28 July 2014

An update on the Differential Reporting Project

The AASB's Differential Reporting project is being progressed in stages. Stage 1 involved the development of reduced disclosure requirements (RDR) for Tier 2 entities and resulted in publication of AASB 1053 *Application of Tiers of Australian Accounting Standards* and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements* on 30 June 2010 (see paragraph 7 below regarding the application dates). The AASB is maintaining the RDR and monitoring its implementation.

Maintaining RDR requirements involves issuing Tier 2 Exposure Drafts and amending standards as well as preparing annual compilations of Standards with RDR requirements included.

Currently the AASB is monitoring the work of various regulators including the Australian Charities and Not-for-profits Commission (ACNC). The AASB is also monitoring the IASB's deliberations in regard to the first comprehensive review of the *IFRS for SMEs*.

Stage 2 involves further research on the remaining AASB proposals in ED 192 *Revised Differential Reporting Framework*, in particular, the use of the reporting entity concept for differential reporting purposes.

The following provides the history and further details of the current status of each stage.

STAGE 1

Background to issuance of Stage 1 Standards

1. The AASB issued ED 192 *Revised Differential Reporting Framework* and its related Consultation Paper *Differential Financial Reporting – Reduced Disclosure Requirements* on 26 February 2010. The closing date for comment for both documents was 23 April 2010.
2. Public Roundtable discussions were held on 5 May 2010 in Sydney and 7 May 2010 in Melbourne.
3. At its May 2010 meeting, in the light of feedback received from its constituents through comment letters and Roundtable discussions, the Board decided that revisions to the differential reporting framework should be made in two stages. In the first stage, the Reduced Disclosure Requirements (RDR) should be introduced as a second Tier of reporting requirements for preparing general purpose financial statements (GPFSs). The Board noted that the aim of this stage is to attend to the immediate reporting needs of entities that currently apply full IFRSs as adopted in Australia but find the disclosures under full IFRSs as adopted in Australia burdensome.
4. In the second stage, the other proposals of ED 192, including clarification of the meaning of GPFSs and the change of application focus of AASB Standards from 'reporting entity' to 'GPFSs', will be further considered.

5. Consistent with the Board's decision at its June 2010 meeting, as part of the first stage, AASB 1053 *Application of Tiers of Australian Accounting Standards* was made and:

   (a) identifies the following type of entities as being required to apply full IFRSs as adopted in Australia (Tier 1) in preparing general purpose financial statements:

      (i) for-profit private sector entities that have public accountability; and

      (ii) the Australian Government and State, Territory and Local Governments.

      Further, subject to AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, GGSs of the Australian Government and State and Territory Governments are required to apply Tier 1 reporting requirements in preparing financial statements; and

   (b) requires the following types of entities, as a minimum, to apply the RDR (Tier 2) in preparing GPFSs:

      (i) for-profit private sector entities that do not have public accountability;

      (ii) all not-for-profit private sector entities; and

      (iii) public sector entities other than those in (a)(ii).

      These types of entities may elect, or be directed by a regulator, to apply Tier 1 reporting requirements in preparing general purpose financial statements.

6. The Board also decided that, under the first stage of revisions to the differential reporting framework, the reporting entity concept should continue to be used for differential reporting purposes.

7. The Board decided that any mandatory application of Tier 2 requirements should be to annual reporting periods beginning on or after 1 July 2013. Entities may apply the Tier 2 requirements to annual reporting periods beginning on or after 1 July 2009 but before 1 July 2013.

IASB's IFRS for SMEs

8. At the time of approving the RDR the AASB confirmed that the IASB's *IFRS for SMEs* is not presently a suitable set of requirements for a second tier of requirements for GPFSs in Australia. However, it was noted the AASB would continue to monitor further changes in the *IFRS for SMEs* and that it is open to the possibility of adopting the *IFRS for SMEs* in future should the changes in that Standard make it practicable to apply in an integrated public sector/private sector reporting environment.

First review of the *IFRS for SMEs*

9. The *IFRS for SMEs* was published by the IASB in July 2009. At the time the IASB noted that it would assess entities' experiences after two years of implementation, and thereafter it expected to review the standard approximately once every three years.

10. In June 2012, the IASB commenced the process for the first review of the standard by issuing a ‘Request for Information’ with a comment date of 30 November 2012.

11. The AASB contributed to the review of the *IFRS of SMEs* by submitting detailed comments to the IASB on the IASB’s Request for Information and offering its experience in determining RDR disclosure requirements. It is expected that any consideration by the AASB of the possibility of adopting the *IFRS for SMEs* would await the completion of the above review and the publication of the revised *IFRS for SMEs*.

12. On 3 October 2013, the IASB published an Exposure Draft of proposed amendments to the *IFRS for SMEs*, which it developed based on its initial comprehensive review of the standard, with a comment date of 3 March 2014.

STAGE 2

Work performed on Stage 2

13. ED 192 *Revised Differential Reporting Framework* included proposals for changing the focus of application of Standards from reporting entity to GPFSs and clarifying the meaning of GPFSs in an Australian context, including that financial statements that are made publicly available and held out to be prepared in accordance with Australian Accounting Standards are GPFSs.

    The comments from constituents on these proposals, particularly the divergence of views as to the functionality of the reporting entity concept, led to the Board deferring a decision on those proposals pending further research into the incidence and nature of special purpose financial statements (SPFSs).

14. A research project was actioned utilising the services of research contractors. The thrust of the research is to profile the characteristics of lodging entities and their accounting policies with a view to shedding some light on (i) whether there is a consistency in the population of entities currently being treated as non-reporting entities; and (ii) the nature of the accounting policy choices being made by those entities.

15. The research contractors have provided the Board with periodic updates of the progress of their work at the June 2011, September 2011, December 2011 and April 2012 meetings. A preliminary draft report provided to the Board’s April 2012 meeting focused on the population of entities that lodge financial statements with the Australian Securities and Investments Commission (ASIC) under the *Corporations Act 2001.*

16. At the December 2012 meeting, the Board considered a draft final research report that continued to focus on the population of entities that lodge financial statements with the ASIC under the Corporations Act.

    The draft report provided to the December 2012 meeting:

    (a) included research findings about whether there is consistency in the treatment of entities as non-reporting entities based on the criteria in the Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity*;

    (b) examined the financial reporting practices of sampled entities across two primary dimensions:

(i) the application of recognition and measurement requirements and, where relevant, disclosure requirements of accounting standards by lodging entities; and

(ii) the quality of accruals made by large proprietary companies lodging with the ASIC with a view to gaining an understanding of whether accrual-based profit is being accurately measured; and

(c) included findings in relation to the nature of financial statements lodged by Co-operatives and Associations with Consumer Affairs Victoria (CAV). (The final version of the report is expected to also include findings in relation to financial statements lodged by Associations and Co-operatives with relevant New South Wales and Queensland registries).

Policy implications of research results

17. At its February and April 2013 meetings, the Board discussed the results emerging from the research into special purpose financial reporting, the possible policy implications arising from the research and a tentative roadmap to addressing those implications. The Board tentatively decided that:

(a) High incidence of SPFSs amongst lodged financial statements suggests there is doubt as to whether the reporting entity concept is being applied as intended by SAC 1 *Definition of the Reporting Entity* in identifying entities that should prepare general purpose financial statements (GPFSs);

(b) a proportion of SPFSs lodged with the ASIC appear not to have applied the recognition and measurement requirements of all applicable Australian Accounting Standards;

(c) as the exemption from lodgement of financial statements of grandfathered large proprietary companies does not stem from accounting standards, if any changes were to be made to the lodging requirements applicable to such entities, they would need to arise from legislative change;

(d) the reporting entity concept should continue to be used as the basis for identifying entities that, in concept, should be subject to general purpose financial reporting requirements. The concept would be used by the Board as the basis for its own deliberations on matters relating to general purpose financial reporting and for its discussions with others in the financial reporting environment. Accordingly, the Board tentatively decided that SAC 1 would not be part of the AASB Framework if there were to be a change of application focus from reporting entity to GPFSs but that material based on SAC 1 could be made available in another form for use in the identification of entities that should be required by other regulators to prepare and lodge GPFSs (whether under Tier 1 or Tier 2);

(e) in regard to the role of the Board as a standard setter:

(i) its mandate should be to set accounting standards for preparing GPFSs under Tier 1 and Tier 2; and

(ii) reporting requirements for SPFSs should be outside its mandate and should be a matter for consideration by preparers and identified users and regulators who are not dependent on GPFSs;

(f) consistent with the suggested implementation roadmap considered at the Board's April 2013 meeting, staff should liaise with regulators, including the Treasury, the ASIC, the ACNC and relevant State government bodies, with a view to coordinating the Board's and those regulators' efforts in dealing with the issues emerging from the research; and

(g) an Exposure Draft should be developed, based on a redeliberation of the ED 192 *Revised Differential Reporting Framework* proposals in relation to the change of the application focus of Australian Accounting Standards from 'reporting entity' to 'general purpose financial statements' and the clarification of general purpose financial statements in the Australian context, and include any amendments to those proposals that might arise from the research report and the liaison with other regulators in regard to any proposed transition.

The Board noted that as its work progresses, that will help inform the Board on what further work should be undertaken. At this stage, the Board intends publishing a paper setting out its assessment of the policy implications of the research conducted on entities lodging with the ASIC and the three State registrars for Cooperatives and Associations that supplied research data, after it has consulted with the relevant regulators. That paper is expected to be published concurrently with the research report.

18. The research is continuing, and will include extending statistical tests to financial statement practices of entities lodging with state registrars for Cooperatives and Associations.

Publication of the Research Report

19. The research work was finalised in the first half of 2014 and in June 2014, the AASB Research Centre published Research Report No. 1 *Application of the Reporting Entity Concept and Lodgement of Special Purpose Financial Statements*, to inform public debate about requirements to lodge financial statements and their quality. The principal authors are Professor Peter Carey (Deakin University), Associate Professor Brad Potter (Melbourne University) and Professor George Tanewski (Deakin University) who acted as the AASB's research contractors on the project.

20. The Research Report analyses financial statements lodged by unlisted companies (including large proprietary companies and public companies limited by guarantee) with the Australian Securities and Investments Commission (ASIC); and financial statements lodged by a range of state-based entities (including incorporated associations) with regulators in Victoria, NSW and Queensland.

21. The AASB, however, decided not to publish, at this stage, a paper setting out its assessment of the policy implications of the research (see paragraph 17 above).

DELIBERATIONS PRIOR TO COMMENCEMENT OF STAGE 1 AND STAGE 2

22. The AASB published Invitation to Comment (ITC) 12 in May 2007 containing the IASB's ED of A Proposed IFRS for Small and Medium-sized Entities (SMEs) and the AASB's proposals for a revised differential reporting regime in Australia.

23. The Board received considerable feedback on its proposals in response to ITC 12 and via Roundtable discussions conducted during the exposure period. The Board began redeliberating ITC 12 proposals in the light of comments received in November 2007. The following reflects a summary of the Board's progress.

Change of application focus

Initial proposals

24. ITC 12 proposed that the application of AASB Standards should no longer depend on whether entities are reporting entities, rather the focus of application would be general purpose financial statements. Accordingly, it was proposed that all entities that prepare general purpose financial statements (GPFSs) would apply either full IFRSs (as adopted in Australia) or an *IFRS for SMEs* (as adopted in Australia), based on criteria that establish which set of these Standards would apply.

Board decisions on redeliberation

25. The Board decided that an Exposure Draft should propose a shift of application focus from the reporting entity to GPFSs on the grounds that:
    (a) Australia has adopted IFRSs, which apply to GPFSs, rather than reporting entities;
    (b) the reporting entity concept is not used internationally for the purpose of determining the application of accounting standards but it is applied in determining the boundaries of the entity being reported on; and
    (c) under the current differential reporting regime, various interpretations have been developed around the reporting entity concept that give rise to inconsistent outcomes. One interpretation is that non-reporting entities lodging financial statements with a regulator should apply the recognition and measurement requirements in the Standards, but need only apply some of the presentation and disclosure requirements. Another interpretation is that entities can selectively apply recognition, measurement and disclosure requirements in the Standards.

General purpose financial statements

Initial proposals

26. ITC 12 proposed that, under a revised differential reporting regime, all financial statements that are on a public register, such as those prepared and lodged with the Australian Securities and Investments Commission (ASIC) under the *Corporations Act 2001*, or otherwise made available to the public at large, such as those tabled in a Parliament, would be regarded as GPFSs.

27. In addition, ITC 12 proposed that, notwithstanding a company being exempt from lodging under the Corporations Act, if it is required under that Act to

prepare financial statements in accordance with Australian Accounting Standards, its financial statements are regarded as GPFSs.

Board decisions on redeliberation

28. The Board decided that an Exposure Draft should propose that financial statements are general purpose if:
    (a) they satisfy the following two conditions:
        (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; and
    (b) they are held out as having been prepared in accordance with Australian Accounting Standards or held out as being GPFSs to any party are GPFSs.

29. The Board decided to propose in an Exposure Draft that:
    (a) ‘preparation in accordance with Accounting Standards’ means the application of all Accounting Standards and not a subset of them; and
    (b) the phrase ‘Accounting Standards’ is taken to be a reference to full IFRSs (as adopted in Australia) and any other reporting requirements that are devised by the AASB for the preparation of GPFSs.

Differential reporting

Initial proposals

For-profit entities

30. ITC 12 proposed the following in respect of for-profit entities that prepare GPFSs:
    (a) publicly accountable for-profit entities as defined by the IASB would apply full IFRSs (as adopted in Australia);
    (b) for-profit entities that do not satisfy the definition of a publicly accountable entity, but are viewed as being ‘important’ from a public interest perspective because of their large size, also would apply full IFRSs. ‘Important’, entities are those that exceed either of the nominated size thresholds (Revenue $500m, Assets $250m); and
    (c) other for-profit entities that are not publicly accountable or not otherwise included in (b) above, would apply the *IFRS for SMEs* (as adopted in Australia). Such entities could choose to apply full IFRSs (as adopted in Australia).

Not-for-profit entities

31. ITC 12 proposed the following in respect of not-for-profit (NFP) private and public sector entities that prepare GPFSs:
    (a) NFP entities exceeding either of the nominated size thresholds (Revenue $25m Assets $12.5m) apply full IFRSs (as adopted in Australia); and

(b) NFP entities that fall under the nominated size thresholds would apply the *IFRS for SMEs* (as adopted in Australia). Such entities could also choose to apply the full set of IFRSs (as adopted in Australia).

32. ITC 12 sought constituents' views about the need for a third tier of simpler reporting requirements for smaller NFP entities because they might find the adoption of the forthcoming *IFRS for SMEs* burdensome on cost-benefit grounds.

Board decisions on redeliberation

33. The Board decided to propose in an Exposure Draft that:

(a) a revised differential reporting framework would consist of two tiers of reporting requirements for preparing GPFSs:

Tier 1: Full IFRSs as adopted in Australia; and

Tier 2: A Reduced Disclosure Regime

(b) a Reduced Disclosure Regime that retains the full IFRS recognition and measurement requirements and substantially reduced disclosures corresponding to those requirements;

(c) publicly accountable for-profit private sector entities should apply Tier 1, and non-publicly accountable for-profit private sector entities have a choice of applying Tier 1 or Tier 2;

(d) not-for-profit private sector entities should have a choice of applying Tier 1 or Tier 2; and

(e) public sector entities should have a choice of applying Tier 1 or Tier 2, except :

(i) Federal, State and Territory Governments;

(ii) Local Governments; and

(iii) Universities;

should apply Tier 1.

Further consultation

Consultation Paper

34. Based on its decisions on redeliberating ITC 12 proposals and its reconsideration of the *IFRS for SMEs* issued in July 2009, the AASB issued a draft Consultation Paper titled *Differential Financial Reporting – Reduced Disclosure Requirements* on 4 December 2009. The Consultation Paper proposed a Reduced Disclosure Regime as a second tier of GPFS reporting requirements instead of the *IFRS for SMEs* that was proposed under ITC 12. The RDR involves recognition and measurement requirements of full IFRSs, as already adopted in Australia, with disclosures substantially reduced compared with those that would be required under full IFRSs as adopted in Australia.

The draft Consultation Paper was finalised and formally issued in February 2010.

35. The AASB Consultation Paper includes background material on the Reduced Disclosure Requirements. It sets out why the proposed Reduced Disclosure Requirements is considered more appropriate, at least at this time, than the *IFRS for SMEs* for the Australian environment on cost-benefit and user needs

grounds and in view of the transaction neutrality policy applicable between the private and public sectors in Australian Accounting Standards. However, the proposed Reduced Disclosure Requirements applies the principles used by the IASB, when preparing the *IFRS for SMEs*, in determining the proposed reductions in disclosures.

ED 192

36. The AASB posted a draft Exposure Draft *Revised Differential Reporting Framework* on its website in December 2009. The draft set out the elements of the proposed revised differential reporting framework. Staff papers set out draft proposed disclosures and analyses showing how the draft proposed disclosures were determined by applying the principles used by the IASB in determining disclosures under the *IFRS for SMEs*.

37. The draft Exposure Draft was amended and formally issued as ED 192 at the same time as the Consultation Paper in February 2009**.** Both documents had the closing date for comment of 23 April 2010. ED 192 noted that the Exposure Draft and the Consultation Paper are complementary and should be read together and that specific questions on the Exposure Draft and the Consultation Paper are included in the Exposure Draft.

In adopting this particular consultation process the AASB Consultation Paper noted:

> *"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."*

Other pertinent issues
Public accountability

38. The Board noted that the notion of public accountability as defined by the IASB has a for-profit context and is not applicable to the not-for-profit sector where entities are involved in pursuing a wide variety of objectives.

39. The Board also considered the option of using a modified definition of public accountability in the NFP sector context. The Board noted that such a definition would not provide a robust basis for identifying entities falling under different reporting tiers since NFP private sector entities, with the likely exception of smaller member-based entities, are generally seen as being publicly accountable in the general sense of the term. A similar argument is made in relation to NFP public sector entities noting that these entities are levying or using public funds and are all generally regarded as publicly accountable.

40. Moreover, a modified notion of public accountability to cater for the NFP sector would probably give rise to the same level of subjectivity as the concept of reporting entity currently being used for differential reporting purposes and there are disparate views among commentators about whether

such a notion can effectively be used to identify entities falling under different reporting tiers in the NFP sector.

41. The Board also noted that some commentators believe the level of public accountability for each entity within the charitable sector depends on a number of entity-specific factors, which reduce its usefulness as a stand-alone criterion for differential reporting purposes in the NFP sector.

42. Accordingly, the Board decided that the notion of public accountability, whether as defined by the IASB or in a modified form, would not provide a robust basis for identifying entities falling under different tiers of reporting requirements in the NFP sector.

Use of size thresholds

43. The Board decided that size thresholds do not provide a robust basis for differential reporting purposes on the grounds that they involve complexities and that the disadvantages of using size thresholds would exceed any advantages that may arise from their use. The Board noted that:

- keeping size thresholds up-to-date would entail additional maintenance and monitoring costs;
- there is no consensus of views among respondents about the use of size thresholds as a basis for identifying entities falling under different tiers of reporting requirements in the NFP sector. There are also differences of view between commentators as to the amounts of the appropriate thresholds;
- particularly in the public sector, unless jurisdiction specific thresholds are prescribed, it would lead to similar entities applying different requirements across different State and Territory jurisdictions because of the size differences between these jurisdictions; and
- problems may arise at the whole of government level if public sector entities were to apply different reporting requirements, possibly resulting in different accounting outcomes that would need to be adjusted on consolidation.

The need for a third tier

44. The Board decided there was no need for a third tier of reporting requirements considering that, at the time:

(a) the Federal Government was considering whether to alleviate the reporting burden of small companies limited by guarantee; and

(b) there was no convergence of views amongst respondents about the requirements of a third tier and the way entities applying those requirements should be identified.

45. The Board noted that many NFP entities in the private sector are established as companies limited by guarantee under the Corporations Act or as associations under relevant Associations Acts in each State. Moreover, many non-trading cooperatives are regulated by State or Territory Acts. It was expected that, in cases where the proposed alternative reporting requirements are regarded as burdensome for small entities, regulators may step in and fill the gap either by exempting certain small entities from reporting or devising the minimum requirements they regard as appropriate for such entities.

Special treatment of charities

46. Some respondents to ITC 12 argued that the disclosures required by full IFRSs or included in the proposed *IFRS for SMEs* do not satisfy the information needs of users of financial statements of charities on the grounds that these Standards have a for-profit focus.

47. The Board decided that, as a general policy, there should not be sub-classification of different types of entities in the NFP sector other than between private and public sector entities for differential reporting purposes (in line with ITC 12). The Board noted that:

    (a) in a transaction-neutral reporting environment, a sub-classification should not be relevant as far as the recognition and measurement of transactions are concerned; and

    (b) a choice of reporting requirements would provide different levels of disclosures appropriate for entities with different levels of activities.

48. The Board noted that this does not rule out specific projects directed at specific aspects of reporting by particular types of NFP entities. A separate project has been actioned that deals with disclosures that might be required of charities, and the Board is monitoring developments relating to the Australian Charities and Not-for-profits Commission (ACNC).

The role of the reporting entity concept

49. 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[1]. Under the proposed differential reporting regime outlined in ED 192, 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.

50. At its May 2010 meeting, the Board decided to defer the decision about the change of application focus of Standards from reporting entity to GPFSs to the second stage of implementing the project, pending further research.

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1 AASB 101 *Presentation of Financial Statements*, AASB 107 *Statement of Cash Flows*, and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, AASB 1031 *Materiality*, AASB 1048 *Interpretation of Standards* and AASB1054 *Australian Additional Disclosures* 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.