

The Revised Differential Reporting Framework and required amendments to APES 205 Conformity with Accounting Standards

Objective

To update APES 205 *Conformity with Accounting Standards* to ensure consistency with AASB 1053 *Application of Tiers of Australian Accounting Standards* issued in June 2010.

Background

As part of the Differential Reporting project, AASB 1053 *Application of Tiers of Australian Accounting Standards* was issued in June 2010 to establish a second Tier of requirements for preparing general purpose financial statements (GPFSSs). The standard requires those entities that prepare GPFSSs to determine whether they are Tier 1 or Tier 2 entities to establish disclosure requirements for financial reporting.

Prior to the introduction of AASB 1053, Australian Accounting Standards were limited to 'full IFRSs as adopted in Australia'. With the establishment of the Tier 2 by way of AASB 1053, the phrase 'Australian Accounting Standards' will refer to two tiers of reporting requirements, namely Tier 1 Australian Accounting Standards (full IFRSs as adopted in Australia) or Tier 2 Australian Accounting Standards – Reduced Disclosure Requirements (RDR).¹

To ensure consistency with AASB 1053, APES 205 needs to be amended to reflect the revised differential reporting framework. The main amendments will include:

- the requirement for a Member who is involved in the preparation of GPFSSs to consider whether Tier 1 or Tier 2 of the Australian Accounting Standards is applicable; and
- the requirement for a Member to exercise professional judgment and exhibit competence when ensuring that the entity complies with the appropriate reporting requirements.

AASB 1053 Status and Update on the revision of the Differential Reporting Framework

The effective date of AASB 1053 is July 2013. However, eligible entities may early adopt the requirements of that Standard. Until other phases of the AASB's Differential Reporting project come to a conclusion, the concept of reporting entity remains the operative factor in determining whether an entity should prepare GPFSSs to comply with Australian Accounting Standards, whether Tier 1 or Tier 2. If an entity falls within the definition of a reporting entity, it is required to prepare GPFSSs that are in full compliance with Australian Accounting Standards. Non reporting entities are not mandated to prepare GPFSSs and may elect to prepare Special Purpose Financial Statement (SPFSs).

¹ Australian Accounting Standards Board 2011, *AASB Exposure Draft 192 – Revised Differential Reporting Framework*, Australian Accounting Standards Board, Australia

Many of the existing Australian Accounting Standards contain the following application paragraphs²:

This Standard applies to:

- (a) Each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporation Act and that is a reporting entity;**
- (b) General purpose financial statements of each reporting entity; and**
- (c) Financial statements that are, or are held out to be, general purpose financial statements.**

The above paragraph demonstrates that prior to AASB 1053, entities falling within the scope of this application paragraph are subject to all the recognition measurement, presentation and disclosure requirements of those standards. These include entities incorporated under the *Corporations Act 2001* that are reporting entities and all other reporting entities that are not incorporated under *Corporations Act*. The AASB had two key concerns in relation to this Reporting Framework:

- i. Some reporting entities are burdened by the requirement of full IFRS compliance despite there being limited users for some of the information disclosed in their GPFs; and
- ii. Some entities are exempting themselves from full compliance with Australian Accounting Standards by claiming themselves as non-reporting entities and accordingly only preparing SPFs.³

To address these concerns, the Differential Reporting Framework Project was initiated. The original Invitation to Comment (ITC 12) that was issued by the AASB in May 2007 contained various proposals to address the concerns above. Numerous comments were received and as a result, the AASB refined its ITC 12 proposals and incorporated these into the Consultation Paper (February 2010) and the accompanying ED 192 (February 2010). ED 192 and the related Consultation Paper include the following key proposals:

- 1) Change of application focus from Reporting Entity to General Purpose Financial Statements;
- 2) Clarification of the meaning of General Purpose Financial Statements; and
- 3) Introduction of a revised differential reporting framework with two tiers of reporting requirements for preparation of GPFs: Tier 1 – Full IFRS as adopted in Australia and Tier 2 – A Reduced Disclosure Regime.

After considering constituent comments on ED 192, the AASB adopted proposal 3 and issued AASB 1053 in June 2010 to alleviate concern (i) above. Further research was undertaken by the AASB to determine how to address concern (ii).⁴

² AASB 101 *Presentation of Financial Statements*, AASB 107 *Statement of Cash Flows*, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, AASB 1031 *Materiality* and AASB 1048 *Interpretation of Standards* have a slightly different application paragraphs to ensure those Standards also apply to non-reporting entities that prepare financial statements under the *Corporations Act 2001*.

³ Australian Accounting Standards Board 2010, AASB 1053 *Application of Tiers of Australian Accounting Standards*, Australian Accounting Standards Board, Australia

On 13th July 2010 a project update was released stating that revisions to the Differential Reporting Framework would most likely be made in two stages.⁵ The first stage will include the introduction of Reduced Disclosure Regime and the issuance of relevant standards (Proposal (3)). The second stage would involve clarification of the meaning of General Purpose Financial Statements (Proposal (2)) and the change of application focus of AASB Standards from 'Reporting Entity' to 'General Purpose Financial Statements' (Proposal (3))⁵.

AASB updated the status of the project on 9 December 2011 stating that in 2012, external consultants expect to present research findings on the characteristics of non-reporting entities and the nature of accounting policies adopted by those entities.

Analysis of Issues

The Reduced Disclosure Regime introduces a second tier of reporting requirements when preparing GPFs. The AASB noted that the aim of stage one was to attend to the immediate reporting needs of entities that were applying full IFRSs as adopted in Australia. However, AASB found such disclosure burdensome (concern (i)).⁵ The release of AASB 1053 *Application of Tiers of Australian Accounting Standards* and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements* retains the concept of Reporting Entity as a determining factor of whether an entity should prepare GPFs.⁵ As a result, Reporting Entities are still required to prepare GPFs to comply with the Australian Accounting Standards. However, under AASB 1053 a Member who is involved in preparing the GPFs for a reporting entity must now decide on the tier that is appropriate.

- 1) Tier 1 Entities are mandated by AASB 1053 to comply with Tier 1 Reporting Requirements – full IFRS as adopted in Australia. AASB 1053 states that Tier 1 reporting requirements apply to entities that are:
 - a) for-profit private sector entities that have public accountability; and
 - b) the Australian Government and State, Territory and Local Governments.
- 2) Tier 2 Entities can elect between Tier 1 or Tier 2 but must comply with Tier 2 Reporting Requirements as a minimum. Tier 2 Entities are also required by paragraph 16 of AASB 1053 to exercise judgment when deciding whether additional reporting requirements under Tier 1 are necessary taking into consideration the objective of General Purpose Financial Statements.⁶

In accordance with AASB 1053, Tier 2 entities are:

- a) for-profit-private sector entities that do not have public accountability;
- b) not-for-profit private sector entities; and

⁴ Australian Accounting Standards Board 2010, AASB 1053 *Application of Tiers of Australian Accounting Standards*, Australian Accounting Standards Board, Australia

⁵ Australian Accounting Standards Board 2011, *Differential Reporting Project Update*, Australian Accounting Standards Board, Australian Accounting Standards Board, Australia

⁶ Australian Accounting Standards Board 2010, AASB 1053 *Application of Tiers of Australian Accounting Standards*, Australian Accounting Standards Board, Australia

- c) public sector entities, whether for-profit or not-for-profit, other than the Australian Government and State, Territory and Local Governments.

Although AASB 1053 does not specifically request the Member to exercise this judgment, the fundamental principle of APES 110 *Code of Ethics for Professional Accountants* (the Code) in relation to professional competence and due care requires Members to prepare financial reports with due care and diligence. Therefore the Member must exercise due care to ensure that the general purpose financial statements not only comply with minimum disclosure requirements but also include any relevant disclosure requirements that are necessary to achieve the objective of GPFs.

Proposed Amendments:

1. The definition of **Australian Accounting Standards** to be amended to incorporate Tier 1 and Tier 2 reporting requirements:

Australian Accounting Standards means the Accounting Standards (including Australian Accounting Interpretations) promulgated by the AASB. For the purposes of this Standard, reference to Australian Accounting Standards includes reference to those standards that apply to entities reporting under Tier 1 and Tier 2 reduced disclosure requirements, as defined in AASB 1053 *Application of Tiers of Australian Accounting Standards*.

2. Section 4 of APES 205 will be maintained to reflect the retention of Reporting Entity concept. Contents of paragraph 4 will need to be reconsidered following the AASB's final decision on stage 2 of the project.
3. The following paragraphs will be inserted to highlight the importance of AASB 1053 reporting requirements:

- 4.4 **Members who are involved in, or are responsible for, the preparation and/or presentation of General Purpose Financial Statements shall ascertain whether the requirements of AASB 1053 *Application of Tiers of Australian Accounting Standards* have been applied.**

Recommendation:

The Board approve the amendments to the definition of **Australian Accounting Standards** and insertion of paragraph 4.4 to revise APES 205 for consistency with AASB 1053.