

To: HKSA members
All other interested parties

Consultation Paper on a Proposed Framework for Differential Reporting

Comments to be received by 31 October 2002

*Issued by the Council,
Hong Kong Society of Accountants*

The Hong Kong Society of Accountants' Council (Council) has issued a consultation paper on a proposed framework for differential reporting in Hong Kong.

--- A copy of the consultation paper and the outline of a Framework for Differential Reporting in Hong Kong, to which the consultation paper refers, are attached. The consultation paper can also be found on-line at:

<http://www.hksa.org.hk/professionaltechnical/accounting/exposedraft/>.

The Council invites comments from any interested party on the issues raised in the consultation paper. Comments should be supported by specific reasoning and should be submitted in written form.

Comments are requested to be received by **31 October 2002** and may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

(August 2002)

Hong Kong Society of Accountants

GAAP for Small Businesses Working Group

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Table of Contents

Document I (pages 4 - 12)

Background Discussion And Issues For Comment

The Need For Differential Reporting
Consultation on a Proposed Framework for Differential
Reporting
Proposed Approach to Differential Reporting
Comparison with Other Jurisdictions
Other Matters Relevant to Differential Reporting
Consultation Issues

Document II (pages 13 - 24)

Framework For Differential Reporting

Introduction
Definitions
Assumptions of Differential Reporting
Discussion
Additional Consideration with Respect to Differential Reporting
Appendix 1

BACKGROUND DISCUSSION AND ISSUES FOR COMMENT

The Society's Council has issued for comment this Consultation Paper on a Proposed Framework for Differential Reporting in Hong Kong.

In 2000, the Council resolved to form a special working group to give consideration to the issue of differential reporting and how it could be applied in Hong Kong if considered appropriate. The Generally Accepted Accounting Practice (GAAP) for Small Businesses Working Group commenced deliberations in April 2000 and the publication of this Consultation Paper represents the culmination of its work.

The Need For Differential Reporting

Currently, Hong Kong SSAPs generally apply to all proprietary enterprises. As a result, profit-oriented enterprises are governed by almost the same financial reporting requirements regardless of their size or the public interest in them. Existing distinctions include segment disclosures and disclosure of earnings per share, required generally only for listed companies.

Recent years have been marked by rapid and widespread developments in financial reporting. A number of these developments have been designed primarily to address the information needs of the users of financial statements of listed companies. Many of these developments derive from the international convergence of accounting standards, which is driven by the globalisation of financial markets and the need to meet the concerns of securities regulators.

While these developments can be justified for public companies on the grounds of public interest, applying the same financial reporting standards to all profit-oriented enterprises, with minor exceptions only, has become more and more debatable. A number of interested parties have questioned whether it continues to be appropriate to burden private companies that are accountable to only a few users with the extensive financial reporting requirements designed primarily for listed companies active in public capital markets.

An argument has been advanced that small entities should be exempted from the application of certain requirements on the basis that the costs of complying with the requirements exceeds the benefits that flow from that compliance. The term "accounting standards overload" has emerged to refer collectively to the problem of reporting burdens imposed on small entities.

Differential reporting is the notion that some entities should be allowed to depart from particular requirements of accounting standards or entire

accounting standards in preparing their financial statements. A variety of alternative differential reporting approaches have been considered and applied internationally.

Consultation on a Proposed Framework for Differential Reporting

Accompanying this Consultation Paper is an outline of a Framework for Differential Reporting ("Framework"). The purpose of the Framework is:

- (i) to establish criteria by which entities can ascertain whether or not they qualify for differential reporting exemptions; and
- (ii) to provide guidance to standard setters when determining which standards, or parts thereof, need not be applied by entities qualifying for differential reporting exemptions.

Proposed Approach to Differential Reporting

The approach to differential reporting outlined in the Framework is based on a benefit:cost criterion i.e. that a specific reporting requirement, or set of requirements, is warranted only when the benefits generated by the imposition of the requirement outweigh the costs involved. In applying the benefit:cost criterion, three broad assumptions have been made. These are detailed in paragraph 22 of the Framework. Surrogates for the benefit:cost criterion have been identified from the three broad assumptions. The three surrogates are:

- public accountability;
- separation of owners and governing body of an entity; and
- size.

(paragraph 23)

Where an entity is publicly accountable as explained in paragraph 24, it is required to comply fully with all applicable Statements of Standard Accounting Practice. Where an entity is not publicly accountable (as defined), then it will qualify for differential reporting exemptions if either:

- (a) it qualifies as a small entity under the criteria set out in paragraph 30; or
- (b) at balance sheet date, all of its owners are also members of its governing body.

The framework for differential reporting is perhaps most easily understood by reference to Figure 1 of the Framework.

Comparison with Other Jurisdictions

The debate about differential reporting is not unique to Hong Kong, and standard setters in several countries have responded in various ways to the challenge posed by universal application of financial reporting requirements.

The Australian Accounting Research Foundation, in its first Statement of Accounting Concepts, linked the obligation to prepare general purpose GAAP financial statements to the existence of external users dependent on financial statements to make decisions. The following factors may be considered to determine whether an entity is a reporting entity:

- separation of management from economic interest;
- economic or political influence; and
- financial characteristics (the Statement of Accounting Concepts mentions the following, with no quantification: value of sales or assets, number of employees or customers or level of indebtedness of the entity).

In a more specific way, the Australian corporations law states that small proprietary companies have to prepare a financial report only if shareholders with at least 5 percent of the votes give the company the direction to do so, or if it is controlled by a foreign company. In addition, the direction may specify that the financial report does not have to comply with some or all of the accounting standards. A company is classified as small for a financial year if it satisfies at least two of the following tests:

- gross operating revenue of less than A\$10,000,000 for the year;
- gross assets of less than A\$5,000,000 at the end of the year; and
- fewer than 50 employees at the end of the year.

The Canadian Accounting Standards Board implemented an Accounting Recommendation on Differential Reporting in 2002. An entity qualifies for differential reporting options when it does not have public accountability and all the owners of an enterprise consent unanimously to the application of a differential reporting exemption. Qualifying entities are granted a number of disclosure exemptions but also a few different measurement treatments (for example, the taxes payable basis is allowed, and long-term contracts may be accounted for using the completed contract method). Differential Reporting in Canada allows selective application of the options provided. An entity that opts for differential reporting must disclose how it qualified and what exemptions it has applied.

The Financial Reporting Standards Board of New Zealand implemented a Framework for Differential Reporting in 1994. An entity qualifies for differential reporting options when it does not have public accountability and:

- at the balance sheet date, all of its owners are members of the entity's governing body; or
- the entity satisfies at least two of the following size tests:
 - total revenue not exceeding NZ\$5,000,000;
 - total assets not exceeding NZ\$2,500,000; and
 - average number of employees not exceeding 20.

Qualifying entities are granted a number of disclosure exemptions but also a few different measurement treatments (for example, the taxes payable basis is allowed, and long-term contracts may be accounted for using the completed contract method). The Framework for Differential Reporting allows selective application of the options provided. An entity that opts for differential reporting must disclose how it qualified and what exemptions it has applied.

In the United Kingdom, the Financial Reporting Standard for Smaller Entities (FRSSE) was first issued in November 1997 and has been updated several times since then. UK company law distinguishes small companies from the body of companies as a whole in terms of the form and the nature of their statutory financial statements. A company qualifies as small if it satisfies any two of the following three conditions:

- annual turnover not exceeding £2,800,000;
- total assets not exceeding £1,400,000; and
- average number of employees not exceeding 50.

The FRSSE applies to small companies as defined in company legislation. It does not apply to public companies, banks, building societies, insurance companies and financial intermediaries. It is designed to provide smaller entities with a single accounting standard tailored to their particular circumstances. The FRSSE sets out a simplified version of all current UK standards but excludes a number of disclosure and presentation requirements and provides a few measurement simplifications (examples include assets are depreciated in accordance with income tax depreciation rates and the asset and the liability related to a finance lease are stated at the fair value of the asset, not at the present value of the minimum lease payments, unless fair value is not a realistic estimate). The FRSSE is not compulsory, but when a small company chooses to adopt the FRSSE, it adopts all of it, and the financial statements state that they have been

prepared in accordance with it. Financial statements prepared by small companies in accordance with company law and the FRSSE are sufficient to give a true and fair view as required by the law.

In the United States of America, compliance with US GAAP is required for public companies subject to regulation by the US Securities and Exchange Commission. Other companies may choose to comply with it voluntarily or for contractual reasons. Essentially, non-listed companies are permitted to prepare their financial statements on other comprehensive bases of accounting (OCBOA). Those bases include the US tax basis, the cash basis of accounting or a modified cash basis of accounting. Financial statements prepared on OCBOA should include in the notes all appropriate disclosures under the basis of accounting applied, as well as disclosure of the differences from GAAP (however, the effect of the differences need not be quantified).

In continental Europe, the distinction between group (consolidated) financial statements and individual company financial statements has been used by regulators as a convenient way of separating smaller companies from larger ones. Consolidated financial statements are required only when the group meets certain size thresholds. Accounting standards applicable to individual financial statements are less demanding and may include different requirements in respect of issues such as leases and income taxes.

At the international level, the Statement published by the Board of the International Accounting Standards Committee in December 2000 recognised that demand exists for a special version of International Accounting Standards for small enterprises. The United Nation's intergovernmental group on International Standards of Accounting and Reporting (ISAR) has set up a working group with the objective of preparing proposals for a differential reporting model linked to International Accounting Standards. The expected outcome is an ISAR guideline intended to be a non-mandatory aid for regulators in developing countries.

As indicated, different solutions have been used to address the issue of standards overload on small and private enterprises and these solutions are significantly influenced by a country's legal environment. The focus of international harmonisation is today on public companies, and a focus on harmonisation of financial reporting requirements for non-public companies is unlikely in the short term. Hong Kong is therefore in a position to develop a solution that best fits its own circumstances.

Other Matters Relevant to Differential Reporting

Whether differential reporting exemptions should be set out in each existing SSAP or in a separate SSAP

In considering the Framework, the Working Group discussed the merits of whether differential reporting exemptions should be set out within the main body of the SSAPs (the "integrated approach", similar to the approach

adopted in Canada and New Zealand) or whether to develop a completely separate SSAP that would apply to qualifying entities exclusive of all other SSAPs (the "separate approach", similar to the approach adopted in the United Kingdom). The Working Group was mindful that differential reporting in Hong Kong should provide primarily disclosure relief, appropriate to the different reporting needs of users of financial statements of qualifying entities, although limited recognition and measurement differences would also be proposed in keeping with the cost:benefit principles set out in the Framework.

Supporters of the integrated approach would contend that, by specifying differential reporting exemptions as part of an SSAP that applies otherwise, there is greater transparency between the SSAPs that apply on a full basis as compared with a differentiated basis. Furthermore, the standard setter is able to consider– and seek views from interested parties – on proposed differential reporting exemptions at the same time when setting a generally-applicable SSAP. The standard setter needs to devote significant additional financial and other resources when developing or revising accounting standards under the separate approach but not under the integrated approach. There is also little if no potential for the accounting standards applicable to qualifying entities to lag behind those applicable generally as there is under the separate approach.

Supporters of the separate approach would contend that a SSAP that applies to qualifying entities exclusively of all other SSAPs assists financial statement preparers and auditors in the preparation and audit of financial statements. A separate SSAP would provide a condensed and more manageable set of standards appropriate to the needs of users and this is consistent with the cost:benefit principle contained in the Framework.

The International Accounting Standards Board (IASB) has embarked on active research in preparation for developing a standard on the application of international accounting standards to small and medium-sized entities and in emerging economies. At the present time, the IASB's project is at a preliminary stage and no indication is yet available on whether either the integrated or separate approach is preferred over the other. The Hong Kong Society of Accountants has a policy of converging the SSAPs with the IASB's standards and the outcome of the IASB's deliberations may have a bearing on the approach ultimately adopted in Hong Kong. In this consultation paper, comment is sought on whether the separate or integrated approach is preferred and specific reasoning in support of that preference. These comments may be made available to the IASB as part of the due process in developing an international standard on differential reporting. For the time being, the HKSA Council considers that it would be advisable to adopt the integrated approach, which would provide more flexibility to switch to whichever approach ultimately adopted by IASB.

Whether financial statements prepared in accordance with the Framework can present a true and fair view

The Working Group considered the issue of whether financial statements prepared on the basis of the Framework can present a true and fair view in accordance with the requirements of sections 123 and 126 of the Companies Ordinance.

On the basis of legal advice received, the Working Group concluded the following:

- A SSAP is a declaration made by the Hong Kong Society of Accountants (being the standard setting authority for professional accountants in Hong Kong), non-compliance with which will suggest that the financial statements do not give a true and fair view.
- “True and fair view” is a legal concept and the question of whether financial statements comply with the relevant sections can only be authoritatively decided by a Court, and reasonable expectation is that the Court will look for guidance on this question by reference to the ordinary practices of professional accountants.
- It is expected that a Court will treat compliance with accepted accounting principles as *prima facie* evidence that the financial statements are true and fair. The SSAPs therefore strengthen the likelihood that a Court will hold that compliance with the prescribed standard is necessary for the financial statements to show a true and fair view.
- There is no obstacle in extending the scope of differential reporting exemptions (whether reflected in each individual SSAP or in a separate SSAP) to encompass section 123 and 126 “true and fair view” financial statements. As with all SSAPs, this would only represent the view of the accountancy profession and would not bind the Courts although it would have a strong persuasive effect.
- In any case, the Framework provides qualifying entities with relief from specified requirements only in respect of Hong Kong SSAPs. The requirements of the law will continue to apply to qualifying entities.

Companies Ordinance – section 141D

SSAP 1, Presentation of Financial Statements, states that those private companies that take advantage of the exemptions granted by Section 141D of the Companies Ordinance are considered to be preparing special purpose financial statements that do not necessarily comply with the requirements of Hong Kong SSAPs, and which do not show a true and fair view, although it has been the practice of preparers and auditors of such financial statements to have regard to the requirements of SSAPs in determining and forming an opinion on the appropriateness of the accounting policies applied.

Although the Framework for Differential Reporting would not necessarily apply to financial statements prepared in compliance with Section 141D, preparers and auditors could similarly take the Framework into account when preparing and auditing financial statements prepared in accordance with Section 141D.

Size criteria

In Hong Kong there is no official definition of a Small or Medium-sized Enterprise (SME). The Working Group was also unaware of any published statistical information that could assist in proposing criteria for application in Hong Kong. In arriving at the thresholds for total revenue and total assets appearing in the Framework, comparisons were made to practices in other jurisdictions. Taking into consideration the nature of the smaller businesses with which members of the Working Group are familiar, the Working Group was of the view that the thresholds on turnover used in the United Kingdom and in Australia could be adopted in Hong Kong. However, by comparison with practice adopted in the UK and in Australia, the Working Group considered that the threshold on gross asset value should be raised in view of significantly higher prices for real estate in Hong Kong.

In respect of the number of employees, 50 is used by many Chambers of Commerce for non-manufacturing businesses (the threshold for manufacturing businesses is higher). This number is consistent with the criteria applied by the Hong Kong Trade & Industry Department for grants to SMEs.

On finalisation of the Framework, the Council intends to review the size criteria currently applying in Hong Kong SSAPs, for example SSAP 13, Accounting for investment properties and SSAP 15, Cash flow statements, for consistency with the Framework.

Consultation Issues

The Council welcomes comments on the Framework from interested parties and would particularly welcome comments on the following questions:

1. Do you consider that there is a need for differential reporting in Hong Kong?
2. Do you consider that differential reporting should be based on a benefit:cost criterion?
3. Do you consider that the following surrogates for the benefit:cost criterion are appropriate?
 - (a) public accountability;
 - (b) separation of owners and governing body;
 - (c) size.

4. Do you consider that access to differential reporting should not be restricted solely to small entities?
5. Small groups, that are not otherwise publicly accountable, would still prepare consolidated financial statements because of legal requirement under the Companies Ordinance. Do you agree with this? Would you support the HKSA lobbying for a change in the law?
6. Do you consider the public accountability criteria detailed in paragraphs 24 and 25 are appropriate?
7. Do you consider that an entity should be deemed to be small if it does not exceed any two of the following criteria?
 - (a) total revenue of \$50 million;
 - (b) total assets of \$50 million;
 - (c) 50 employees.(paragraph 30).
8. Do you consider that differential reporting exemptions should apply immediately if an enterprise qualifies on a basis other than that covered by paragraph 34?
9. Do you support the selective application of differential reporting exemptions (paragraph 37) or, alternatively, should entities that choose differential reporting be required to apply all of the applicable exemptions and alternative treatments?
10. Do you consider that the differential reporting exemptions appearing in Appendix 1 of the Framework are appropriate? Are there any other exemptions that should be considered for differential reporting purposes?
11. At the present time, the HKSA Council would propose that differential reporting exemptions be set out within the main body of each SSAP (the integrated approach, similar to that adopted in Canada and New Zealand). Do you have any comment on that proposal?
12. Do you have any other comments on the Framework?

Attachment

FRAMEWORK FOR DIFFERENTIAL REPORTING

INTRODUCTION

1. This Framework explains differential reporting and its application in the context of the *Foreword to Statements of Standard Accounting Practice, Interpretations and Accounting Guidelines* and the *Framework for the Preparation and Presentation of Financial Statements*.
2. This Framework has two purposes:
 - a. to set out criteria by which entities qualify for differential reporting exemptions;
 - b. to guide those who prepare and set Statements of Standard Accounting Practice (SSAP) in establishing differential reporting exemptions in those Statements.
3. In the future, as SSAPs are developed or revised, each SSAP will specify any differential application of that Statement. Preparers of financial statements will not be allowed to vary the application of a SSAP except in the ways described in that Statement. Appendix 1 to this Framework lists the differential reporting application of the current versions of SSAPs. As revisions of these SSAPs are published, their differential reporting paragraphs may change. Reference should be made to the application paragraph of each particular new or revised SSAP.
4. This Framework applies in respect of periods ending on or after [date]. However, entities may elect to apply this Framework with immediate effect.

DEFINITIONS

5. The following terms are used in this Framework with the meanings specified:

General purpose financial statements *has the same meaning as in SSAP 1, Presentation of Financial Statements, being financial statements that are intended to provide information to meet the needs of those external users who are not in a position to demand reports tailored to meet their specific information needs.*

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

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.

Owner is a party that 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.*

Qualifying entities are entities that meet the requirements of this Framework, to qualify for differential reporting exemptions in SSAPs.

Total revenue comprises the annualised gross operating revenue based on the amount reported in the entity's income statement 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.

Total assets are the value of all assets (including intangible assets) reported in the entity's balance sheet at the end of the current reporting period.

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

ASSUMPTIONS OF DIFFERENTIAL REPORTING

6. Differential reporting allows entities in different circumstances to differ in the financial statement disclosures made and the accounting practices adopted. Differential reporting does not apply to the disclosure of accounting policies.
7. Differential reporting is needed because the benefits and costs of compliance with SSAPs differ between reporting entities.
8. This Framework has been developed on the basis of the following assumptions:
 - a. compliance with SSAPs creates costs (usually for the reporting entity) and benefits (usually for users of the financial statements);
 - b. compliance should be required only when the benefits of compliance exceed the costs;
 - c. SSAPs will be more accepted if they apply only where benefits are generally agreed to exceed costs.
9. Differential reporting is consistent with the legal requirements for financial statements to give a true and fair view. In the rare circumstances that compliance with generally accepted accounting practice does not result in the financial statements giving a true and fair view, additional information and explanations are to be provided in order to give a fair presentation. In this document, *true and fair view* has the same meaning as *fair presentation* and *fairly reflects*.

DISCUSSION

General Purpose Financial Statements

10. Entities often prepare financial statements to comply with legislation or statutory regulation or with the terms of a contract with another entity.
11. 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 statements are appropriate.
12. Where users have the power to specify the information to be included in financial statements, these financial statements are considered to be special purpose financial statements.
13. Where financial statements are prepared solely to meet the requirements of a contract or agreement, these financial statements are considered to be special purpose financial statements. Users likely to request special purpose financial statements include:
 - a. major lenders such as banks and financial institutions;
 - b. government agencies;
 - c. credit-rating agencies.
14. Whenever special purpose financial statements are prepared, the user is able to specify the extent to which SSAPs are to be applied. For this reason, this Framework applies only to general purpose financial statements and does not apply to special purpose financial statements.
15. For the purposes of this Framework, where legislation requires financial statements to give a true and fair view of the financial affairs of the reporting entity, these financial statements are always considered to be general purpose financial statements. Legislation may also require specific measurement, disclosure or presentation in the financial statements of certain entities and these requirements may limit or exclude use of differential reporting by those entities.

Benefit:Cost Criterion

16. The benefit:cost criterion is met when the benefits of financial reporting requirements outweigh the costs imposed.
17. 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.

18. 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.
19. The benefits of financial reporting reflect the value of information to the users of the financial statements. The benefits, therefore, will usually correlate 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.
20. SSAPs should meet the benefit:cost criterion. SSAPs are justified where the marginal benefits of their application exceed the marginal costs of their application. Financial reporting regulation (including SSAPs) imposes costs of preparing and revising SSAPs, 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.

Application of the Benefit:Cost Criterion

21. To measure the costs and benefits of financial reporting requirements is difficult and this Framework therefore uses surrogates based on broad assumptions.
22. The broad assumptions are:
 - a. More benefits are derived from the general purpose financial statements 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 statements 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 statements, and the greater the benefit likely to be derived.
23. Using the three broad assumptions above, the surrogates for the Benefit:Cost Criteria for a reporting entity is:
 - a. public accountability;
 - b. separation of owners and governing body of an entity; and
 - c. size.

Public Accountability

24. 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) is an issuer of securities, that is, its equity or debt securities are publicly traded or it is in the process of issuing equity or debt securities;
 - b. the entity is an institution authorised under the Banking Ordinance;
 - c. the entity is an insurer authorised under the Insurance Companies Ordinance; or
 - d. the entity is dealer and/or an investment adviser authorised under the Securities Ordinance or Commodities Trading Ordinance.
25. An entity does not have public accountability, for the purposes of this Framework, solely by reason of receiving public funds from another entity that has the power to tax, rate or levy to obtain public funds.

Separation Between Owners and Governing Body of an Entity

26. 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 29 and 30 below, in such circumstances the entity will qualify for differential reporting exemptions provided it does not have public accountability.
27. 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.
28. The definition of an owner in paragraph 5 of this Framework identifies an owner as a party that has a beneficial interest in the residual value of the entity's assets. Therefore when the entity preparing financial statements 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 power to tax, rate or levy

29. If the parent or ultimate controlling entity has the 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 government departments, agencies, related organisations, or government business enterprises 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

30. An entity is small if it does not exceed any two of the following:
- a. total revenue of \$50 million;
 - b. total assets of \$50 million;
 - c. 50 employees.

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 this Framework. The size criteria will be reviewed from time to time.

Groups of Entities

31. Where the reporting entity is a group, the criteria in paragraphs 24 to 30 shall be applied to the group comprising the parent and its subsidiaries. For a group the criteria of size in paragraph 30 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 to have public accountability in terms of paragraph 24.
32. A group should however not be considered to have public accountability solely by reason of a subsidiary or associate having public accountability.

Framework for Differential Reporting

33. An entity qualifies for differential reporting exemptions (is a qualifying entity) when the entity does not have public accountability (paragraphs 24 - 25), and:
- a. at balance sheet date, all of its owners are members of the entity's governing body; or
 - b. the entity is small in terms of paragraph 30;

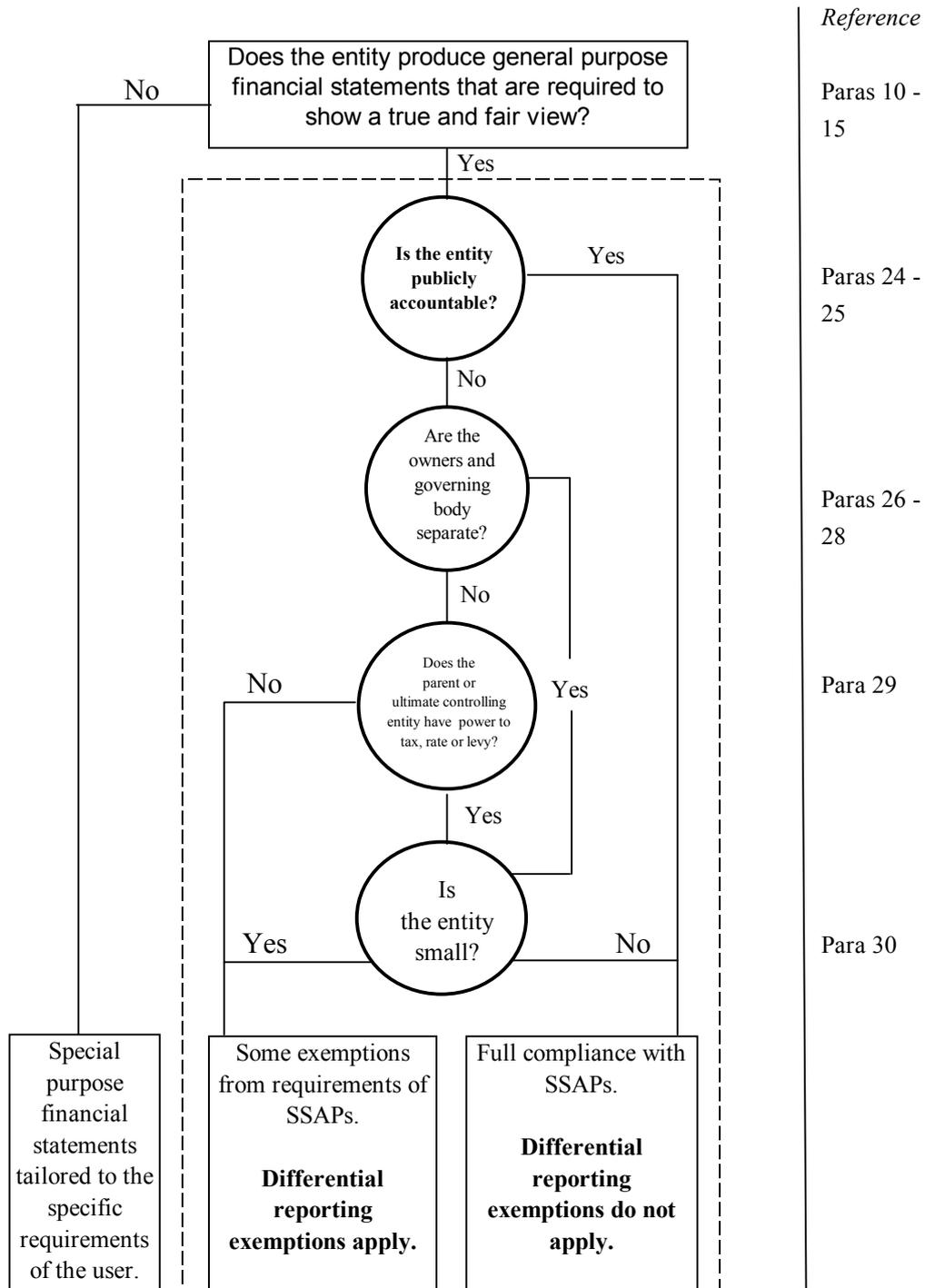
except that an entity which does not have public accountability but whose parent or ultimate controlling entity has the power to tax, rate or levy to obtain public funds may only qualify for differential reporting where it is small in terms of paragraph 30.

These criteria are demonstrated in Figure 1 below.

34. When an entity has not been small in terms of paragraph 30 and subsequently becomes small, the entity will not qualify for differential reporting exemptions in terms of paragraphs 33b until the entity is small 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.
35. Where an entity has previously qualified for differential reporting exemptions in terms of paragraph 33, but no longer qualifies, the entity shall cease immediately to apply differential reporting exemptions. Unless impracticable, the entity shall provide comparative figures for the previous period without applying differential reporting exemptions to the comparative figures.

Figure 1: Framework for Differential Reporting

Note: material within the dotted area indicates the Framework for Differential Reporting



ADDITIONAL CONSIDERATION WITH RESPECT TO DIFFERENTIAL REPORTING

36. In the future when each SSAP is prepared or revised, the benefit:cost criterion mentioned in paragraph 16 will be considered; where appropriate, differential reporting exemptions will be included in the new SSAP.
37. In all cases where entities qualifying to do so take advantage of differential reporting exemptions, they should disclose in their general purpose financial statements:
 - a. the fact that the financial statements have been prepared applying differential reporting exemptions;
 - b. the criteria on which they qualify to apply differential reporting exemptions;
 - c. whether the differential reporting exemptions have been applied in full or selectively.

APPENDIX 1

Application of Differential Reporting to Statements of Standard Accounting Practice

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

The Framework for Differential Reporting grants either full, partial or no exemption from SSAPs.

Full Exemption

Qualifying entities are granted full exemption from:

SSAP 5: Earnings per share

SSAP 12: Accounting for deferred tax

SSAP 15: Cash flow statements

SSAP 20: Related party disclosures, but only on the unanimous written agreement of the shareholders. If the shareholders have not agreed to apply this exemption, SSAP 20 should be complied with in full.

SSAP 25: Interim financial reporting

SSAP 26: Segment reporting

SSAP 33: Discontinuing operations

It should be noted that SSAP 12 contains recognition, measurement, and disclosure requirements. When an entity applies the exemption in respect of SSAP 12:

- income tax is accounted for using the liability (taxes payable) method, whereby the income tax liability is recognised and measured in accordance with SSAP 28: Provisions, contingent liabilities and contingent assets; and
- the entity 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 discloses the accounting policy adopted for income tax, in accordance with SSAP 1: *Presentation of financial statements*.

Partial Exemption

Qualifying entities are given partial exemption from the following SSAPs:

- SSAP 1: Presentation of financial statements: Qualifying entities are not required to disclose the information required by paragraph 56.
- SSAP 2: Net profit or loss for the period, fundamental errors and changes in accounting policies: Qualifying entities are not required to disclose the information required by paragraph 29.
- SSAP 9: Events after the balance sheet date: Qualifying entities are not required to disclose the information required by paragraphs 16 and 18.
- SSAP 13: Accounting for investment properties: Qualifying entities may apply the exemption from open market value provisions in paragraphs 12 and 13 to all their investment properties.
- SSAP 14: Leases: Qualifying entities are given several disclosure concessions in paragraphs 23, 30, 42 and 53. An asterisk in the standard identifies each disclosure concession. Qualifying entities are exempt from the requirements of paragraphs 23 (b), 30 (a), 42 (a) and 53 (b) and may satisfy the requirements of those paragraphs by disclosing lease liabilities and commitments classified into current and non-current amounts only.
- SSAP 17: Property, plant and equipment: Qualifying entities are permitted to adopt the same rates of depreciation for financial reporting as for income tax purposes except when assets have been revalued. Qualifying entities are not required to disclose the information required by paragraph 72 (b).
- SSAP 18: Revenue: Qualifying entities are not required to disclose the information required by paragraph 35(b) & (c).
- SSAP 19: Borrowing costs: Qualifying entities are not required to disclose the information required by paragraph 25 (d).
- SSAP 22: 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 30 (b). Qualifying entities are not required to disclose the information required by paragraph 30 (c), (d) and (e).
- SSAP 23: Construction contracts: Qualifying entities are not required to disclose the information required by paragraphs 38 (a), 39 and 41.

- SSAP 28: Provisions, contingent liabilities and contingent assets: Qualifying entities are not required to disclose the information required by paragraphs 84, 85, 89, 91 and 92.
- SSAP 29: Intangible assets: Qualifying entities are not required to disclose the information required by paragraph 111 (c).
- SSAP 31: Impairment of assets: Qualifying entities are not required to disclose the information required by paragraphs 117 and 118.
- SSAP 34: Employee benefits: Qualifying entities are not required to disclose the information required by paragraphs 46, 123, 150 and 151.

Full Compliance (No Differential Reporting Concessions)

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

- SSAP 10: Accounting for investments in associates
- SSAP 11: Foreign currency translation
- SSAP 21: Accounting for interests in joint ventures
- SSAP 24: Accounting for investments in securities (NB: Because this SSAP is due to be revised, with the publication of ED/Financial Instruments, differential reporting exemptions will be considered at a later stage)
- SSAP 27: Accounting for group reconstructions
- SSAP 30: Business combinations
- SSAP 32: Consolidated financial statements and accounting for investments in subsidiaries