AASB Exposure Draft

ED 2XX
April 2019

General Purpose Financial Statements – Tier 2 Framework

Comments to the AASB by x xx 20xx

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by x xx 20xx.

Formal Submissions

Submissions should be lodged online via the "Work in Progress – Open for Comment" page of the AASB website (www.aasb.gov.au/comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@aasb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

ISSN 1030-5882

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PREFACE

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards.

The AASB is a Commonwealth entity under the *Australian Securities and Investments Commission Act 2001*. AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of Australian Accounting Standards.

Exposure Drafts

The publication of an Exposure Draft (ED) is part of the due process that the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

What we are proposing

This ED proposes:

(a) a new set of principles to be used in determining the level of Tier 2 disclosures that are necessary for meeting user needs, to replace the current Reduced Disclosure Requirements (RDR) framework;

(b) Tier 2 disclosure requirements that are the result of applying those principles; and

(c) a new approach to presenting the Tier 2 disclosures in the Australian Accounting Standards. This approach will result in a separate disclosure standard for for-profit entities that must comply with the recognition and measurement requirements (R&M) of full IFRS but do not have public accountability and hence may not need to provide all of the disclosures required by full IFRS.

The ED does not change which entities are permitted to report in accordance with Tier 2 accounting requirements and does not change the recognition and measurement requirements applying to Tier 2 entities.

The approach currently used by the AASB to identify Tier 2 disclosures is by shading in Australian Accounting Standards and Interpretations the disclosures that are not required for Tier 2 entities. This ED proposes a different approach. The disclosures that are relevant to Tier 2 entities will be set out 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 a base of the new Tier 2 standard.

Why we are making these proposals

AASB 1053 sets out the application of two tiers of General Purpose Financial Statements (GPFS) both with the same recognition and measurement requirements, but different levels of disclosure. In this context:

(a) for-profit entities with 'public accountability' (such as listed companies) and governments at the federal, state/territory and local; levels must apply Tier 1; and

(b) for-profit entities (other than for-profit entities with public accountability), not-for-profit private sector entities and public sector entities other than governments can apply Tier 2 and have the option to apply Tier 1.

At present, entities that are required to prepare financial statements in compliance with Australian Accounting Standards but have assessed that they are not a reporting entities as defined in SAC 1 *Definition of the Reporting Entity,* can also prepare special purpose financial statements (SPFS). SPFS only need to comply with the disclosure requirements of specified standards. However, the AASB decided in xxx 2019 to repeal SAC 1 and remove the Australian reporting entity concept for for-profit private sector entities such that these entities would be required to prepare GPFS going forward. The reporting requirements of not-for-profit and public sector entities will be considered in a separate project.

In this context, the AASB further agreed to revise the Tier 2 disclosure framework for for-profit private sector entities. Although there is a need for GPFS to cater for the information needs of a wide range of users, the objective is to find a balance between the benefits of financial information to the users and the costs to the preparers of providing that information. There is also a need to ensure that the users are not overburdened with unnecessary information that make financial statements less understandable to them.

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 uses the IFRS for SMEs Standard as the starting point and:

(a) draws directly 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.

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

In 2016/17 (TBC), the AASB carried out a post-implementation review of the current Tier 2 framework which identified:

(a) that the existing Tier 2 disclosure requirements determined using the approach described above has 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.[1]

In response to the findings of the post implementation review, the AASB issued ED 277 *Reduced Disclosure Requirements for Tier 2 Entities*[2] 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.

The framework was based on Key Disclosure Areas (KDAs) 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. Any further work or outreach on ED 277 was put on hold with the commencement of the Conceptual Framework project.

In May 2018, the AASB issued ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (ITC 39). In ITC 39, the AASB proposed an alternative Tier 2 framework which combined full recognition and measurement requirements with specified disclosures from some Accounting Standards, including consolidation and equity accounting where applicable ('Specified Disclosure Requirements'; SDR).

Feedback received on the proposals in ITC 39 through roundtable discussions, a user and preparer survey and submissions was that the majority preferred retaining full recognition and measurement requirements, but did not like either the current GPFS RDR framework or the proposed alternative SDR framework. Instead, respondents felt that something in between the RDR and SDR framework would better satisfy user needs.

1 Further details about the post-implementation review are included in the preface to ED 277 *Reduced Disclosure Requirements for Tier 2 Entities*.

2 Link to ED 277 *Reduced Disclosure Requirements for Tier 2 Entities*

In summary, the following shortfalls were identified in the different options used and considered in the past as a possible Tier 2 GPFS framework:

(a) Current Tier 2 disclosure framework (RDR)

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 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* 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 Australian Accounting Standard (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 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.

After considering the shortfalls of the RDR and the other two alternatives previously suggested, and the disclosure principles applied by the IASB for the IFRS for SMEs standard, the AASB decided to develop a new Tier 2 disclosure framework using the disclosure requirements in IFRS for SMEs Standard as a base. Under this approach, 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 AASB considers 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 approach

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

(a) The IASB has developed the IFRS for SMEs disclosures 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 approach introduces more flexibility as it would allow drafting disclosures to suit the circumstances and not be restricted by existing full IFRS disclosures;

(c) 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);

(d) This approach 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

(e) Using IFRS for SME basis has a potential advantage that if the IASB were to take this on as project[3] as mentioned in paragraph 2 above, the AASB might ultimately be able to benefit from their work.

3 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.

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;

(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.

Who would be affected

It is proposed that the Tier 2 disclosure requirements in this ED shall apply to the GPFS of for-profit private sector entities that do not have public accountability. These entities may elect to apply Tier 1 reporting requirements in preparing GPFS.

We need your feedback

Comments are invited on any of the proposals in this Exposure Draft by x xx 20xx. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue (whether an issue specifically identified below or another issue).

Application date

It is proposed that this [draft] Standard be applicable to annual reporting periods beginning on or after 1 January 20xx.

Specific matters for comment

The AASB would particularly value comments on the following:

<To be completed>

General matters for comment

The AASB would also particularly value comments on the following general matters:

1 Whether *The AASB's For-Profit Standard-Setting Framework* has been applied appropriately in developing the proposals in this Exposure Draft?

2 Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Financial Statistics (GFS) implications?

3 Whether, overall, the proposals would result in financial statements that would be useful to users?

4 Whether the proposals are in the best interests of the Australian economy?

5 Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or

qualitative? In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

[DRAFT] FRAMEWORK FOR DETERMINING DISCLOSURES FOR FOR-PROFIT PRIVATE SECTOR TIER 2 ENTITIES IN AUSTRALIA

Preface

1 In accordance with AASB 1053 *Application of Tiers of Accounting Standards*, Tier 2 requirements comprise the recognition and measurement requirements of Tier 1 but substantially reduced disclosure requirements. The Tier 2 requirements in AASB 1053 currently apply to for-profit and not-for-profit private and public sector entities alike. However, the AASB decided in xxx 2019 to amend paragraph 13 of AASB 1053 such that separate tier 2 requirements will apply to for-profit private sector entities, not-for-profit entities and public sector entities.

2 The framework proposed in this exposure draft and the associated disclosures will only apply to for-profit private sector entities. This group of entities is similar in nature to the entities that are permitted to apply the IFRS for SMEs standard overseas. While the AASB has decided not to adopt IFRS for SMEs as an alternative for Tier 2, the IASB's assessment of user needs and cost-benefit considerations in relation to the disclosures for this group of entities will be similarly relevant to Australian for-profit private sector entities without public accountability.

3 The proposed framework is therefore based on the premise 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. Disclosures relating to R&M options or treatments in SMEs that are not available in full IFRS will be removed.

4 Judgement is required when applying the framework and the overarching principles of user needs and cost-benefit are considered when determining the disclosures that relevant Tier 2 entities.

5 The disclosures that are relevant to for-profit private sector Tier 2 entities will be set out in a separate standard (ie will not be shaded in the body or the appendix of each IFRS Standard). They are expected to be appropriate for general purpose financial statements that are publicly lodged or are required to comply with Australian Accounting Standards, but do not relate to entities that are publicly accountable.

Basis for development of proposed Tier 2 disclosure framework

6 The Tier 2 disclosure framework has been developed to provide a consistent basis for determining the minimum disclosure requirements for for-profit private sector Tier 2 entities.

7 The overarching principles of this framework are that:

(a) the information provided by the financial statements meets user needs; and

(b) the benefits of providing the disclosures exceed the costs.

8 AASB 1053 sets out the eligibility criteria that entities must meet to report in accordance with Australian Accounting Standards – Tier 2 framework. This framework does not change those criteria.

Tier 2 disclosure framework and principles applied

9 The main premise of the disclosure framework is that IFRS for SMEs disclosures should be retained where the recognition and measurement (R&M) principles and options are the same or similar in IFRS for SMEs and full IFRS. Disclosures relating to R&M options or treatments in SMEs that are not available in full IFRS will be removed.

10 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 removed.

11 AASB 101 *Presentation of Financial Statements* and 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 changes in equity and statement of income and retained earnings*; and

(e) Section 7 *Statement of cash flows*.

12 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).

13 Adding any disclosures to the IFRS for SME base is justified with a clear rationale. The following broad key principles[4] are applied 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.

14 The AASB is also mindful of the IASB's comments in relation to the proposed *SMEs that are Subsidiaries* project[5], 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.

Key methodology

2 The key steps applied in developing the proposed disclosure standard are as follows[6]:

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 14) 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

4 These principles are similar to those IFRS for SMEs standard is based on – See BC157 of IFRS for SMEs standard – Part B
5 IASB Project website *SMEs that are Subsidiaries*
6 To identify R&M differences, the AASB has referred to:

- the staff paper Comparison of Standards for Smaller Entities prepared and published in April 2018;
- Full IFRS vs IFRS for SMEs comparisons included in IFRS for SMEs modules published by the IASB; and
- Individual analysis of standards, where a topic is covered by neither of these two sources.

[DRAFT] TIER 2 DISCLOSURE STANDARD 10XX

<To be completed>