AASB Consultation Paper **February 2010**

Differential Financial Reporting – Reducing Disclosure Requirements

A Proposed Reduced Disclosure Regime for Non-publicly Accountable For-profit Private Sector Entities and Certain Entities in the Not-for-profit Private Sector and Public Sector

Comments to the AASB by 23 April 2010 (refer to inside cover)

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Consultation Paper

This is the final version of a draft Consultation Paper issued on 4 December 2009. The AASB also issued Exposure Draft ED 192 *Revised Differential Reporting Framework* on 26 February 2010. The closing date for comments on that Exposure Draft is 23 April 2010. This Consultation Paper and the Exposure Draft are complementary and should be read together. Specific questions on this Consultation Paper and the Exposure Draft are included in the Exposure Draft.

Comments should be addressed to:

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

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 Chairman of the AASB agrees to those submissions being treated as confidential. The latter will only occur if the public interest warrants such treatment.

Obtaining a Copy of this AASB Consultation Paper

This Consultation Paper is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this Consultation Paper are available by contacting:

The Customer Service Officer
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne Victoria
AUSTRALIA

Phone: (03) 9617 7637
Fax: (03) 9617 7608
E-mail: publications@aasb.gov.au
Postal address:
PO Box 204
Collins Street West Victoria 8007

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Approach to Asking for Comments to the AASB

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

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Differential Financial Reporting ─ Reducing Disclosure Requirements

(A Proposed Reduced Disclosure Regime for Non-publicly Accountable For-profit Private Sector Entities and Certain Entities in the Not-for-profit Private Sector and Public Sector)

February 2009

Prepared by the Australian Accounting Standards Board (AASB)

Introduction

This Consultation Paper sets out a proposal to introduce a second tier of reporting requirements into the Australian financial reporting framework to substantially reduce the burden of financial reporting for certain entities in both the private and public sectors in preparing their general purpose financial statements (GPFSs). It proposes a regime which requires disclosures that are substantially reduced when compared with those required under the 'full IFRSs as adopted in Australia'[1].

The proposed Reduced Disclosure Regime would not change the current AASB policy of transaction neutrality, which is designed to ensure that all Australian entities preparing financial statements (whether for-profit or not-for-profit) apply the same bases of recognition and measurement to the extent possible.

With the introduction of the Reduced Disclosure Regime, the Australian Accounting Standards would consist of two tiers of reporting requirements that would apply to GPFSs:

Tier 1: full IFRSs as adopted in Australia; and

Tier 2: the Reduced Disclosure Regime[2].

Tier 1 would be required of relatively few entities preparing financial statements.

1 The current Australian Accounting Standards incorporate International Financial Reporting Standards (IFRSs) and include modifications for not-for-profit entity specific issues and also includes other domestic standards dealing with domestic and not-for-profit issues. These Standards are referred to in this paper as 'full IFRSs as adopted in Australia' to distinguish them from the proposed reduced disclosure regime, which would be regarded as the second tier of reporting requirements under Australian Accounting Standards.

2 The proposed reduced disclosure regime would be part of the AASB's proposed revised differential reporting framework as depicted in Appendix 1.

In the private sector, for-profit entities that do not meet the definition of a publicly accountable entity would be able to apply the requirements of the Reduced Disclosure Regime.[3]

The proposed Reduced Disclosure Regime would also be available as a choice for not-for-profit entities in the private sector in preparing their GPFSs, unless relevant regulators require application of full IFRSs as adopted in Australia.

In the public sector, entities that would not otherwise be required by the AASB to apply full IFRSs as adopted in Australia would also have the choice of using the requirements of the proposed Reduced Disclosure Regime, depending upon the requirements of the relevant public sector entity regulator.

AASB Approach

The proposals are intended to be a pragmatic but significant response to the need to reduce the burden of accumulated disclosure requirements on Australian reporting entities.

The proposals are not held out as the complete or final answer to that need. The focus of the initial reforms is through the Australian differential reporting framework and benefits only those entities that would be able to apply Tier 2 requirements. The AASB will continue its deliberations on a revised differential reporting regime with a view to further improvements. The AASB is of the view that the reforms proposed in this Paper should not be delayed while consideration of other possible areas of reform continues.

Moreover, important reforms are also currently being considered to reduce the complexity of International Financial Reporting Standards (full IFRSs), including in the area of financial instruments, which would help reduce reporting complexities when adopted in Australia. The IASB will move beyond financial instruments in its efforts to simplify requirements and the AASB encourages and supports those efforts.

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3 An entity has been defined by the International Accounting Standards Board in the *IFRS for SMEs* as having public accountability if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

The proposals draw on the disclosures set out in the IASB's *IFRS for SMEs*, adjusted where necessary for recognition and measurement differences between full IFRSs as adopted in Australia and the *IFRS for SMEs*.

Alternatives to a Reduced Disclosure Regime / Structure of Paper

This paper consists of two parts.

Part A contains background material on the current differential reporting framework and discusses Options for establishing a second tier of reporting requirements for GPFSs, including the 'Option of using the *IFRS for SMEs*'. This includes consideration of the costs and benefits of each Option.

Part B sets out the main tenets of the proposals for a Reduced Disclosure Regime.

Appendices 1 to 5 include additional information on some of the issues discussed in the paper.

Beneficial and Adverse Impacts on Australian Entities

As indicated, it is anticipated that the disclosure regime proposed in this paper would substantially reduce the disclosure burden of the great majority of preparers of GPFSs. It would also clarify the circumstances in which financial statements are regarded as GPFSs.

However, it is acknowledged that it may also indirectly lead to an increase in the reporting burden of entities currently lodging on public registers financial statements that are not GPFSs. Section 9 clarifies that the phrase 'prepared in accordance with Accounting Standards', means prepared in accordance with all reporting requirements under a Tier and not a subset of them. This will impact on entities that lodge special purpose financial statements when such statements are required to comply, or are held out as complying with, Accounting Standards.

In both the public and private sectors, when responsible authorities are making decisions about which entities are to prepare GPFSs under the Reduced Disclosure Regime, given GPFS consolidation requirements, they would need to bear in mind any consequences for those GPFSs, higher in the sector, prepared under Tier 1 requirements.

Section 11 discusses the impacts on the preparers and users of applying the proposed Reduced Disclosure Regime.

Important Related Reforms

The Australian Government has issued proposals, in respect of entities regulated under the *Corporations Act 2001*, dealing, among other matters, with reporting by companies limited by guarantee, parent-entity financial statements and the requirement to pay dividends out of profits.

The AASB has previously recommended reform in those areas and regards the Australian Government's proposals as not only being significant in their own right, but also as facilitating the AASB's proposed financial reporting reforms. Some of those reforms may well impact respondents' views on alternative approaches and so the AASB would encourage respondents to consider both sets of initiatives before commenting.

The AASB encourages other regulators (e.g., those with industry responsibilities) that set down or invoke financial reporting requirements to review their positions to ensure that those requirements remain compatible with the revisions to the Australian differential reporting framework and GPFSs. The AASB has been concerned for some time that some entities are being required to apply full IFRSs as adopted in Australia in circumstances in which it is doubtful that a reporting entity, as envisaged in the financial reporting framework, exists. The additional concern now is that regulators may not act to adjust their requirements, even if correctly focussed on reporting entities, to reflect the introduction of a second tier of disclosure requirements.

Part A: Background

1. Differential reporting

1.1 It is relatively common around the world for jurisdictions to have a framework that determines which entities prepare financial statements and the requirements those entities must apply. Often, entities are subclassified and different reporting requirements apply to each class. These are referred to as 'differential reporting frameworks', in that not all entities have to prepare the same financial statements.

1.2 Many regulators are presently involved with Australia's differential reporting framework, including the AASB, the Australian Securities and Investments Commission (ASIC), and the Treasuries and other agencies at the Commonwealth level and in each State and Territory.

1.3 Under the existing Australian framework some entities are required to prepare financial statements in accordance with the accounting standards (such as many Corporations Act entities), others are required to apply only some of those standards (such as associations in some states), and some are exempted from preparing financial statements at all (such as small proprietary companies).

1.4 The Australian Accounting Standards are generally promulgated to apply to the reporting of transactions and other events irrespective of the nature of economic activity of the entity and the sector in which it carries out those activities.

2 General purpose financial statements

2.1 Under the existing differential reporting framework, general purpose financial statements (GPFSs) are prepared using all applicable accounting standards. GPFSs are:

> financial statements intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.[4]

If an entity does not apply accounting standards in preparing its financial statements or applies only some of the applicable accounting standards, the resulting financial statements are termed 'special purpose financial statements' (SPFSs).

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4 AASB 101 *Presentation of Financial Statements.*

2.2 The AASB’s accounting standards have incorporated the concept of ‘reporting entity’ since the early 1990s[5]. A reporting entity is:

> an entity in respect of which it is reasonable to expect the existence of users who rely on the entity’s general purpose financial statements for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.[6]

2.3 Reporting entities are required by the accounting standards to prepare GPFSs. A number of accounting standards specifically also apply to non-reporting entities.[7]

3 International Financial Reporting Standards (IFRSs)

3.1 ‘Full IFRSs as adopted in Australia’ have applied to all entities preparing GPFSs since 2005. The current Australian Accounting Standards incorporate International Financial Reporting Standards (IFRSs) and include modifications for not-for-profit entity specific issues and also include other additional domestic standards dealing with domestic and not-for-profit issues.

3.2 In July 2009, the IASB published the International Financial Reporting Standard for Small and Medium-sized Entities (*IFRS for SMEs*)[8]. The *IFRS for SMEs*, if invoked in a country, applies to entities that:

(a) do not have public accountability; and

(b) publish GPFSs.

The *IFRS for SMEs* is not a mandatory part of IFRSs that Australia or any country or region applying IFRSs is obliged to adopt. Each jurisdiction needs to consider its suitability, including how it will impact on entities already applying full IFRSs, its usefulness to entities that are not for-profit private sector entities and its applicability when a country, such as Australia, has an integrated policy for financial reporting across all sectors. The IASB only addresses financial reporting by for-profit private sector entities.

5 Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity*.
6 AASB 101, paragraph Aus7.2.
7 AASB 101, AASB 107 *Statement of Cash Flows*, and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* apply to each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act regardless of whether the entity is a reporting entity.
8 The IFRS for SMEs can be reached on the IASB website (www.IASB.org).

3.3 The *IFRS for SMEs* defines ‘public accountability’ as follows:

> An entity has public accountability if:
>
> (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or
>
> (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.[9]

3.4 Entities with public accountability must apply ‘full IFRSs’ to their GPFSs to claim compliance with IFRSs, while entities that do not have public accountability can apply the *IFRS for SMEs* to their GPFSs and claim compliance with the *IFRS for SMEs*. That is, within the IASB’s reporting framework, there are now two forms of GPFSs.

4 Concerns about the existing Australian framework

4.1 There is clearly a need for more than one tier of financial reporting. That need has generally been satisfied in Australia by entities either applying all of the standards and preparing GPFSs or applying only those standards that the entity judges to be suitable and preparing SPFSs. For example, wholly-owned subsidiaries of listed entities that prepare financial statements and lodge them with the ASIC often apply the recognition and measurement requirements of all the standards, but few of the disclosure requirements. They see that as suiting their needs because their results need to be consolidated into a group, which applies full IFRSs, while many of the disclosures are prepared only at the group level.

4.2 A commonly voiced concern is that the existing framework does not allow entities that have limited external users a set of requirements that are less burdensome than full IFRSs as adopted in Australia, but would nevertheless lead to GPFSs.

4.3 Another related concern raised is that entities are asserted to be ‘abusing’ the reporting entity concept by claiming to be non-reporting entities and preparing SPFSs when they should be preparing GPFSs. An impetus for this is the desire to avoid the cost and exposure that would come from applying full IFRSs as adopted in Australia.

4.4 A further related concern is that many of the regulators requiring the preparation and lodgement of financial statements may not have given sufficient consideration to the

9 *IFRS for SMEs*

nature of the information they require and the needs of any external users of that information. That is, there may be entities that are required to prepare financial statements in accordance with accounting standards for which there are few if any users, or potential users, or for which there are particular users whose needs are not being met because the relevant entities are preparing SPFSs that are inadequate.

4.5 In May 2007, in response to the above concerns, the AASB released Invitation to Comment 12 *Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities* (ITC 12). The AASB began redeliberating the ITC 12 proposals in late 2007 in the light of feedback received from constituents through comment letters and via Roundtable discussions. Appendix 1 provides a brief background to the proposed revised differential reporting regime outlined in this paper.

4.6 Some other jurisdictions are also currently considering their differential reporting frameworks, including Canada, New Zealand, the United Kingdom and the United States. Some have been prompted to do so by the recent development by the IASB of the *IFRS for SMEs*. Appendix 4 summarises current differential reporting deliberations in a number of other jurisdictions.

4.7 Developments in differential reporting in New Zealand are of particular interest to Australia. Recently a Statement of Intent was signed between the Prime Ministers of Australia and New Zealand that includes Outcome Proposals aimed at convergence in the area of financial reporting in the two countries. Appendix 5 to this paper further explains these Outcome Proposals.

5. Options for a second tier of GPFS reporting requirements

5.1 Options for a second tier of GPFS reporting requirements are:

Option 1: The Reduced Disclosure Regime

Option 2: The *IFRS for SMEs* as adopted in Australia

Option 3: The status quo

5.2 The AASB considers that any second tier GPFS requirements should be available to:

(a) for-profit private sector entities that do not have public accountability (as defined by the IASB);

(b) not-for-profit private sector entities unless relevant regulators require Tier 1; and

(c) for-profit public sector entities;

(d) not-for-profit public sector entities other than those required by the AASB to apply Tier 1 (such as the Commonwealth, State and Territory Governments, Local Governments and Universities), subject to the requirements of relevant public sector entity regulators.

5.3 A large number of preparers in both the for-profit and not-for-profit sectors are expected to be affected by any second tier GPFS requirements.

(a) In the for-profit sector, for example, many of the approximately 7,000 large proprietary companies that lodge financial statements with the ASIC would be able to apply second tier requirements. If such companies currently prepare GPFSs under full IFRSs as adopted in Australia, they would, under the proposals, have a substantially reduced disclosure burden. However, the AASB notes that companies currently preparing special purpose financial statements, if required to prepare GPFSs under any of the options canvassed in this paper, would most likely face increased reporting requirements. This is discussed further below.

(b) There are approximately 11,000 public companies limited by guarantee that lodge financial statements with the ASIC. Many of these companies are not-for-profit entities and, therefore, may apply second tier requirements unless relevant regulators require Tier 1. Should the Australian Government proceed with its proposals to introduce exemptions from financial reporting for some of these companies, the cost benefit analysis here would be affected.

(c) There are approximately 7,000 unlisted public companies limited by shares that are required to lodge financial statements with the ASIC. Many such entities are not publicly accountable and would, therefore, be able to apply second tier GPFS requirements.

(d) In the public sector, there are potentially thousands of entities that would be able to apply a second tier of GPFS requirements.

(e) There are also potentially thousands of entities established under legislation other than the Corporations Act and that operate in the not-for-profit private sector that would be able to apply a second tier of reporting requirements.

Expressed differently, the number of entities required to prepare GPFSs in accordance with full IFRS as adopted in Australia would be a small minority.

Option 1

5.4 This option, the proposal in this paper, concentrates on substantially reducing the burden of disclosures currently faced under full IFRS as adopted in Australia. It does not involve changes to existing recognition and measurement requirements. The AASB considered alternative approaches to determining disclosures under this Option and chose to propose an approach which uses the same principles as employed by the IASB when determining disclosures under the *IFRS for SMEs*. Appendix 3 outlines the alternative approaches considered and the AASB's proposed approach.

Option 2

5.5 Option 2 is to use the *IFRS for SMEs*[10] as a second tier of reporting requirements for preparing GPFSs under Australian Accounting Standards.

5.6 ITC 12, issued in May 2007, included the Exposure Draft of A Proposed *IFRS for SMEs* and proposed its use as a second tier of reporting requirements (see Appendix 1).

5.7 Respondents to the ITC 12 proposals expressed mixed views. Some supported using the *IFRS for SMEs* as a basis for a revised differential reporting framework. Others saw the *IFRS for SMEs* as only one element in a revised differential reporting framework possibly combined with the reporting entity concept. A third group advocated the continued use of the reporting entity concept for differential reporting purposes.

5.8 In relation to the disclosure burden of Australian Accounting Standards, constituents' comments included the following narrower concerns.

(a) Wholly owned subsidiaries of listed companies that cannot avail themselves of relief under the ASIC class order on cross guarantees, expressed concern that while they have to apply the parent's recognition and measurement accounting policies based on full IFRSs as adopted in Australia, they should not need to include all the disclosures required under those standards.

(b) Other respondents noted that many not-for-profit private and public sector entities find the disclosure requirements in Australian Accounting Standards burdensome.

10 The *IFRS for SMEs* would need to be subjected to an adoption process similar to that needed when adopting full IFRSs. It would also need to be adjusted for Australian legal requirements.

Reconsidering the final IFRS for SMEs

5.9 The *IFRS for SMEs* was published in July 2009. It applies to non-publicly accountable for-profit entities that prepare GPFSs. The *IFRS for SMEs* changes some full IFRS recognition and measurement accounting policy options by mandating or eliminating a particular option or introducing ‘new’ options. That means some of the full IFRS recognition and measurement accounting policy options are not available to SMEs and there are some that differ from comparable full IFRS recognition and measurement requirements. Appendix 2 contains a high level comparison of the *IFRS for SMEs* and full IFRSs.

5.10 The AASB discussed the final content of the *IFRS for SMEs* with a view to assessing its suitability as a second tier set of reporting requirements. The AASB noted that there are concerns about adopting the *IFRS for SMEs* in Australia for the following reasons:

(a) some of the accounting policy options that have been removed would be the favoured accounting policies for many Australian entities;

(b) entities applying the *IFRS for SMEs* would be deprived of improvements and simplifications as they become available at the full IFRS level because the IASB has stated that it will only update the *IFRS for SMEs* once there have been two years of broad adoption and, thereafter, every three years;

(c) changes to full IFRS recognition and measurement requirements under the *IFRS for SMEs* and the absence of some accounting policy options from the *IFRS for SMEs* would force subsidiaries to adjust accounting policies for consolidation purposes when parents apply full IFRSs;

(d) possible benefits that might result from comparability with overseas entities applying the *IFRS for SMEs* would:

(i) depend on how widely adopted it becomes, which is unknown at this stage;

(ii) be limited because entities seeking to access international capital markets would generally apply full IFRSs; and

(iii) be mitigated due to a loss of comparability across all types of entities’ GPFSs within Australia;

(e) having different streams of recognition and measurement requirements involves different streams of knowledge, such that education and training at the tertiary level and within the accounting profession would become more costly;

(f) there would be start up costs because entities preparing GPFSs have already made the effort to apply full IFRSs;

(g) adoption of the *IFRS for SMEs* may be seen as a retrograde step in a country that has already adopted full IFRS recognition and measurement accounting policy options;

(h) the actual changes in recognition and measurement requirements in the *IFRS for SMEs* would not produce any real economies for Australian SMEs (see Appendix 2); and

(i) in the event that an entity moves to, or from, full IFRSs, there would be costs involved in migrating from the recognition and measurement requirements of one tier of reporting to another.

5.11 The AASB notes that the need for the *IFRS for SMEs* in Australia may be confined to entities that have a foreign parent that wants its domestic subsidiaries to apply the *IFRS for SMEs*. There are not expected to be many such entities. There are a number of options for making the *IFRS for SMEs* available to this limited set of entities. These include making the *IFRS for SMEs* available:

(a) through a stand-alone Application Standard envisaged to deal with the application of different tiers of reporting requirements under the proposed revised differential reporting regime; or

(b) through requirements of other regulators, such an ASIC class order, subject to agreement of those regulators.

Option 3

5.12 Under this Option, the disclosure burden of Australian entities remains unaddressed and all entities that prepare GPFSs would continue to have to apply full IFRSs as adopted in Australia.

6. Cost and benefit assessment of different Options

6.1 The AASB assesses from a public interest perspective whether the costs of providing certain financial information exceed the benefits to be derived from its provision. There is no universally accepted methodology for quantitatively measuring costs and benefits of information presented in financial statements. The costs of providing financial information are incurred, in the main, by preparers of GPFSs, but extend in various direct and indirect ways to the users of GPFSs. There is no guarantee that the costs are borne ultimately by those who derive the benefits.

6.2 The following tables provide a qualitative assessment of: (1) a Reduced Disclosure Regime as a second tier of GPFS reporting requirements; (2) the *IFRS for SMEs* as a second tier of GPFS reporting requirements; and (3) the status quo in respect of the overall effect on preparers, users, and the accounting profession.

Option 1: The Reduced Disclosure Regime

Preparers

Assessment	Overall effect	Analysis
Significantly reduced preparation costs	Positive	Application of the Reduced Disclosure Regime has the potential to reduce preparation costs significantly. The number of disclosures an entity would be required to make under the Reduced Disclosure Regime is likely to be a fraction of those under full IFRSs as adopted in Australia. Preparers in all sectors can draw on a common knowledge pool revolving around a single integrated set of reporting requirements.
Significantly reduced audit and assurance costs	Positive	On the basis that there are significantly fewer disclosures, the extent of audit and assurance work in connection with the GPFSs is expected to be reduced with a commensurate reduction of costs.
Limited transition costs	Neutral or positive	For many entities, there would be no significant costs involved in reconstructing financial statements when migrating between Tiers (from Tier 1 to the RDR, or from the RDR to Tier 1) because there are no differences in the ongoing recognition and measurement requirements.
One set of pronouncements	Positive	Having all the requirements of Tier 1 and the RDR in one set of pronouncements readily enables those entities applying the RDR to benefit from relevant additional explanations if the need arises.

Users

Assessment	Overall effect	Analysis
Unchanged usefulness to users	Neutral or positive	Users, including analysts who represent them, will be faced with a substantially reduced volume of information. This may mean that the GPFSs prepared under the Reduced Disclosure Regime are less useful. However, on the basis that the Reduced Disclosure Regime has been designed to meet the particular needs of users of GPFSs of such entities, the information that would no longer be provided is regarded as being less relevant, and therefore, of less value to those users. For the same reason, the financial statements may be more understandable and, therefore, more useful to users.
Unchanged comparability	Neutral	The financial statements prepared under option 1 are comparable to financial statements prepared under full IFRSs as adopted in Australia. This is because Option 1 uses the same recognition and measurement principles as full IFRSs adopted in Australia. The reduction of disclosures under Option 1 would not affect comparability since only less relevant disclosures have been omitted.

Accounting profession

Unchanged costs of education and professional development	Neutral	Since the recognition and measurement requirements under the Reduced Disclosure Regime and full IFRSs as adopted in Australia are the same, there are no significant costs involved either initially or ongoing in training professionals to apply and audit the GPFSs prepared under the Reduced Disclosure Regime. A single integrated body of requirements will continue to be the focus.

Option 2: The IFRS for SMEs

Preparers

Assessment	Overall effect	Analysis
Significantly reduced preparation costs	Positive or neutral for some. Possibly negative for others.	As for option 1, with a reduction in benefits due to the factors listed in 5.11. Changed recognition and measurement requirements are marginal and could disadvantage some entities when engaging in business combinations or being compared for funding or other reasons with peers applying full IFRSs. Option 2 does not provide for revaluations of fixed assets and this would undermine the possibility of transaction neutrality across sectors. The AASB believes this would be potentially quite harmful to preparers in the public sector. The AASB believes that the costs of intermittent changes to *IFRS for SMEs* under the IASB's policy for its maintenance will prove significant, depriving SMEs of planned generic improvements in full IFRSs along the way and accumulating changes to be made after gaps of two or three years.
Significantly reduced audit and assurance costs	Mainly positive	As for option 1. Offsetting effects will exist in groups when parents comply with full IFRSs as adopted in Australia and in relation to particular transactions (eg business combinations) if they require full IFRS financial statements to be constructed.
Increased transition costs	Negative	In the event that an entity moves between tiers, there are additional costs involved in migrating from one tier of reporting to another due to differences in recognition and measurement requirements under the two tiers.
Separate pronouncements	Neutral	There may be an advantage to having a separate 'smaller' book for entities applying the *IFRS for SMEs*. However, this advantage would be mitigated by the likely need for reference to be made to Tier 1 requirements when issues arise which are explained more comprehensively in Tier 1. Furthermore, the same advantage could be obtained by reproducing the RDR in a separate publication.

Users

Assessment	Overall effect	Analysis
Unchanged usefulness to users	Mainly positive	As for option 1, but subject to limitations on comparability (see below).
Reduced comparability	Negative	GPFSs prepared under Option 2 are not comparable to those prepared under full IFRSs as adopted in Australia to the extent that there are differences in recognition and

		measurement requirements between the two tiers. These differences would also translate into differences in disclosures. Users will potentially find differing approaches to measuring equity, assets, liabilities and profit or loss confusing.

Accounting profession

Assessment	Overall effect	Analysis
Increased costs of education and professional development	Negative	Since the recognition and measurement requirements under the *IFRS for SMEs* and full IFRSs differ, there are additional costs involved in training professionals to apply and audit the GPFSs prepared under the *IFRS for SMEs*. Physically, Option 1 can be achieved within the existing single set of accounting standards and can be maintained over time in an integrated fashion as one body of information. Option 2 would lead to two sets of standards that would not always be synchronised, given the IASB's intended policy for updating *IFRS for SMEs*, but whose relationship would need to be carefully tracked by professionals, commentators and students.

Option 3: The status quo

6.3 The analysis above considered the benefits and costs of adopting Options 1 and 2 relative to continuing with Option 3 and, therefore, also reflects the benefits and costs of maintaining the status quo. As shown below, the AASB considers the outcomes of Option 3 as being negative on some assessment criteria and neutral on others.

Preparers

Assessment	Overall effect	Analysis
Ongoing significant preparation costs	Negative	Application of full IFRSs as adopted in Australia is burdensome for many entities in the private and public sectors. For example many of the approximately 7,000 large proprietary companies that lodge financial statements with the ASIC would be carrying a higher reporting burden than if either Options 1 or 2 were adopted. Those entities currently preparing GPFSs under full IFRSs as adopted in Australia would be deprived of concessions under a second tier of GPFS requirements. Moreover, entities that currently prepare special purpose financial statements, if required to prepare GPFSs would experience a significant rise in their reporting burden and preparation costs since they would be left with a single tier of GPFS requirements,

		that is full IFRSs as adopted in Australia. The number of disclosures an entity would be required to make under full IFRSs as adopted in Australia would be a multiple of those required under Options 1 or 2. A similar situation applies to the approximately 11,000 public companies limited by guarantee and approximately 7,000 unlisted public companies limited by shares that are required to lodge financial statements with the ASIC.
Ongoing significant audit and assurance costs	Negative	On the basis that the significantly reduced disclosures under a second tier of GPFS requirements would not be available to eligible entities, the extent of audit and assurance work in connection with the GPFSs is expected to remain significant.
No transition costs	Neutral	There are no transition costs associated with migration between tiers since there is only one tier.

Users

Assessment	**Overall effect**	**Analysis**
Unchanged usefulness to users	Neutral	Users will be faced with a substantially higher volume of information. Under this Option, the level of useful information remains the same or in the case of lodging entities currently preparing SPFSs would be greater. However, in the latter case the greater level of information for these entities that would arise under Option 3 might not bring additional benefits. This is because of the nature of the needs of the users of those entities' financial statements, which may be satisfied using the lower level of information provided under another Option such as Option 1.
Unchanged comparability	Neutral	There would not be any change in comparability as only a single set of GPFS requirements are available.

Accounting profession

Unchanged costs of education and professional development	Neutral	There would not be any significant change in costs of education and professional development since only one set of GPFS requirements is involved.

Concluding comments

6.4 The AASB considers the Reduced Disclosure Regime proposed in this paper to be more appropriate than the *IFRS for SMEs* in meeting the immediate reporting needs of many Australian entities that find the disclosures under full IFRSs as adopted in Australia burdensome.

6.5 Accordingly, the AASB's intention is that the *IFRS for SMEs* would not be used as a second tier set of GPFS requirements in Australia in the short term, and that its longer term adoption would depend on how widely it is adopted in other jurisdictions and the extent to which possible future changes in the standard would help satisfy Australian financial reporting needs. In particular, the *IFRS for SMEs* would need to be adapted so that it does not disadvantage NFP entities in the public and private sectors whose needs have not yet been considered by the IASB.

Part B: The Proposed Reduced Disclosure Regime

7. The nature of the Reduced Disclosure Regime

7.1 The Reduced Disclosure Regime is proposed in response to constituents' concerns about the disclosure burden of particular entities. This regime is a second tier set of reporting requirements that retains the full IFRS recognition and measurement requirements and substantially reduced disclosures corresponding to those requirements.

7.2 The proposed Reduced Disclosure Regime applies to GPFSs. In developing the Regime, the AASB was conscious that reducing disclosures below a certain level would run the risk of not satisfying the objective of GPFSs[11] which is "to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions".[12] The *IFRS for SMEs* which also applies to GPFSs, notes that the application of its disclosure requirements is presumed to result in financial statements that achieve a fair presentation of the financial position, financial performance and cash flows by non-publicly accountable for-profit private sector entities and that the disclosure requirements in the *IFRS for SMEs* should be regarded as the minimum requirements. Accordingly, the AASB is of the view that the extent of disclosures under the Reduced Disclosure Regime, as a second tier set of GPFS requirements, cannot be reduced below a level that undermines the general purpose nature of the entity's financial statements.

7.3 The Appendix to the Exposure Draft ED 192 *Revised Differential Reporting Framework* includes proposed disclosures under the Reduced Disclosure Regime.

8. Determining the disclosures

8.1 In determining the Reduced Disclosure Regime the AASB has sought to balance the need to reduce disclosures with the need to satisfy the objective of GPFSs.

8.2 A number of approaches were considered and Appendix 3 discusses their points of strength and weakness. From amongst those possible approaches, this paper proposes an approach that:

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11 See IFRS for SMEs, Basis for Conclusions, paragraph BC74.
12 AASB *Framework for the Preparation and Presentation of Financial Statements*, paragraph 12.

(a) draws on the *IFRS for SMEs* to identify disclosures in cases where the recognition and measurement accounting policy options available under the proposed Reduced Disclosure Regime align with those available under the *IFRS for SMEs*;

(b) applies the 'user need' and 'cost-benefit' principles (that is, the same principles used by the IASB in determining disclosures under the *IFRS for SMEs*) to arrive at reduced disclosure requirements in cases where the recognition and measurement accounting policy options under the proposed Reduced Disclosure Regime differ from those under the *IFRS for SMEs*.

This approach does not necessarily use the *IFRS for SMEs* disclosures directly, rather it benchmarks the disclosures under the Reduced Disclosure Regime to those under the *IFRS for SMEs* which are seen as the minimum disclosures required to satisfy the objective of GPFSs. This approach would help minimise the cost of determining and maintaining disclosures under the proposed Reduced Disclosure Regime. Satisfying the objective of GPFSs would be the basis for determining the disclosures under the Reduced Disclosure Regime whether or not the recognition and measurement accounting policy options available under that regime align with those provided under the *IFRS for SMEs*.

8.3 In relation to user needs, the *IFRS for SMEs* notes that users of the financial statements of for-profit entities that do not have public accountability are particularly interested in information about:

(a) short-term cash flows and about obligations, commitments or contingencies, whether or not recognised as liabilities;

(b) liquidity and solvency;

(c) measurement uncertainties;

(d) the entity's accounting policy choices;

(e) disaggregations of amounts presented in the financial statements; and

(f) transactions and other events and conditions encountered by such entities.

However, in determining disclosures under the Reduced Disclosure Regime, in addition to particular information needs of users of non-publicly accountable for-profit entities noted above, the information needs of the users of the financial statements of NFP entities in both the private and public sectors would be considered.

9. The meaning of GPFSs in the Australian context

9.1 GPFSs are defined in Section 2 above. To clarify the application of the definition in the Australian context, financial statements that satisfy the following two conditions are GPFSs:

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

(ii) they are either**:**

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

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

9.2 Financial statements held out as having been prepared in accordance with Australian Accounting Standards or held out as being GPFSs to any party are GPFSs. This is because there is an expectation that financial statements held out as GPFSs would be relied upon by users to make economic decisions and should, therefore, faithfully report what is expected to be reported in GPFSs.

9.3 The AASB has also clarified that:

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

(b) 'preparation in accordance with Accounting Standards' means the application of all Accounting Standards in a reporting regime and not a subset of them.

9.4 The reporting tiers made available under Australian Accounting Standards apply to GPFSs. Selective or partial use of accounting standards would lead to financial statements that would not satisfy the objective of GPFSs.

9.5 Financial statements that are not GPFSs are regarded as special purpose financial statements (SPFSs) and would not fall within the ambit of Australian Accounting Standards. SPFSs are prepared only for use by users who can command financial information to satisfy their specific needs. It is those users, rather than the AASB, who identify relevant reporting requirements for preparing SPFSs. Accordingly SPFSs should not claim compliance, or be held out to comply, with Australian accounting Standards.

9.6 Under the above clarifications, financial statements prepared under a legal mandate in accordance with Accounting Standards and lodged on a public register, such as that of the

ASIC, would be regarded as GPFSs. Because of public interest in such entities, the legislator has required lodgement of the financial statements by these entities. For example, in relation to financial statements lodged with the ASIC, Regulatory Guide 43 *Financial reports and audit relief,* October 2008, paragraph RG 43.2 notes[13]:

> "Requiring entities to prepare financial reports that comply with the requirements of Ch 2M and lodge those reports with ASIC is designed to make available information that is useful to a wide range of users to help them make economic decisions. The legislative policy underlying these requirements indicates an expectation that there are 'users' of financial reports."

9.7 A similar view is noted in the Regulation Impact Statement (RIS) relating to *Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007.* The focus of this regulation was on the financial affairs of proprietary companies which have a significant economic influence. The RIS notes that requiring these companies to lodge annual reports is in the public interest for the following reasons[14]:

- the collapse of an economically significant company could have an impact on the community in general, particularly in regional areas;
- smaller trade creditors are not in a position to demand financial information before doing business with a company; and
- employees and representative groups are not in a position to demand financial information from a company.

9.8 Accordingly, preparation of SPFSs by entities that are required by law to prepare financial statements in accordance with accounting standards and be lodged on a public register contradicts the legislation's objective of providing information to a wide range of users who are not in a position to command specific information to satisfy their needs.

Retaining the reporting entity concept as an underpinning concept

9.9 Currently the reporting entity concept is used conceptually to identify when any entity should prepare GPFSs and to discern the borders of that entity. It is also employed operationally in application clauses of standards for differential reporting purposes in Australia. Currently reporting entities must apply all Australian Accounting Standards and non-reporting entities may apply a subset of them[15]. Under the proposed differential

13 Paragraph RG 43 also notes a number of case laws that support the existence of users relying on lodged financial statements.

14 See, paragraph 9.4, Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007.

15 As indicated in paragraph 2.3, AASB 101, AASB 107 *Statement of Cash Flows*, and AASB 108 *Accounting Policies,* Changes *in Accounting Estimates and Errors* apply to each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act regardless of whether the entity is a reporting entity.

reporting regime outlined in this paper, the reporting entity concept would no longer be used to operationalise differential reporting and the focus of application of Australian Accounting Standards would move from 'reporting entity' to GPFSs.

9.10 Whether GPFSs are prepared under full IFRSs as adopted in Australia, or are prepared under the proposed Reduced Disclosure Regime, they are still intended to meet the needs of users dependent on their production. Thus the shift away from using the reporting entity concept per se to scope the application clauses of standards is not in any way inconsistent with the concept itself. Rather it is to achieve more precision in conveying the content of GPFSs, and which form of GPFSs should be employed by which entities. The AASB has retained the reporting entity concept as the underpinning concept for GPFS requirements and will continue to use it as the basis for its own deliberations in the future[16]. The AASB also intends that the reporting entity concept be used as a benchmark for other regulators to identify entities that should prepare GPFSs and those that need not.

9.11 If other regulators were to use the reporting entity concept it would help ensure consistency in identifying entities that should prepare GPFSs across jurisdictions. Under this concept, all reporting entities would be required to prepare GPFSs. With the introduction of the Reduced Disclosure Regime as a second tier of reporting requirements, certain reporting entities would be able to prepare GPFSs under this regime. However, not all entities preparing GPFSs would necessarily be reporting entities. Non-reporting entities may be required to prepare GPFSs under a legal mandate or by virtue of holding out their financial statements as GPFSs or holding them out as having been prepared in accordance with accounting standards.

10. Entities that may apply the Reduced Disclosure Regime

Publicly accountable for-profit private sector entities

10.1 In the private sector, for-profit entities that do not meet the definition of a publicly accountable entity under the *IFRS for SMEs* would be able to apply the requirements of the Reduced Disclosure Regime. The AASB proposes using the IASB's definition from its *IFRS for SMEs*, under which publicly accountable entities are those that meet either of the following conditions:

16 For example, in extending or limiting the types of economic entities that are required to prepare consolidated financial statements.

(a) have their debt or equity instruments traded in a public market or who are in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(b) hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses (typical examples are banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks).[17]

The AASB, in the Exposure Draft, has add to the IASB list of typical examples of publicly accountable entities. The AASB's purpose is to include entities that it considers publicly accountable in the Australian context as a means of clarifying the IASB definition (rather than widening the principle as to which entities fall within the scope of the IASB definition). Typical examples are registered managed investment schemes which are seen as being the Australian equivalents of mutual funds in other jurisdictions and disclosing entities other than those already falling under subparagraph (a) immediately above.

10.2 The above notion of public accountability only applies to for-profit private sector entities and would not be used to identify NFP private sector entities and NFP public sector entities that are permitted to apply the Reduced Disclosure Regime in preparing GPFSs. The AASB notes that adopting a broader notion of public accountability generally used in relation to NFP entities, particularly in the public sector, would not be practicable as a basis for identifying entities that should apply the Reduced Disclosure Regime. This notion of public accountability is a notion reflecting public accountability in the general sense of the term and not with specific meaning employed by the IASB and used in this paper to distinguish between for-profit private sector entities that should apply full IFRSs as adopted in Australia and for-profit private sector entities that can choose to apply a Reduced Disclosure Regime.

NFP private sector entities

10.3 The proposed Reduced Disclosure Regime would be available as a choice for application by NFP entities in the private sector in preparing GPFSs. This choice would only be restricted if relevant regulators of such entities decide that entities in their jurisdictions should apply full IFRSs as adopted in Australia. The Reduced Disclosure Regime will cater for the needs of users of these entities in a manner that is consistent with general NFP

17 The description of publicly accountable entities is derived from the IASB's *IFRS for SMEs*.

modifications introduced in adopting full IFRSs in Australia. Additionally, the AASB currently is undertaking a project designed specifically to improve financial reporting requirements for NFP entities in the private sector. The combination of the Reduced Disclosure Regime and the outcome of that project is expected to result in considerable benefits to the sector.

Public sector entities

10.4 In the public sector, some entities would be specifically required to apply full IFRSs as adopted in Australia. These include Federal, State or Territory Governments, Local Governments, and Universities. Public sector entities, whether for-profit or not-for-profit, other than those required by the AASB to apply full IFRSs as adopted in Australia would have a choice of preparing their GPFSs using the requirements of the proposed Reduced Disclosure Regime, subject to the requirements of relevant public sector entity regulators.

Summary of revised differential reporting framework

10.5 The table below summarises the AASB's proposed differential reporting framework and shows the position of the Reduced Disclosure Regime within that framework.

<table>
<tr><th rowspan="2"></th><th colspan="3">Sector</th></tr>
<tr><th>For-profit Private</th><th>Not-for-profit private</th><th>For-profit and Not-for-profit public</th></tr>
<tr><td>Tier 1

Full IFRSs as adopted in Australia</td><td>Publicly accountable (per IASB definition, with additional examples of publicly accountable entities in the Australian context)</td><td rowspan="2">All NFP private sector entities have a choice of applying Tier 2 requirements unless the relevant regulator requires application of full IFRSs as adopted in Australia</td><td>Federal, State and Territory Governments, Local Governments, and Universities*</td></tr>
<tr><td>Tier 2

Reduced Disclosure Regime
(entities may choose to apply full IFRSs as adopted in Australia)</td><td>Non-publicly accountable</td><td>Entities other than Tier 1 entities noted above, subject to the requirements of relevant public sector entity regulators</td></tr>
</table>

(*) The list is not intended to be exhaustive. The AASB seeks comments on whether other categories of public sector entities should be included (see paragraph 46 of the Exposure Draft).

11 The beneficial and adverse impacts on the preparers and users of applying the proposed Reduced Disclosure Regime

11.1 Many entities in the private and public sectors that currently prepare GPFSs under full IFRSs as adopted in Australia would benefit from being able to apply the Reduced Disclosure Regime in preparing their GPFSs (see paragraphs 5.3 and 6.2). On the other hand, some entities that currently do not prepare GPFSs would have to do so under the proposed revised differential reporting framework. This would include some wholly owned subsidiaries of parents, applying full IFRSs as adopted in Australia, that cannot avail themselves of the ASIC class order exemptions, and large proprietary companies that identify themselves as non-reporting entities, and lodge SPFSs with the ASIC. The extent to which the burden is increased for these entities under the Reduced Disclosure Regime depends on the extent of their current application of accounting standards in their SPFSs. The extent of the impact may be mitigated by removing the need for some separate entity reporting obligations which is being considered by the Australian Government. However, in the absence of a Reduced Disclosure Regime, such entities would have to apply full IFRSs as adopted in Australia in preparing their GPFSs, which would be significantly more burdensome.

11.2 The other side to this issue is the impact on users. The users of financial statements of entities that might move from full IFRSs as adopted in Australia to the Reduced Disclosure Regime would have less information available to them. However, the reason the disclosure regime benchmarks to disclosure principles used by the IASB in determining disclosures under the *IFRS for SMEs* is to help ensure that users of these GPFSs are provided with information that satisfies their needs. It is also expected that the removal of less relevant disclosures would benefit users by making the financial statements more understandable to them. Users of the financial statements of entities that move from SPFSs to a Reduced Disclosure Regime would generally have more information available to them.

Appendices:

Appendix 1: Background to Consultation Paper Proposals

Appendix 2: High-level Comparison of the *IFRS for SMEs* and Full IFRSs

Appendix 3: The Basis for the Recommended Approach to Determining Disclosures under the Reduced Disclosure Regime

Appendix 4: Current Differential Reporting Deliberations in other Jurisdictions

Appendix 5: Achieving Trans-Tasman Harmonisation Outcomes

Appendix 1: Background to Consultation Paper Proposals

ITC 12

A.1.1. In May 2007, the AASB released Invitation to Comment 12 *Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities* (ITC 12). ITC 12 proposed that:

(a) the application of accounting standards would no longer depend on whether entities are reporting entities, rather the focus would be GPFSs;

(b) all entities that prepare GPFSs would apply either the full IFRSs or the *IFRS for SMEs* (suitably modified in the case of not-for-profit entities);

(c) full IFRSs would apply to:

(i) for-profit entities that meet the IASB's definition of public accountability;

(ii) for-profit entities that do not have public accountability, but are important from a public interest perspective based on nominated size thresholds;

(iii) not-for-profit entities that exceed nominated size thresholds; and

(iv) public sector entities that exceed nominated size thresholds;

(d) the *IFRS for SMEs* would apply to:

(i) for-profit entities that do not have public accountability, or do not fall under (c)(ii) above;

(ii) not-for-profit entities that fall below nominated size thresholds; and

(iii) public sector entities that fall below nominated size thresholds; and

(e) entities required to apply the *IFRS for SMEs* could choose to apply full IFRSs.

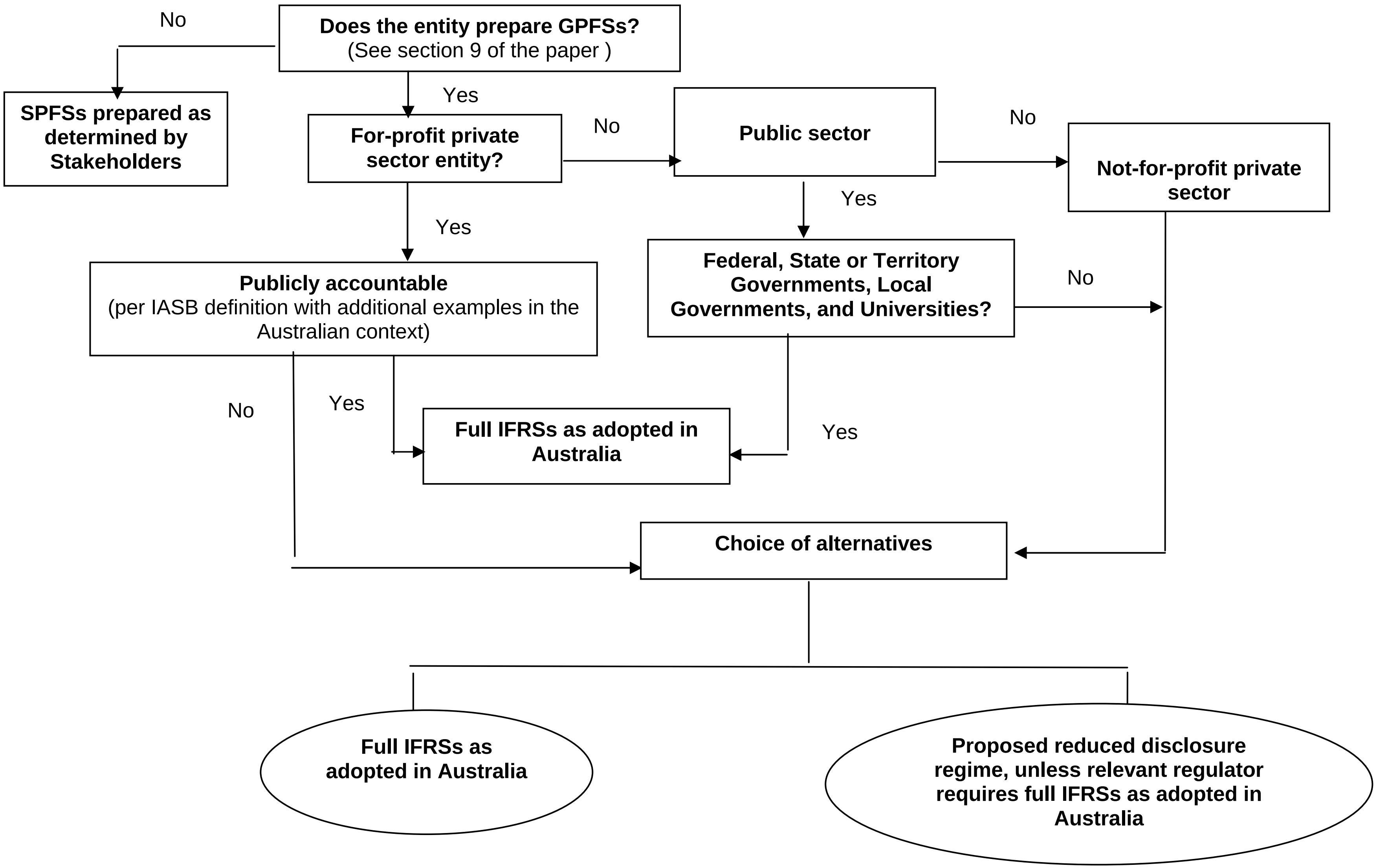
A.1.2. In general, constituents' responses to ITC 12 did not favour the use of quantitative thresholds for determining which entities could apply either full IFRSs or the *IFRS for SMEs* on the basis that setting those thresholds is likely to be an arbitrary exercise with no conceptual basis.

A.1.3. There was support for using public accountability as defined by the IASB as a distinguishing factor for the for-profit private sector. The AASB notes that applying a similar concept in the NFP public sector and NFP private sector would be problematic since all types of entities in those sectors are often considered to have public accountability in the general sense of that term.

A.1.4. ITC 12 also proposed that financial reports on a public register or otherwise made available to the public at large would be regarded as GPFSs. Constituents generally commented that a key feature of GPFSs is the existence of dependent users. The AASB confirmed this view and clarified the meaning of GPFSs in the Australian context (see Section 9 of the paper). The AASB also confirmed that it should be focused only on GPFSs and not promulgate accounting standards for SPFSs.

A.1.5. The diagram on the next page depicts the proposals for a revised differential reporting framework as outlined in this paper which have resulted from redeliberating the ITC 12 proposals.

Proposed Revised Differential Reporting Framework



APPENDIX 1

Appendix 2: High-level Comparison of the *IFRS for SMEs* and Full IFRSs

A.2.1. The *IFRS for SMEs* is intended to be applied by for-profit private sector entities that prepare general purpose financial statements but are not publicly accountable. Under the *IFRS for SMEs* an entity has public accountability if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

A.2.2. The *IFRS for SMEs* is a standard of 230 pages organised by topic that does not include cross-references to full IFRSs, except for IAS 39 *Financial Instruments: Recognition and Measurement*.

A.2.3. It is up to jurisdictions to decide whether to require or permit its use. Accordingly, the Standard does not have an effective date.

Accounting policy hierarchy

A.2.4. When the Standard contains no specific guidance on an issue, the entity's management should apply its judgement using the following sources in descending order:

(a) the requirements and guidance in the *IFRS for SMEs* dealing with a similar and related issue; and

(b) the definitions, recognition criteria and measurement concepts and the pervasive principles in section 2 *Concepts and Pervasive Principles* of the *IFRS for SMEs*.

The entity's management may also consider the requirements and guidance in full IFRSs dealing with similar and related issues, but is not required to do so.

A.2.5. The hierarchy of sources for determining accounting policies under the *IFRS for SMEs* is different from that in full IFRSs. Under full IFRSs management should use its judgement using the following sources in descending order:

(a) the requirements and guidance in full IFRSs dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework for Preparation and Presentation of Financial Statements*.

In making this judgement, management may also consider the most recent pronouncements of other standard setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in (a) and (b) above. The use of concepts and pervasive principles, and not full IFRSs, as the second source under the hierarchy in the *IFRS for SMEs* means that the *IFRS for SMEs* would allow entities to ignore the requirements of full IFRSs even when the specific accounting issue is addressed in those IFRSs. This would mean identical transactions can be accounted for differently by different entities and differently from publicly accountable entities.

Five types of differences

A.2.6. The *IFRS for SMEs* is different from full IFRSs in a number of ways:

(a) some topics in full IFRSs are omitted;

(b) SMEs are limited to particular accounting policy options — either one option in full IFRSs is mandated or a 'new' accounting policy is required;

(c) recognition and measurement differences;

(d) presentation differences and substantially fewer disclosures; and

(e) simplified drafting.

Omitted topics

A.2.7. The *IFRS for SMEs* does not address the following topics:

(a) earnings per share;

(b) interim financial reporting;

(c) segment reporting; and

(d) special accounting for assets held for sale.

SMEs limited to particular accounting policy options

A.2.8. The following table shows examples where the *IFRS for SMEs* limits entities to particular accounting policy options in full IFRSs or requires a new accounting policy.

Subject	IFRS for SMEs Treatment	Full IFRS Treatment
Non-current assets (or groups of assets and liabilities) held for sale	Holding assets for sale triggers an assessment for impairment, but otherwise no special 'held-for-sale' classification or special accounting requirements.	IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*: Measured at lower of carrying amount and fair value less costs to sell. Depreciation stops when classified as held for sale.
Unvested past service cost of defined benefit pension plans	Recognise in profit or loss immediately.	IAS 19 *Employee Benefits*: Recognise as an expense on a straight-line basis over the average period until the benefits become vested.
Exchange differences on a monetary item that forms part of the net investment in a foreign operation, in consolidated financial statements	Recognise in other comprehensive income and do not reclassify in profit or loss on disposal of the investment	IAS 21 *The Effects of Changes in Foreign Exchange Rates*: Reclassify in profit or loss on disposal of the investment.
Borrowing costs	Must be charged to expense. Capitalisation not an option.	IAS 23 *Borrowing Costs*: Costs directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised.
Investment in an associate for which there is a published price quotation	Must be measured at fair value through profit or loss.	IAS 28 *Investments in Associates*: Must be measured using the equity method.
Investment in a jointly controlled entity for which there is a published price quotation	Must be measured at fair value through profit or loss.	IAS 31 *Interests in Joint Ventures*: Must be measured using the equity method or proportionate consolidation.

Subject	IFRS for SMEs Treatment	Full IFRS Treatment
Investment property whose fair value can be measured reliably without undue cost or effort	Must be measured at fair value through profit or loss.	IAS 40 *Investment Property*: Accounting policy choice of fair value through profit or loss or cost-depreciation-impairment model.
Biological assets	Measure at fair value through profit or loss only if fair value is readily determinable without undue cost or effort.	IAS 41 *Agriculture*: Presumption that fair value can be reliably measured.
Share-based payments with cash alternatives in which the terms of the arrangement provide the counterparty with a choice of settlement	Account for the transaction as a cash-settled share-based payment transaction unless either the entity has a past practice of settling by issuing equity instruments or the option to settle in cash has no commercial substance.	Under IFRS 2 *Share-based Payment* when the entity has a choice of settlement in a transaction, it accounts for the transaction as equity-settled provided the entity has the stated intent and ability to settle in equity instruments. Otherwise the transaction is accounted for as cash-settled. When the counterparty has the choice of settlement, the accounting is akin to a compound instrument with liability and equity components accounted for separately.
Research and development costs	Must be charged to expense. Capitalisation not an option.	Research costs are expensed. Capitalisation of development costs required if certain criteria met.
Government grants	All grants are recognised in income when the performance conditions are met or earlier if there are no performance conditions. All grants are measured at the fair value of the asset received or receivable. (similar to IAS 41 *Agriculture* requirements in respect of government grants).	IAS 20 *Accounting of Government Grants and Disclosure of Government Assistance* permits a range of methods based on the matching notion that are not available under the *IFRS for SMEs*.

Subject	IFRS for SMEs Treatment	Full IFRS Treatment
Property, Plant and Equipment and Intangible Assets other than Goodwill	Subsequent measurement at cost less accumulated depreciation or amortisation and impairment losses. Revaluation is not permitted. No annual review of the useful life, residual value, and depreciation or amortisation method. Instead, a review is required only if there is an indication that there has been a significant change since the last annual reporting date. All intangibles are assumed to have finite lives and amortised over their useful lives (if not determinable over 10 years).	IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* permit subsequent measurement at cost or revaluation, subject to specific guidance in those Standards. IAS 16 and IAS 38 require useful lives, residual values and depreciation or amortisation methods to be reviewed at least at each financial year-end. Under IAS 38 intangibles may have indefinite useful lives and those with indefinite lives are not amortised.

Recognition or measurement differences

A.2.9. The following table shows examples of recognition and measurement differences between the *IFRS for SMEs* and full IFRSs:

Subject	IFRS for SMEs Treatment	Full IFRS Treatment
Financial instruments	**IAS 39:** The entity has a choice of referring to IAS 39 for recognition and measurement. (Please note: Disclosures would, however, not follow IFRS 7 rather it should follow those required by the *IFRS for SMEs*). **Classification:** Financial instruments that meet specified criteria are measured at cost or amortised cost (section 11 of the Standard), and all others are measured at fair value through profit or loss (section 12 of the Standard). The available-for-sale and held-to-maturity	IAS 39 does not differentiate between basic and complex financial instruments. IAS 39 has two more classifications; that is the available-for-sale and held-to-maturity classifications. (Please note: A process of simplifying the financial instruments requirements is in progress and is planned to completely replace IAS 39. As part of this

Subject	IFRS for SMEs Treatment	Full IFRS Treatment
	classifications in IAS 39 are not available. **Derecognition:** The *IFRS for SMEs* establishes a simple principle for derecognition. **Hedge accounting**: The *IFRS for SMEs* focuses on the types of hedging that SMEs are likely to do, specifically hedges of: (i) interest rate risk of a debt instrument measured at amortised cost; (ii) foreign exchange risk or interest rate risk in a firm commitment or a highly probable forecast transaction; (iii) price risk of a commodity that it holds or in a firm commitment or a highly probable forecast transaction to purchase or sell; and (iv) foreign exchange risk in a net investment in a foreign operation. Section 12 requires periodic recognition and measurement of hedge ineffectiveness, but under less strict conditions than those in IAS 39.	process IFRS 9 *Financial Instruments*, which deals with the classification and measurement of financial assets, was published on 12 November 2009 and is applicable from 1 January 2013 but can be early adopted for December 2009 accounts. The other phases of the project are expected to be completed during 2010.) IAS 39 relies on the 'pass-through' and 'continuing involvement' provisions in relation to derecognition transactions. IAS 39 is not as restrictive as the *IFRS for SMEs* in respect of risks to be hedged; and has complex ongoing hedge effectiveness testing.
Goodwill and other indefinite-lived intangible assets	These assets should be amortised over their estimated useful lives, with a maximum amortisation	Under IAS 36 *Impairments of Assets* goodwill and indefinite–lived intangible assets are not amortised and

Subject	IFRS for SMEs Treatment	Full IFRS Treatment
	period of ten years. The assets need to be assessed for impairment only when there is an indication of impairment.	are tested for impairment annually regardless of there being an indication of impairment.
Associates and joint ventures for which there is not a published price quotation	Cost method for associates and joint ventures in addition to equity method. (But any investment in an associate or jointly controlled entity for which there is a published price quotation must be measured at fair value through profit or loss.)	IAS 28 *Investments in Associates* requires an entity to account for its investments in associates by the equity method. IAS 31 *Interests in Joint Ventures* allows an entity to account for its investments in jointly controlled entities by either the equity method or proportionate consolidation.
Actuarial gains and losses of defined benefit plans	Recognise actuarial gains and losses in profit or loss or other comprehensive income.	Under IAS 19 *Employee Benefits*, an entity can choose any of the following approaches for recognising actuarial gains and losses: (a) in full in profit or loss when they occur; (b) in full directly in other comprehensive income when they occur; (c) using the corridor approach; or (d) in profit or loss using any systematic method that results in faster recognition than (c) above.
Defined benefit obligation measurement	If information based on the projected unit credit calculations of IAS 19 is already available or can be obtained without undue cost or effort, SMEs must use that method. Otherwise apply an approach that is based on IAS 19 but does not consider future salary progression, future service or possible mortality during an employee's period of service.	IAS 19 *Employee Benefits* requires that a defined benefit obligation always be measured using the projected unit credit actuarial method.

Subject	IFRS for SMEs Treatment	Full IFRS Treatment
Income Tax	An entity must assume recovery though sale when calculating the tax basis in *IFRS for SMEs*. Current and deferred tax balances must be measured using a probability weighted average. Entities must now recognise all deferred tax balances and use a valuation allowance to measure any uncertainty. Several exceptions are different for deferred tax arising on initial recognition of assets and liabilities and investments.	Entities determine tax bases with reference to how the entity expects the tax base will be recovered. Under IAS 12 entities would only recognise a deferred tax asset if it were probable that is would be recovered.

Presentation differences

A.2.10. The following table shows examples of presentation differences in the *IFRS for SMEs* compared with full IFRSs:

Subject	IFRS for SMEs Treatment	Full IFRS Treatment
Comparatives	An entity need only present one comparative statement of financial position.	IAS 1 *Presentation of Financial Statements* requires an entity to present two comparative statements of financial position when the entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.
Income Statement and Statement of Changes in Equity	An entity is permitted to present a single statement of income and retained earnings in place of separate statements of comprehensive income and changes in equity if the only changes to its equity during	IAS 1 requires a complete set of financial statements.

	the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy.	

A.2.11. The disclosure requirements in the *IFRS for SMEs* are substantially reduced compared with the disclosure requirements in full IFRSs. There are four principal bases on which the disclosures have been reduced:

(a) some disclosures are not included because they relate to topics covered in full IFRSs that are omitted from the *IFRS for SMEs*;

(b) some disclosures are not included because they relate to recognition and measurement requirements in full IFRSs that are not available in the *IFRS for SMEs*;

(c) some disclosures are not included because they relate to optional accounting policies in full IFRSs that are not included in the *IFRS for SMEs*; and

(d) some disclosures are not included on the basis of users' needs or cost-benefit considerations.

Appendix 3:

The Basis for the Recommended Approach to Determining Disclosures under the Reduced Disclosure Regime

A.3.1. There are a number of possible approaches to determining disclosures under the Reduced Disclosure Regime, including the following.

(a) Use the disclosures in the *IFRS for SMEs* in relation to recognition and measurement accounting policy options that align with full IFRSs. In determining disclosures relating to full IFRS recognition and measurement accounting policy options that have not been included in the *IFRS for SMEs*, principles used by the IASB in determining disclosures under that Standard (that is, user needs and cost benefit considerations) would be used to the extent applicable.

(b) Use the ASIC model in regard to reporting by *Corporations Act 2001* entities that are not reporting entities. ASIC guidance[18] is that non-reporting entities required to prepare financial reports in accordance with Chapter 2M of the Corporations Act comply with the recognition and measurement requirements of accounting standards and the presentation and disclosure requirements of AASB 101 *Presentation of Financial Statements,* AASB 107 *Statement of Cash Flows* and AASB 108 A*ccounting Policies, Changes in Accounting Estimates and Errors* in full, and interpretations to the extent relevant under AASB 1048 *Interpretation and Application of Standards*.

(c) Use AASB 1039 *Concise Financial Reports* as a model.

(d) Use the 'reporting by exception' principle underlying interim financial reporting.

(e) Apply a fully developed and principled approach to rationalising disclosures under full IFRSs (including for differential reporting purposes)[19].

18 Reporting requirements by non-reporting entities, An ASIC guide, July 2005.

19 FASB initiated its Disclosure Framework project in July 2009. The work resulting from this project can be a good source for devising display principles.

(f) Apply the basis used for special purpose financial statements (SPFSs) where requirements are applied selectively.

A.3.2. Approaches (b) to (f) were assessed as being unsuitable for determining disclosures under the Reduced Disclosure Regime for the following reasons:

Approach (b)

Although this approach has the advantage of being based on current practice, it does not provide all the necessary disclosures under the Reduced Disclosure Regime that would satisfy the objective of general purpose financial reporting.

Approach (c)

Concise financial reports provide limited information and are intended to help shareholders identify if and when they consider it would be useful to obtain more comprehensive and detailed information by requesting a copy of the (full) financial report. Moreover, AASB 1039 does not purport that concise financial reports are general purpose. Accordingly, a regime based on this approach would not, on its own, lead to financial statements that satisfy the objective of financial reporting.

Approach (d)

Under AASB 1034 *Interim Financial Reporting*, interim financial statements are seen as updates on the latest annual financial statements and focus on new activities, events, and circumstances and should not duplicate information previously reported. The use of a 'reporting by exception principle' is therefore conditional on the existence of another financial report, namely; the previous annual report. Accordingly, a regime based on this approach would not be appropriate because the Reduced Disclosure Regime is a set of requirements for preparing GPFSs in its own right.

Approach (e)

This would be an ideal approach since it uses clear display principles. However, this approach would only be feasible in the long term because considerable research would need to be undertaken to create a principled Reduced Disclosure Regime. It would not be appropriate in the current circumstances, where for pragmatic reasons, a Reduced Disclosure Regime needs to be created in the short-term.

Approach (f)

This approach would not be suitable because selective application of recognition and measurement requirements underlying the preparation of SPFSs does not accord with the Reduced Disclosure Regime that is intended to apply to GPFSs.

A.3.3. Approach (a) was assessed as being the most appropriate in the current circumstances for the following reasons:

(a) it is consistent with the notion of a common basis across GPFSs of all types of entities in terms of recognition and measurement;

(b) it uses the same principles applied by the IASB in developing the *IFRS for SMEs*, that is, user needs and cost-benefit considerations. This allows it:

(i) to identify disclosures required by the *IFRS for SMEs* in relation to recognition and measurement accounting policy options that align with full IFRSs as the benchmark; and

(ii) to determine minimum disclosures in relation to full IFRS recognition and measurement accounting policy options which do not have *IFRS for SMEs* equivalents, using similar principles.

Appendix 4: Current Differential Reporting Deliberations in other Jurisdictions

A.4.1. The New Zealand Ministry of Economic Development (MED) and Accounting Standards Review Board (ASRB) released discussion documents in September 2009 proposing a new statutory framework for general purpose financial reporting in New Zealand. The differential reporting aspect of proposals proposed by the ASRB can be summarised as follows:

		Sector		
		For-profit	**Not-for-profit private**	**Not-for-profit public**
Tier 1	Entity	Publicly accountable per IASB definition	Large recipients of public donations	Leviers of coercive revenue
	Accounting Standards	'pure' IFRSs	IPSASs – NFP Application	'pure' IPSASs
Tier 2	Entity	Others required to report	Other large entities and Non-large recipients of public donations	Other large entities
	Accounting Standards	*IFRS for SMEs* or (an alternative regime that could comprise current NZ differential reporting or the Australian proposed Reduced Disclosure Regime)	Differential NFP Application	Differential public sector standard (based on IPSASs)
Tier 3	Entity	N/A	Other small entities	Other small entities
	Accounting Standards	N/A	Simple format reporting	Simple format reporting

The ASRB proposals envisage a Reduced Disclosure Regime similar to that proposed in this paper. This would provide a basis for harmonising differential reporting in the for-profit private sectors in Australia and New Zealand. Appendix 5 discusses Outcome Proposals aimed at convergence in the area of financial reporting in Australia and New Zealand.

A.4.2. Canada plans to adopt full IFRSs as from January 2011 for publicly accountable entities. In April 2009, the Canadian Institute of Chartered Accountants released an Exposure Draft *Generally Accepted Accounting Principles for Private Enterprises*, proposing that private enterprises apply a separate standard based on current CICA Handbook material that is less prescriptive and more principle-based than the existing Handbook.

A.4.3. The UK Accounting Standards Board issued a consultation paper *The Future of UK GAAP* in August 2009 setting out its Policy Proposals, which can be summarised in the following table:

Standards	***Type/nature of entities***
IFRSs (EU adopted)	EU listed-consolidated Alternative Investment Market (AIM)
IFRS (EU Adopted)	Publicly accountable including publicly accountable wholly-owned subsidiaries
IFRS for SMEs	Large and medium non-publicly accountable
Financial Reporting Standard for Smaller Entities (part of UK GAAP)	Small

A.4.4. In the United States, the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants have embarked on a major initiative to further improve the FASB's current standard-setting process to consider the financial reporting needs of private companies and their constituents. Part of that initiative involves a new committee, the Private Company Financial Reporting Committee (PCFRC), whose primary objective is to provide recommendations to the FASB. The PCFRC is monitoring the progress of the Securities and Exchange Commission's efforts on adopting full IFRSs for public companies, and is discussing possible models for private company accounting, on the assumption that US public companies will be required to comply with full IFRS. These initial models include making available the option of following: the *IFRS for SMEs*; the *IFRS for SMEs* tailored to suit the needs of private company financial reporting constituents in the United States; full IFRSs modified to suit the needs of private company financial reporting constituents; and separate private company GAAP.

Appendix 5: Achieving Trans-Tasman Harmonisation Outcomes

A.5.1. On 20 August 2009, the the Prime Ministers of Australia and New Zealand signed a Joint Statement of Intent which agreed on a framework of Outcome Proposals for developing cross-border economic initiatives. A range of shared Outcome Proposals have already been identified across a wide range of business law areas, including in relation to financial reporting. The outcomes are expected to accelerate and deepen trans-Tasman regulatory integration as part of a broader single economic market initiative. Outcome Proposals relating to financial reporting include:

For-profit entities

(a) "Profit entities are able to use a single set of accounting standards and prepare only one set of financial statements (timeframe: short term – within two years)".

(b) "Trans-Tasman companies have to prepare only one set of financial statements to one set of standards (timeframe: short term – within two years)".

Not-for-profit entities

"Not-for-profit entities are able to use a single set of accounting standards and prepare only one set of financial statements (timeframe: medium term – within five years)".

A.5.2. These Outcome Proposals are intended to reduce compliance costs for entities operating across the Tasman and support trans-Tasman investment through the consistency of financial statements. The use of full IFRSs as the foundation standard in both countries provides a sound basis for achieving the above Outcome Proposals. However, further harmonisation in regard to financial reporting by entities other than those that are required to apply full IFRSs would be necessary to achieve the Outcome Proposals. This would be achieved by convergence of the differential reporting frameworks in the two countries.

A.5.3. Convergence of differential reporting frameworks would be an easier task in relation to for-profit private sector entities than not-for-profit private sector entities of two countries. In relation to not-for-profit public sector entities there are a number of significant issues that would need to be addressed in order to achieve convergence.

A.5.4. New Zealand already adopts a differential reporting regime which is expected to undergo restructuring in the light of the NZ Ministry of Economic Development review of standard setting arrangements. Australia is engaged in a debate to revise its differential reporting regime. Close monitoring of these developments by the two countries would help identify an appropriate approach to converge the differential reporting frameworks in the two countries.

A.5.5. NZ is expected to employ a notion of public accountability that is close to the IASB's definition to distinguish between for-profit entities that apply NZ IFRSs and those that can avail themselves of concessions under the differential reporting framework. The use of the IASB's notion of public accountability under the Reduced Disclosure Regime in Australia provides common ground to discuss the harmonisation of the two countries differential reporting frameworks in regard to for-profit private sector entities.

A.5.6. Since, regulators other than the AASB also play significant roles in differential financial reporting in Australia and New Zealand, the joint publication of this Consultation Paper and other cooperation between Australian and New Zealand regulators will be needed to create a united approach and ensure the achievement of the Outcome Proposals.