

DIFF REP FRAMEWORK

Institute of Chartered Accountants of New Zealand

FRAMEWORK FOR DIFFERENTIAL REPORTING

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*This document should be read in the context of the Explanatory Foreword to
General Purpose Financial Reporting published by the Council, Institute of
Chartered Accountants of New Zealand.*

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The Accounting Standards Review Board has directed, under the Financial Reporting Act 1993, that the Framework for Differential Reporting has authoritative support within the accounting profession in New Zealand.

1 INTRODUCTION

1.1 The *Framework for Differential Reporting* explains differential reporting and its application in the context of *the Explanatory Foreword to General Purpose Financial Reporting* (1995) and *the Statement of Concepts for General Purpose Financial Reporting* (1993).

1.2 The *Framework for Differential Reporting* has two purposes:

- (a) to set out criteria which qualify entities for differential reporting exemptions;
- (b) to guide those who prepare financial reporting standards¹ in establishing differential reporting exemptions in financial reporting standards.

1.3 In the future, as financial reporting standards are developed or revised, each financial reporting standard will specify any differential application of that standard. Preparers of financial reports will not be allowed to vary the application of a financial reporting standard except in the ways described in that financial reporting standard.

Appendix 1 to this document lists the differential reporting application of the current (March 2002) versions of Statements of Standard Accounting Practice (SSAP) and Financial Reporting Standards (FRS). As revisions of these SSAPs and FRSs are published, their differential reporting paragraphs may change. Reference should be made to the application paragraph of each particular new or revised FRS.

1.4 This *Framework for Differential Reporting* applies in respect of periods ending on or after 31 December 1997. However, entities may elect to apply this Framework with immediate effect.

2 DEFINITIONS

The following terms are used in this framework with the meanings specified:

2.1 **General purpose financial reports** are financial reports which are intended to provide information to meet the needs of those external users who are unable to

¹ *Financial reporting standards* means Financial Reporting Standards (FRS) and existing Statements of Standard Accounting Practice (SSAPs) of the New Zealand Institute of Chartered Accountants.

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require, or contract for, the preparation of special reports to meet their specific information needs.

2.2 **Special purpose financial reports** *are financial reports tailored to meet the specific information needs of a particular user.*

2.3 **Governing body** *means the body responsible for the financial, investing or operating policies of an entity; for example, the board of directors of a company, or its equivalent in other entities, in both the private and public sectors.*

2.4 **Exempt company** *is a company as defined in the Financial Reporting Act 1993. (Refer Appendix 2).*

2.5 **Owner** *is a party which has:*

- (a) *an equitable or beneficial interest in the residual value of an entity's assets; or*
- (b) *the right to participate in the election or appointment of an entity's governing body.*

2.6 **Qualifying entities** *are entities which meet the requirements of this Framework for Differential Reporting, to qualify for differential reporting exemptions in financial reporting standards.*

2.7 **Total revenue** *comprises the annualised gross operating revenue based on the amount reported in the entity's statement of financial performance for the current reporting period. Total revenue includes, but is not limited to, sales, fee income, grants, output appropriations, cost recoveries, donations, dividends, interest, and subscriptions.*

2.8 **Total assets** *is the value of all assets (including intangible assets) reported in the entity's statement of financial position at the end of the current reporting period.*

2.9 **Total employees** *comprise the number of full-time equivalent persons in the paid employment of the entity, calculated on an annual basis.*

3 ASSUMPTIONS OF DIFFERENTIAL REPORTING

3.1 Differential reporting allows entities in different circumstances to differ in the financial reporting disclosures made and the accounting practices adopted. Differential reporting does not apply to the disclosure of accounting policies.

3.2 Differential reporting is needed because the benefits and costs of compliance with financial reporting standards differ between reporting entities.

3.3 This *Framework for Differential Reporting* has been developed on the basis of the following assumptions:

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- (a) compliance with financial reporting standards creates costs (usually for the reporting entity) and benefits (usually for users of the financial reports);
- (b) compliance should be required only when the benefits of compliance exceed the costs;
- (c) financial reporting standards will be more accepted if they apply only where benefits are generally agreed to exceed costs.

3.4 Differential reporting is consistent with legal requirements for financial reports to comply with generally accepted accounting practice. In the rare circumstances that compliance with generally accepted accounting practice does not result in the financial reports giving a fair presentation, additional information and explanations are to be provided in order to give a fair presentation. In this document, *fair presentation* has the same meaning as *a true and fair view* and *fairly reflect*.

4 DISCUSSION

General Purpose Financial Reports

4.1 Entities often prepare financial reports to comply with legislation or statutory regulation or with the terms of a contract with another entity.

4.2 A legal or statutory requirement to report usually indicates the existence of a range of users; for example, a company with a number of shareholders. Where there is a number and range of users, general purpose financial reports are appropriate.

4.3 Where users (for example, the Inland Revenue) have the power to specify the information to be included in financial reports, these financial reports are considered to be special purpose financial reports.

4.4 Where financial reports are prepared solely to meet the requirements of a contract or agreement, these financial reports are considered to be special purpose financial reports. Users likely to demand special purpose financial reports include:

- (a) major lenders such as banks and financial institutions;
- (b) government agencies such as the Inland Revenue or the Department of Statistics;
- (c) credit-rating agencies.

4.5 Whenever special purpose financial reports are prepared, the user is able to specify the extent to which financial reporting standards are to be applied. For this reason, this *Framework for Differential Reporting* applies only to general purpose financial reports and does not apply to special purpose financial reports.

4.6 For the purposes of this *Framework for Differential Reporting*, where legislation requires financial reports to provide a fair presentation of the financial affairs of the reporting entity, these financial reports are always considered to be

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general purpose financial reports. Legislation may also require specific measurement, disclosure or presentation in the financial reports of certain entities and these requirements may limit or exclude use of differential reporting by those entities.

4.7 Section 12 of the Financial Reporting Act 1993 requires “an exempt company” to prepare financial statements which are in the form and contain the particulars and comply with the directions as to the preparation of those statements prescribed by the Governor-General by Order in Council. Accordingly they are not included within this *Framework for Differential Reporting*. Preparers of exempt company financial statements may, however, choose to prepare their financial statements in accordance with this Framework as long as the requirements of the Order in Council continue to be met.

Benefit: Cost Criterion

4.8 The benefit: cost criterion is met when the benefits of financial reporting requirements outweigh the costs imposed.

4.9 Costs of financial reporting are mainly incurred by the entity reporting, though information users and standard setters also incur costs. All costs should be considered when applying the benefit: cost criterion to financial reporting requirements.

4.10 The benefits arising from financial reporting are more difficult to determine and to measure than the costs. Benefits may be derived by the entity itself, by those to whom the entity is accountable or by those who have some other interest in the entity.

4.11 The benefits of financial reporting reflect the value of information to the users of the reports. The benefits, therefore, will usually increase with:

- (a) the number and diversity of users;
- (b) their information needs; and
- (c) the qualitative characteristics of the information, such as reliability, relevance and timeliness.

4.12 Financial reporting standards should meet the benefit: cost criterion. Financial reporting standards are justified where the marginal benefits of their application exceed the marginal costs of their application. Financial reporting regulation (including financial reporting standards) imposes costs of preparing and revising financial reporting standards, costs of compliance (where compliance changes existing practice), and costs of enforcement.

Standard setters are to consider if a financial reporting requirement creates a net benefit. Where different classes of users receive varying levels of benefit from financial reports, standard setters should take this into consideration.

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Application of the Benefit: Cost Criterion

4.13 To measure the costs and benefits of financial reporting requirements is difficult and this *Framework for Differential Reporting* therefore uses surrogates based on broad assumptions.

4.14 The broad assumptions are:

- (a) More benefits are derived from the general purpose financial reports of entities with public accountability because the reports of such entities are likely to have more users.
- (b) There is generally no accountability requirement when all of the owners of an entity are also members of its governing body. However, where the owners and the governing body of an entity are different, an accountability requirement arises. In this case, the value of the entity's general purpose financial reports to users may be expected to increase, and greater benefit is likely to be derived.
- (c) In general, the larger the entity, the more extensive the group of users benefiting from the information provided in its general purpose financial reports, and the greater the benefit likely to be derived.

4.15 Using the three broad assumptions above, the surrogates for the Benefit: Cost Criterion for a reporting entity are:

- (a) public accountability;
- (b) separation of owners and governing body of an entity; and
- (c) size.

Public Accountability

4.16 An entity has public accountability for the purposes of this Framework if:

- (a) at any time during the current or the preceding reporting period, the entity (whether in the public or the private sector) was an issuer as defined in the Financial Reporting Act 1993; or
- (b) the entity has the coercive power to tax, rate or levy to obtain public funds.

4.17 Public accountability is particularly important for public sector entities because:

- (a) office holders are accountable to the general public and to electors for the management of public sector entities;
- (b) elected officers are like trustees in their stewardship on behalf of the public; and
- (c) the statutory right to tax, to levy or otherwise to acquire funds compulsorily, creates an obligation to report to the public on the use of the funds acquired compulsorily.

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4.18 An entity does not have public accountability, for the purposes of this Framework, solely by reason of receiving public funds from another entity which has the coercive power to tax, rate or levy to obtain public funds.

Separation Between Owners and Governing Body of an Entity

4.19 Where every owner of an entity is also a member of the entity's governing body, there is no accountability requirement between the governing body and the owners. Subject to paragraphs 4.22 and 4.23 below, in such circumstances the entity will qualify for differential reporting exemptions provided it is not publicly accountable.

4.20 Where an owner of an entity is not a natural person (for example the owner is a company or a trust) and the owner appoints a representative to the governing body, that representative is considered to be an owner for the purposes of this Framework. In the example of a wholly owned subsidiary, the directors appointed by the holding company are considered to be the owners of the subsidiary.

4.21 The definition of an owner in paragraph 2.5 of the Framework identifies an owner as a party which has a beneficial interest in the residual value of the entity's assets. Therefore when the entity preparing the financial report is a trust, all beneficiaries must be trustees in order to meet the requirement that there is no separation between the owners and the governing body.

Closely-held entities where the parent or ultimate controlling entity has the coercive power to tax, rate or levy

4.22 If the parent or ultimate controlling entity has the coercive power to tax, rate or levy to obtain public funds, the entity is not permitted to use a lack of separation between the owners and the governing body as a basis for qualifying for differential reporting exemptions. Such entities may qualify for differential reporting only on the basis of size. This is because it is not appropriate that entities such as Local Authority Trading Enterprises, Crown entities, State-owned enterprises or government departments should be permitted to use a lack of separation between the owners and the governing body as a basis for qualifying for exemptions because the public have a beneficial interest in the entity and in many cases the public indirectly provides funds to such entities through taxes, rates or levies.

Size

4.23 An entity is large if it exceeds any two of the following:

- (a) total revenue of \$20.0 million;
- (b) total assets of \$10 million;
- (c) 50 employees.

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For the purposes of the application of the size criteria the total revenue and total assets are determined after the application of any allowable exemptions permitted by the Framework.

The size criteria will be reviewed regularly.

Groups of Entities

4.24 Where the reporting entity is a group, the criteria in paragraphs 4.16 to 4.23 shall be applied to the group comprising the investor, its subsidiaries and in-substance subsidiaries. For a group the criteria of size in paragraph 4.23 shall be applied to the totals of an actual or notional consolidation. When the parent of the group is an issuer, the group is an issuer and is deemed publicly accountable in terms of paragraph 4.16. A group should however not be considered publicly accountable solely by reason of a subsidiary or associate being publicly accountable.

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4.25 An entity qualifies for differential reporting exemptions (is a qualifying entity) when the entity does not have public accountability (paragraphs 4.16 to 4.18), and:

- (i) at balance date, all of its owners are members of the entity's governing body; or
- (ii) the entity is not large in terms of paragraph 4.23.

Except that an entity which does not have public accountability but whose parent or ultimate controlling entity has the coercive power to tax, rate or levy to obtain public funds may only qualify for differential reporting where it is not large in terms of paragraph 4.23.

4.26 This means that an entity does not qualify for differential reporting exemptions (is not a qualifying entity) when:

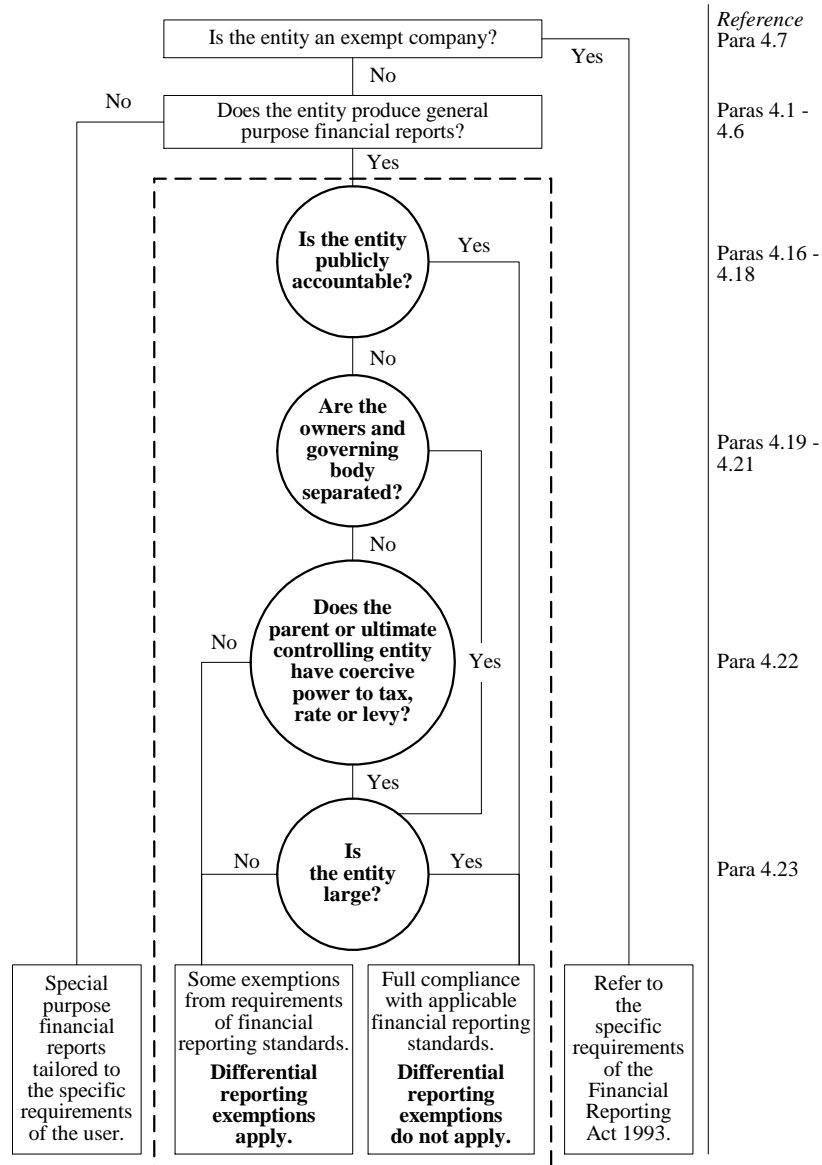
- (a) it has public accountability; or
- (b) both:
 - (i) at balance date the entity has owners who are not members of the governing body; and
 - (ii) the entity is large in terms of paragraph 4.23; or
- (c) both:
 - (i) the parent or ultimate controlling entity of the entity has the coercive power to tax, rate or levy to obtain public funds; and
 - (ii) the entity is large in terms of paragraph 4.23.

These criteria are demonstrated in Figure 1.

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Figure 1: Framework for Differential Reporting

Note: material in the dotted box indicated the Framework for Differential Reporting



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4.27 When an entity has been large in terms of paragraph 4.23 and subsequently ceases to be large, the entity will not qualify for differential reporting exemptions in terms of paragraphs 4.25(ii) until the entity ceases to be large for two consecutive reporting periods. However, when the size criteria have been amended, an entity may apply the revised size criteria in the first year of application and qualify for differential reporting exemptions.

4.28 Where an entity has previously qualified for differential reporting exemptions in terms of paragraph 4.25, but no longer qualifies, the entity shall cease immediately to apply differential reporting exemptions. Where practicable, the entity shall provide comparative figures for the previous period without applying differential reporting exemptions to the comparative figures.

5 ADDITIONAL CONSIDERATIONS WITH RESPECT TO DIFFERENTIAL REPORTING

5.1 In the future when each financial reporting standard is prepared or revised, the benefit: cost criterion mentioned in paragraph 4.8 will be considered; where appropriate, differential reporting exemptions will be included in the new financial reporting standard.

5.2 Individual financial reporting standards may also specifically exempt certain entities from complying with the standard or parts thereof, and/or may provide additional bases for the application of differential reporting with respect to the standard.

5.3 Qualifying entities may selectively apply the provisions of financial reporting standards from which they are exempt under the *Framework for Differential Reporting* where this will not affect the recognition or measurement of revenues, expenses, assets or liabilities.

5.4 Where a qualifying entity discloses information for which there is an exemption in accordance with the *Framework for Differential Reporting*, it will not be compelled to comply fully with the relevant financial reporting standard. If a qualifying entity chooses to give any disclosure from which it is exempt, the entity shall make the disclosure in accordance with the relevant standard.

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APPENDIX 1

Application of Differential Reporting to Statements of Standard Accounting Practice and Financial Reporting Standards

This Appendix lists the differential reporting provisions available in all Statements of Standard Accounting Practice (SSAPs) and Financial Reporting Standards (FRSs). It is correct at date of publication; but reference should be made to the individual application any FRS published after that date.

The *Framework for Differential Reporting* grants either full, partial or no exemption from financial reporting standards.

Full Exemption

Any qualifying entity is granted full exemption from:

FRS-10: *Statement of Cash Flows*

SSAP-12: *Accounting for Income Tax*

SSAP-23: *Financial Reporting for Segments*

FRS-31: *Disclosure of Information About Financial Instruments*

It should be noted that SSAP-12 contains recognition, measurement, and disclosure requirements. When the entity chooses to tax effect account, it must do so in accordance with SSAP-12. Whether the entity accounts for income tax using the liability or the taxes payable method, it is not required to make any particular income tax note disclosures. However, when the entity voluntarily makes disclosures from which it is exempt, these disclosures should be made in accordance with SSAP-12. In all instances, the entity shall disclose the accounting policy adopted for income tax, in accordance with FRS-1: *Disclosure of Accounting Policies*.

Partial Exemption

Qualifying entities are given partial exemption from the following standards.

FRS-3: *Accounting for Property, Plant and Equipment*: Qualifying entities may choose to adopt any of the following exemptions from the requirements of FRS-3:

- (a) In respect of those items of property, plant and equipment accounted for under the historical cost system of accounting, the entity may adopt the rates of depreciation applicable for income tax purposes. If this exemption is taken, the entity is not required to comply with the requirements of paragraphs 8.16 and 8.19 of FRS-3.
- (b) The entity is not required to comply with paragraph 5.24 of FRS-3. If this exemption is taken, the entity must expense all borrowing costs as incurred.
- (c) The entity is not required to disclose the information denoted with an asterisk in FRS-3.

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FRS-4: *Accounting for Inventories*: Qualifying entities are not required to sub-classify inventory (into categories such as raw materials, work in progress and finished goods) as required by paragraph 5.29(b)(ii) of FRS-4.

FRS-9: *Information to be Disclosed in Financial Statements*: This financial reporting standard identifies the specific components that must be disclosed separately. Qualifying entities are given several concessions. Each disclosure concession is identified by an asterisk in the standard.

FRS-13: *Accounting for Research and Development Activities*: Qualifying entities are required to comply with FRS-13 with the exception of section 5. Where this exemption is applied, all research and development costs shall be recognised as an expense in the period they are incurred.

FRS-14: *Accounting for Construction Contracts*: Qualifying entities may recognise profit on all construction contracts on a completed method as described in paragraph 4.1 of FRS-14 and need not comply with any other paragraphs of FRS-14.

FRS-15: *Provisions, Contingent Liabilities and Contingent Assets*: Qualifying entities are not required to make disclosures in their financial statements of the requirements in FRS-15 denoted with an asterisk.

SSAP-17: *Accounting for Investment Properties and Properties Intended for Sale*: Qualifying entities which recognise investment property revaluations or development margins shall comply with all provisions of SSAP-17. Other qualifying entities need not account for investment properties and properties intended for sale in terms of SSAP-17.

SSAP-18: *Accounting for Leases and Hire Purchase Contracts*: Qualifying entities are exempt from the requirements of paragraph 5.15(b) and may satisfy the requirements of paragraphs 5.15(c) and 5.17 by disclosing lease liabilities and commitments classified into current and non-current amounts only.

FRS-19: *Accounting for Goods and Services Tax*: Qualifying entities may recognise revenue and expense items either with Goods and Services Tax (GST) included (gross) or with GST excluded (net), provided that:

- (a) the method adopted by the reporting entity shall be:
 - (i) applied consistently to all revenue and expense items; and
 - (ii) disclosed in the statement of accounting policies in terms of 5.8 of FRS-19;
- (b) where GST input tax is irrecoverable, paragraph 5.6 of FRS-19 shall apply.

FRS-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates*: Qualifying entities are not required to:

- (a) translate transactions measured in a foreign currency using the exchange rate in effect at the transaction date, or at a rate approximating this rate, as

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required by paragraph 5.1 of FRS-21. If transactions are not translated at the rate in effect at the transaction date, or a rate approximating this rate, then transactions settled in the accounting period shall be translated at the settlement rate, and transactions unsettled at balance date shall be translated at the closing rate in accordance with paragraph 5.3 of FRS-21; or

- (b) separately disclose the net exchange difference included in the statement of financial performance for the period as required by paragraph 7.1(b) of FRS-21.

SSAP-22: *Related Party Disclosures*: Qualifying entities shall comply with SSAP-22, paragraphs 5.1(a) and (b). Qualifying entities are exempt from the requirements of other paragraphs of SSAP-22.

FRS-24: *Interim Financial Statements*: All entities that prepare general purpose interim financial statements shall comply with FRS-24 except that qualifying entities may apply differential reporting exemptions available under other specific financial reporting standards in addition to the specific disclosure exemptions identified in the Standard. Each specific exemption is identified by an asterisk in the Standard. FRS-24 does not apply to interim financial statements prepared for inclusion in a registered prospectus.

FRS-30: *Reporting Share Ownership Arrangements Including Employee Share Ownership Plans*: Qualifying entities are exempt from the requirements of paragraph 5.6 of FRS-30.

Full Compliance (No Differential Reporting Concessions)

Qualifying entities must comply with all the provisions in the following standards:

FRS-1: *Disclosure of Accounting Policies*

FRS-2: *Presentation of Financial Reports*: This financial reporting standard must be followed by all entities. While there are certain exemptions for qualifying entities within FRS-2 these all relate to exemptions provided by other standards. For example, FRS-2 notes that qualifying entities will not be required to prepare a statement of cash flows.

SSAP-3: *Accounting for Depreciation*

FRS-5: *Events After Balance Date*

SSAP-6: *Materiality in Financial Statements* (to be withdrawn)

FRS-7: *Extraordinary Items and Fundamental Errors*

FRS-20: *Accounting for Shares Issued Under a Dividend Election Plan*:

All companies must comply with FRS-20

SSAP-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates*

SSAP-25: *Accounting for Interests in Joint Ventures and Partnerships*

FRS-26: *Accounting for Defeasance of Debt*

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FRS-27: *Right of Set-Off*

FRS-29: *Prospective Financial Information*

FRS-32: *Financial Reporting by Superannuation Schemes*

FRS-33: *Disclosure of Information by Financial Institutions*

FRS-34: *Life Insurance Business*

FRS-35: *Financial Reporting of Insurance Activities*

FRS-36: *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*

FRS-37: *Consolidating Investments in Subsidiaries*

FRS-38: *Accounting for Investments in Associates*

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APPENDIX 2

Exempt Company – As Defined in the Financial Reporting Act 1993²

6A Meaning of exempt company

- (1) In this Act, exempt company means a company, other than an overseas company or an issuer, if—
 - (a) at least 2 of the following subparagraphs apply:
 - (i) as at the balance date of the accounting period for which financial statements are required, the value of the total assets of the company (including intangible assets) reported in the statement of financial position did not exceed \$1,000,000;
 - (ii) in the accounting period for which financial statements are required, the turnover of the company did not exceed \$2,000,000;
 - (iii) as at the balance date of the accounting period for which financial statements are required, the company has 5 or fewer full-time equivalent employees; and
 - (b) as at the balance date of the accounting period for which financial statements are required, the company—
 - (i) was not a subsidiary of another body corporate or association of persons; and
 - (ii) did not have any subsidiaries.
- (2) The Governor-General may, by Order in Council, make regulations for all or any of the following purposes:
 - (a) amending the maximum amount of assets that applies under subsection (1)(a)(i);
 - (b) amending the maximum amount of turnover that applies under subsection (1)(a)(ii);
 - (c) amending the maximum number of full-time equivalent employees that applies under subsection (1)(a)(iii).
- (3) In counting employees for the purposes of subsection (1), part-time employees must be taken into account as an appropriate fraction of a full-time equivalent.

² The Financial Reporting Amendment Act 2006 amended the definition of an exempt company in the Financial Reporting Act 1989. For detail of the commencement date of this amendment refer to the Financial Reporting Amendment Act 2006 at:
http://www.lexisnexis.co.nz/products/bulletins/legislation/nz_act_public_2006-No-064.txt

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