 277, making it necessary to find an alternative solution.

Why should the AASB consider developing a separate disclosure standard using IFRS for SMEs Standard as a base?

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8 AASB 1053 *Application of Tiers of Australian Accounting Standards* – BC76
9 See ED 277 *Reduced Disclosure Requirements for Tier 2 Entities*
10 The Key Disclosure Areas are:
(a) current liquidity and solvency of the entity; and
(b) transactions and other events that are significant or material to an understanding of the entity's operations as represented by the financial statements. This comprises disclosures about:
  (i) the nature of the transaction or event that makes it significant or material to the entity;
  (ii) associated risks specific to a transaction or event;
  (iii) associated accounting policy on recognition or measurement specific to a transaction or event;
  (iv) associated significant estimates and judgements specific to a transaction or event;
  (v) commitments and contingencies;
  (vi) impairment;
  (vii) related parties; and
  (viii) subsequent events.
11 See minutes of the August 2017 AASB meeting

20 Feedback on the current Reduced Disclosure Requirements (RDR) and other options considered as a possible Tier 2 GPFS framework have generally been mixed and in some instances unfavourable:

(a) Current Tier 2 disclosure framework (RDR)

As explained in paragraph 16 above, refining the principles used in determining the level of RDR to achieve an appropriate balance between the benefits of financial information to the users and the costs to the preparers of providing that information is crucial. The feedback from the roundtables, surveys and submissions on ITC 39 indicated that RDR has too many disclosure requirements. A mechanism of shading the disclosures not applicable to Tier 2 entities is used in the RDR framework. While starting with IFRS for SME disclosures, this is a top-down approach which uses the full IFRS disclosures and then identifies those that can be removed. There is a tendency to retain disclosures in circumstances where a direct comparison is not possible.

(b) Proposed Tier 2 framework in ED 277

The approach taken in this ED was to include an Australian Appendix in each AAS that identifies the disclosures that Tier 2 entities are required to provide, thereby addressing concerns by those that find the shading confusing. However, while ED 277 was based on clear disclosure principles, it still resulted in too many disclosures. The cost-benefit analysis was difficult to apply in the context of disclosures and the top-down approach (starting with full IFRS and removing disclosures) resulted in too many retained disclosures, as removal was difficult to justify with the KDAs.

(c) Specified disclosure framework (SDR) as proposed in ITC 39.

The feedback has been that the SDR is too much in some ways but falls short in many other ways. For example, the feedback received from roundtables, survey and submissions on ITC 39 Phase 2 (see paragraphs 11-13 above) was that whilst the disclosures in SDR are important, requiring full disclosure of those nine standards was too much. Most participants further suggested that SDR might not be appropriate for all industry sectors and is missing some critical disclosures to help predict the viability of an entity such as liquidity, contingent liabilities, subsequent events and commitment disclosures.

21 Staff note that the nature and degree of the differences between full IFRSs and an IFRS for SMEs is determined on the basis of users' needs and cost-benefit analyses[12]. The disclosures are based on six broad principles, see paragraph 33 below. In addition to this consideration, the IFRS for SMEs also allows an undue cost or effort exemption in certain specific and defined circumstances. As a consequence, the disclosure requirements in the IFRS for SMEs are substantially reduced when compared with the disclosure requirements in full IFRSs. The reasons for the reductions are of four principal types:

(a) Some disclosures are not included because they relate to topics covered in IFRSs that are omitted from the IFRS for SMEs (see paragraph BC88 of IFRS for SMEs Standard – Part B);

(b) Some disclosures are not included because they relate to recognition and measurement principles in full IFRSs that have been replaced by simplifications in the IFRS for SMEs (see paragraphs BC98–BC136 of IFRS for SMEs Standard – Part B);

(c) Some disclosures are not included because they relate to options in full IFRSs that are not included in the IFRS for SMEs (see paragraphs BC84–BC86 of IFRS for SMEs Standard – Part B); and

12 As per BC46 of IFRS for SMEs Standard – Part B

(d) Some disclosures are not included on the basis of users' needs or cost-benefit considerations (see paragraphs BC44–BC47, BC157 and BC158 of IFRS for SMEs Standard – Part B).

22 After considering the shortfalls of RDR and the other Tier 2 options in paragraph 20 above and the disclosure principles applied by the IASB for the IFRS for SMEs standard, staff decided to consider whether a new Tier 2 disclosure framework could be developed using the disclosure requirements in IFRS for SMEs Standard as a base.

23 Under this option, disclosures that are relevant to Tier 2 entities would be set out in a separate standard, and would be developed via a 'bottom-up' approach based on the IFRS for SMEs disclosures, without reference to the full IFRS disclosures (ie no shading). The key methodology followed is explained paragraph 27-35 of this paper.

24 Staff consider that the final disclosures would be appropriate for general purpose financial statements that are publicly lodged or are required to comply with AAS, but do not relate to entities that are publicly accountable.

Advantages and Disadvantages of the proposed option

25 Advantages of using IFRS for SMEs Standard as a base are as follows:

(a) The IASB has developed the disclosures in IFRS for SMEs s with for-profit entities that are not publicly accountable entities in mind and considers that they are adequate to meet the needs of the relevant users;

(b) This option is based on a bottom-up approach in developing disclosures and avoids needing to identify specific full IFRS disclosures that need to be retained and those that can be excluded;

(c) This option introduces more flexibility as it would allow drafting disclosures to suit the circumstances and not be restricted by existing full IFRS disclosures;

(d) Setting out the disclosures in a separate standard will make it easier for users, as it avoids having to identify applicable disclosures via shading in between the full disclosures. It will also improve readability where parts of sentences are currently shaded (ie excluded);

(e) This option results in more effective and easier way of reducing disclosures to an appropriate level (based on previous experiences with RDR approach), as it involves needing to justify additional disclosures rather than the removal of disclosures from full IFRS; and

(f) Using the disclosures in IFRS for SME as a base has a potential advantage that if the IASB were to take this on as project as mentioned in paragraph 2 and 6 above, the AASB might ultimately be able to benefit from their work.

26 However, there are also some disadvantages in this approach:

(a) New tier two disclosures will be contained in a separate standard which might not be welcomed by preparers who prefer seeing the disclosure requirements together with the recognition and measurement in each Standard;

(b) Some users may feel the level of disclosures is inadequate;

(c) Adopting this approach will result in a divergence from New Zealand RDR Framework. As per the AASB's For-Profit Standard-setting Framework, differences between accounting standards issued in Australia and New Zealand for For-Profit entities should be minimised wherever possible to reduce the costs for entities operating trans-Tasman. Staff have had preliminary discussions NZASB staff regarding the objective of this project and will continue to engage with NZASB staff about the future direction of this project. As noted under 'Next steps' below, staff will obtain feedback from the NZASB staff following the February Board meeting;

(d) The IFRS for SMEs standard requires reconciliations in certain instances, where ED 277 had proposed not to require such reconciliations.

(e) The IFRS for SMEs standard was last reviewed and updated in 2015. Thus any of the new standards or amendments issued after 2015 have not been incorporated or at least considered in the Basis for Conclusions. It will take additional time and effort to consider whether and how the resulting R&M differences between full IFRS and the IFRS for SMEs standard may affect the required disclosures; and

(f) Australian specific standards will have to be addressed separately as they are not covered in IFRS for SMEs standard.

Key methodology

27 As explained above, the disclosures that are relevant to Tier 2 entities will be in a separate standard (ie will not be shaded in the body or the appendix of each IFRS Standard) and IFRS for SMEs disclosures will be used as the base of the new Tier 2 standard. The final disclosures are expected to be appropriate for general purpose financial statements that are publicly lodged or are required to comply with AAS, but do not relate to entities that are publicly accountable.

28 The disclosures are developed via a bottom-up approach which avoids having to identify specific full IFRS disclosures that need to be retained and those that can be excluded.

29 The main premise is that IFRS for SMEs disclosures should be retained where the R&M principles and options are the same or similar in IFRS for SMEs and full IFRS. For example, finance lease accounting is similar to lease accounting under IFRS 16, so the disclosure for finance leases in the IFRS for SMEs Standard are adequate for all leases under IFRS 16.

30 Disclosures relating to R&M options or treatments in IFRS for SMEs that are not available in full IFRS will be removed. For example, goodwill is not amortised under full IFRS, hence the related disclosures in IFRS for SMEs will not be retained.

31 IAS 1/AASB 101 *Presentation of Financial Statements* and IAS 7/AASB 107 *Statement of Cash Flows* in full IFRS will be replaced in their entirety with the following equivalent sections from the IFRS for SMEs standard:

(a) Section 3 Financial Statement Presentation;

(b) Section 4 Statement of Financial Position;

(c) Section 5 Statement of comprehensive income and income statement;

(d) Section 6 Statement of chnages in equity and statement of income and retained earnings; and

(e) Section 7 Statement of cash flows.

As a consequence, any R&M-related paragraphs in those sections will also be retained in the new disclosure standard for Tier 2 entities: This will make applying the new framework easier for Tier 2 entities, as they will not need to identify the few R&M-related requirements in those standards (e.g. in relation to going concern).

32 To identify R&M differences, staff will refer to:

(a) the staff paper *Comparison of Standards for Smaller Entities* prepared and published in April 2018;

(b) Full IFRS vs IFRS for SMEs comparisons included in [IFRS for SMEs modules] published by the IASB; and

(c) Individual analysis of standards, where a topic is covered by neither of these two sources.

33 Adding any disclosures to the IFRS for SME base should be justified with a clear rationale. Staff propose applying the following broad principles[13] when determining what disclosures should be added where the R&M principles are significantly different, or certain topics are not addressed under IFRS for SMEs standard:

(a) users of the financial statements of for-profit entities that are not publicly accountable entities are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not recognised as liabilities. Thus disclosures in full IFRSs that provide this sort of information are necessary;

(b) users of the financial statements of for-profit entities that are not publicly accountable entities are particularly interested in information about liquidity and solvency. Thus disclosures in full IFRSs that provide this sort of information are necessary;

(c) information on measurement uncertainties is important;

(d) Information about an entity's accounting policy choices is important;

(e) disaggregations of amounts presented in for-profit entities that are not publicly accountable entities' financial statements are important for an understanding of those statements; and

(f) some disclosures in full IFRSs are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical for-profit entities that are not publicly accountable entities.

34 Staff will further be mindful of the IASB's comments in relation to the proposed *SMEs that are Subsidiaries* project, being that any tailoring of the disclosure requirements should be restricted to the absolute minimum:

(a) to avoid the risk of appearing to create a third dialect of IFRS Standards (alongside IFRS Standards and the IFRS for SMEs Standard); and

(b) to minimise the work needed, both for stakeholders and for the Board and staff.[14]

Key steps

35 The key steps are as follows:

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13 These principles are similar to those IFRS for SMEs standard is based on – See BC157 of IFRS for SMEs standard – Part B
14 IASB Project website *SMEs that are Subsidiaries*

1. Start with the full text of the IFRS for SMEs Standard
2. Strike off the recognition and measurement texts from IFRS for SMEs Standard
3. Use work performed already (as explained in paragraph 32) in identifying if the R&M in full IFRS is different to IFRS for SMEs Standard.
4. Identify topics with same or similar R&M – retain disclosures without change
5. Identify topics with R&M options not available under full IFRS – remove disclosures
6. Where R&M are significantly different, and for topics not covered by IFRS for SMEs Standard - consider what additional disclosures are needed
7. Check that complete suite of IFRS standards, interpretations and Australian specific standards have been considered

Staff recommendations

36 Staff recommend:

(a) developing a separate disclosure standard (ie moving away from shading or appendix in each standard) that is based on the IFRS for SMEs Standard to be included as part of the proposals in the ED related to Phase 2 of ITC 39 but would apply to entities that comply with full recognition and measurement requirements of full IFRS;

(b) following the approach and key steps explained in paragraph 27-35 in performing the analysis and comparison of recognition and measurement (R&M) and determining which disclosures from IFRS for SMEs may need to be adapted and where it is necessary to add any disclosures requirements in IFRS for SMEs Standard and full IFRS.

Question 1 for Board members

Do Board members agree with the staff recommendations in paragraph 36 above?

Question 2 for Board members

Do Board members have any preliminary feedback on staff's assessment of R&M differences and related recommendations in the agenda paper 7.2?

Next steps

Date	**Project milestone**
19 February	The Board to comment on staff recommendations on this agenda paper
21 February	Liaise with NZASB and obtain their comments on the Board's recommendations

Date	Project milestone
March-April	Staff to finalise the comparison of R&M and disclosures requirements of full IFRS and IFRS for SMEs Staff to draft pre ballot draft ED
30 April/1 May	The Board to review the final analysis and comment on staff recommendations as to which disclosures to retain, add or remove using IFRS for SMEs Standard as a base The Board to review the pre ballot draft ED
6-16 May	Staff to address Board's comments on the pre ballot draft ED
22 May	Send ballot draft ED to Board for voting out of session
5 June	Voting closes on ballot draft of ED
September	Incorporate the final proposals relating to disclosures for Tier 2 GPFS in the overall ED related to Phase 2 of ITC 39. (The timing of exposure of the Tier 2 disclosure proposals will depend on the timing of the overall ED for Phase 2 of ITC 39)

Question 3 for Board members

Do Board members agree with the proposed plan above?