

2 September 2004

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Dear Paul

Discussion Paper: Preliminary Views on Accounting Standards for Small and Medium-sized Entities (SMEs)

The Institute of Chartered Accountants in Australia (ICAA) welcomes the opportunity to make a submission on the IASB's discussion paper on accounting standards for SMEs. It is an issue that we have had significant involvement with here in Australia.

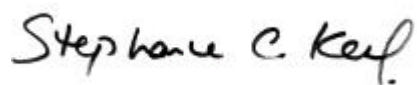
Our members in small to medium-sized practices have long complained that general purpose financial reports prepared in accordance with all the standards are overkill for small business and we have been working on a similar project ourselves, our Business Practice Guide (BPG). The BPG can be downloaded from our website at <http://www.icaa.org.au/tech/index.cfm?menu=312&id=A106597203>.

In considering an issue such as this, we must not lose sight of the objective of financial reporting, namely to provide information to users. Accounting is a means of communicating financial information to the users of those accounts and in the case of SMEs, the users are not generally highly financially literate and able to cope with all the complex information that is contained in general purpose financial reports prepared in accordance with IFRS. This project is an opportunity to create something simpler, which can be used for smaller entities around the world and in developing economies. Accordingly we recommend that you do not place too much emphasis on marrying the SME standard to the recognition and measurement principles in full IFRSs (Issue 7) to the detriment of clear communication with the lay user.

Some academic accountants will argue that "profit is profit is profit" and that there should be no compromise to the measurement principles in full IFRS. In our view, this contradicts the objective of the exercise, namely to simplify financial reporting for SMEs. Many jurisdictions are already comfortable with the existence of two profit figures, namely tax profit and accounts profit and these can be reconciled. We would envisage that profit under an SME standard would be more akin to tax profit, with additional disclosures as to expenditure commitments and the deferred tax consequences of current policies. We suspect that such an approach would be easier for the small business owner to understand. It may be that a necessary precursor to the development of an SME standard is a survey of the needs of SME users, similar to that being undertaken in the USA by the AICPA.

Our detailed comments on your questions are attached. If we can be of any assistance to you with this project, please do not hesitate to contact us.

Yours sincerely

A handwritten signature in black ink that reads "Stephanie C. Kemp". The signature is written in a cursive style with a large, stylized 'S' and a clear 'Kemp' at the end.

Stephanie Kemp, MA, CA
Technical Standards Consultant

Attachments:
ICAA's Business Practice Guide
Statements of Accounting Concepts SAC1 and SAC 2

c.c. Warren McGregor, Member, International Accounting Standards Board
David Boymal, Chairman, Australian Accounting Standards Board

Accounting Standards for Small and Medium-sized Entities (SMEs)

Issue 1. Should the IASB develop special financial reporting standards for SMEs?

1a Do you agree that full IFRSs should be considered suitable for all entities? If not, why not?

We understand the conceptual argument that what constitutes an asset, liability, expense or revenue should be universal. However, we believe that accounting is now so complex that the burden of compliance with some standards is now unacceptable for small business – the costs of calculating the information outweigh the benefits to the users. In addition, we believe that financial reporting should meet the purposes of the principal users, typically for SMEs, the owners. As such, users are often in a position to obtain information to meet their specific needs. Therefore, standards promulgated to meet the requirements of publicly accountable entities represent an unnecessary regulatory burden for SMEs. Such an approach would be consistent with the concept of Relevance.

1b Do you agree that the Board should develop a separate set of financial reporting standards suitable for SMEs? If not, why not?

We agree with this proposal. In fact, we have completed a similar project here in Australia and eagerly await the results of the IASB's endeavours. A separate set of standards provides a single source of reference for SMEs rather than an SME section within existing IFRS standards. We would prefer a single omnibus standard for SMEs that would form a "one-stop shop" of financial reporting requirements for SMEs.

1c Do you agree that IASB standards for SMEs should not be used by publicly listed entities (or any other entities not specifically intended by the Board), even if national law or regulation were to permit this? Do you also agree that if the IASB Standards for SMEs are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs? If not, why not?

We agree that the IFRS for SMEs should not be used by publicly listed companies. It should be for entities that are not publicly accountable as discussed later in the paper. In Australia, we have worded the concept of public accountability in terms of "reporting entity". Under Statement of Accounting Concepts SAC 1, reporting entities are "all entities ... in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for making and evaluating decisions about the allocation of scarce resources". A general purpose financial report is "a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs." This is further discussed in SAC 2, "Objective of General Purpose Financial Reporting".

In Australia, a non-reporting entity (SME without public accountability) is allowed to produce simplified financial reports. In note 1, the entity has to identify those accounting standards it has chosen to apply in preparing its financial report, referred to as a *special purpose financial report*. The auditor's report also refers to the financial report being a special purpose financial report, prepared in accordance with accounting standards selected by the directors. With our own SME project, the

Business Practice Guide (BPG), the entity simply has to refer to compliance with one document, rather than list a number of standards as at present.

Note that non-reporting entities in Australia are not obliged to follow the BPG; it is optional guidance only. Entities can select appropriate accounting policies straight from the full standards if they wish and disclose which standards they have applied. The nature of a special purpose report assumes that the users are involved in the business and in a position to command the financial information they need.

We attach copies of SAC 1 and SAC 2 for your information. If it would help, we can send also send you examples of various SME accounting policy notes and a special purpose audit report.

We would expect a financial report prepared under IFRS for SMEs to be described as such. The report could not merely refer to compliance with IFRS, as that would be misleading. We agree that if a publicly accountable entity uses the standard for SMEs, the financial statements cannot be described as being in compliance with the IFRS for SMEs, as the wrong framework has been adopted. Full IFRS is the appropriate framework in this case and the auditor should qualify for non-compliance with full IFRS.

Issue 2. What should be the objectives of a set of financial reporting standards for SMEs?

2 Are the objectives of IASB Standards as set out in preliminary view 2 appropriate and, if not, how should they be modified?

We agree with the objectives in PV 2, but can see theoretical difficulties with (c) “be built on the same conceptual framework as IFRSs” if the other objectives are to be met to any significant extent. Accordingly, it may be appropriate to start the SME standard with an SME Framework, which emphasises the identified needs of SME users, as distinct from users of general purpose financial reports.

In preparing a standard for SMEs, we must not lose sight of the qualities of financial reporting outlined in IAS 8, such as relevance and reliability to the users of the statements. While it would be ideal if the standard for SMEs had the same conceptual basis, in reality, there may be instances where recognition of an asset or liability is not appropriate because of the cost involved in the calculations and because the information derived is too complicated for the users to assimilate. Prime examples of this are financial instruments and tax effect accounting balances. From the point of view of a small business user, a hedge should be accounted for in the traditional manner to reflect the reason the business went in to it, rather than giving rise to a plethora of assets and liabilities. Similarly, the small business user is interested in what tax he or she has to pay in the near future, while more remote consequences are reflected in budgets and cash flow forecasts. Accordingly, note disclosure of more remote consequences may well serve the SME user’s purposes better than recognition of complex deferred tax assets and liabilities.

We suggest that Para (c) be modified by adding “subject to cost benefit constraints”.

Issue 3. For which entities would IASB standards for SMEs be intended?

3a Do you agree that the Board should describe the characteristics of the entities for which it intends the standards but that those

characteristics should not prescribe quantitative ‘size tests’? If not, why not, and how would an appropriate size test be developed?

We agree with the Board’s proposal. Australia has been using the reporting entity concept for many years now and has found it satisfactory. See also our answer to 1c above.

3b Do you agree that the Board should develop standards that would be suitable for all entities that do not have public accountability and should focus only on some entities that do not have public accountability, such as only the relatively larger ones or only the relatively smaller ones? If not, why not?

In practice, in Australia, we have found the need for guidance comes from what you might call the “larger smalls”. Really small entities (sole traders and some partnerships and small companies) are outside the scope of our Corporations Act and tend to be owner managed, and only need financial information for tax purposes. These entities are effectively deregulated from a financial reporting standpoint. It is the next level of small business that needs guidance in an SME standard. These businesses are typically still owner managed, but have some outside finance and significant creditors. If the IASB develops a SME standard, those very small entities that are deregulated as far as financial reporting is concerned can choose to continue to do tax-based accounting, but may choose to use the SME standard if they wish. The next tier of entities that have to lodge financial reports on the public record but are still of little interest to anyone outside their circle of owners and creditors would use an SME standard.

We see the issue of applicability of a SME standard at the smaller end as being fraught with problems. Australia has circumvented this by allowing non-reporting entities to choose which standards are appropriate to the entity. In the spirit of this, the ICAA’s BPG is optional guidance, rather than mandatory. See also our comments at 9 below.

3c Do the two principles in PV 3.2, combined with the presumptive indicators of ‘public accountability’ in PV 3.3, provide a workable definition and appropriate guidance for applying the concept of ‘public accountability’? If not, how would you change them?

We agree with this approach. It is similar to what we have been using in Australia for a number of years and we have found it satisfactory. Of course, there are circumstances where professional judgement has to be exercised, but this is the case in almost every aspect of financial reporting and auditing.

3d Do you agree that an entity should be required to use full IFRSs if one or more of the owners of its shares object to the entity’s preparing its financial statements on the basis of IASB Standards for SMEs? If not, why not?

In Australia, we have a provision in the Corporations Act that relieves small companies from having to file accounts. Owners with 5% or more of the issued share capital can, however, serve a demand on the company to prepare financial statements and have them audited. This seems to work fine. You may find that enabling just one member to require full IFRS will lead to members making such a request as a means of being difficult for personal reasons. In practice, we find that these kinds of requests tend to occur when a family business is breaking down (for example in a

divorce), those involved are no longer on good terms and legal proceedings are commencing. Generally it benefits everyone at this point to assume the business is a reporting entity and prepare full general purpose financial reports.

Sometimes, for example in the case of small clubs, our members will put a resolution to the AGM asking the membership to approve the preparation of special purpose financial reports (leaving out some of the more complicated requirements). This gives the users the opportunity to choose their financial reporting framework.

3e Do you agree that if a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements of its parent, venturer or investor, the entity should comply with full IFRSs and not IASB Standards for SMEs, in its separate financial statements? If not, why not?

We strongly disagree with this suggestion. The head entity in these circumstances is in a position to request all the information it needs from its investment and may well receive more detailed information by way of consolidation schedules than it would if it received financial statements under IFRS.

The decision as to whether the investee complies with full IFRS should be made on the basis of its own public accountability. If the parent entity is the only significant user, we see reason for the investee to prepare full IFRS statements. If, however, the investee is an associate, which is also listed on a stock exchange, of course it must prepare full IFRS statements.

Issue 4. If IASB Standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, now should that entity resolve the issue?

4 Do you agree that if IASB Standards for SMEs do not address a particular accounting recognition or measurement issue, the entity should be required to look to the appropriate IFRS to resolve that particular issue? If not, why not, and what alternative would you propose?

Where the issue is material to the financial statements, we agree with the proposal to look to the relevant IFRS for guidance. Application of all the IFRSs should not be mandatory.

Issue 5. May an entity using IASB Standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB standard for SMEs?

5a Should an SME be permitted to revert to an IFRS if the treatment in the SME version of the IFRS differs from the treatment in the IFRS, or should an SME be required to choose only either the complete set of IFRSs or the complete set of SME standards with no optional reversion to individual IFRSs? Why?

We believe optional reversion to IFRS should be permitted, but suspect that in practice the incidences of this happening will be few and far between. We would not wish to stand in the way of an entity adopting what it considers to be the most appropriate accounting policy for its specific circumstances. Adoption of an IFRS by

an entity otherwise using the IFRS for SMEs should be disclosed in the accounting policy note and referred to as a modification of the accounting framework.

- 5b If an SME is permitted to revert to an IFRS, should it be:**
- (a) required to revert to the IFRS in its entirety (a standard by standard approach);**
 - (b) permitted to revert to individual principles in the IFRS without restriction while continuing to follow the remainder of the SME version of the IFRS (a principle by principle approach); or**
 - (c) required to revert to all of the principles in the IFRS that are related to the treatment in the SME version of that IFRS while continuing to follow the remainder of the SME version of the IFRS (a middle ground between a standard-by-standard and principle-by-principle approach)?**

Please explain your reasoning and, if you favour (c), what criteria do you propose for defining 'related' principles?

We prefer option (a). Options (b) and (c) are appealing conceptually, but would lead to very complicated accounting policy disclosures and a loss of comparability between entities. Option (a) will enable entities to state that they comply with the IFRS for SMEs with the exception of such and such an aspect, which is accounted for as per IAS XXX.

6 Do you agree that development of IASB Standards for SMEs should start by extracting the fundamental concepts from the Framework and the principles and related mandatory guidance from IFRSs (including Interpretations), and then making modifications deemed appropriate? If not, what approach would you follow?

We agree with this approach. It is the approach the ICAA followed in preparing our BPG.

7a Do you agree that any modifications for SMEs to the concepts or principles in full IFRSs must be on the basis of the identified needs of users of SME financial statements or cost-benefit analyses? If not, what alternative bases for modifications would you propose, and why? And if so, do you have suggestions about how the Board might analyse the costs and benefits of IFRSs in an SME context?

We agree that any modifications must be based on the needs of SME users and cost-benefit analysis. We draw your attention to a web survey being conducted by the AICPA, which is designed to find out precisely this kind of information. See http://www.aicpa.org/news/2004/2004_0712.htm for further details. We also refer you to the UK Accounting Standards Board Financial Reporting Standard for Smaller Entities (FRSSE) including the precursor document, "Designed to Fit". In addition the UK ASB has recently issued a discussion paper, "A 'one-Stop Shop' FRSSE".

7b Do you agree that it is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost-benefit analyses and that the disclosure modifications could increase or decrease the current level of disclosure for SMEs? If not, why not?

We agree that such modifications are likely. We find it hard to believe that a standard for SMEs would increase the level of disclosure above that required for an

SME complying with IFRS in the absence of an SME standard, unless perhaps enhanced disclosure is replacing a complex measurement issue.

7c Do you agree that, in developing standards for SMEs, the Board should presume that no modification would be made to the recognition or measurement principles in IFRS, though that presumption could be overcome on the basis of user needs and a cost benefit analysis? If not, why not?

We do not agree with this presumption, as the whole purpose of the exercise is to SIMPLIFY reporting requirements for SMEs. Some of the calculations presently required in financial reporting (for example long tail employee entitlements and effectiveness testing requirements for hedge accounting) are taxing even for the technical accountant and quite hard for the SME user to understand.

Issue 8. In what format should IASB Standards for SMEs be published?

8a Do you agree that the IASB Standards for SMEs should be published in a separate printed volume? If you favour including them in separate sections of each IFRS (including Interpretations) or some other approach, please explain why.

We agree with this approach. If you put the SME requirements in each separate standard, there is a strong possibility some will not be noticed and the statement that the financial statements comply with IFRS for SMEs will be meaningless.

8b Do you agree that IASB Standards for SMEs should be organised by IAS/IFRS number rather than in topical sequence? If you favour a topical sequence or some other approach please explain why.

We are of the view that organising the material by topic will make it easier to use for the preparers of SME accounts. It does however mean that there needs to be a reference document that links the requirements of the SME standard to the source in the IFRS and Interpretations. This document then becomes the theoretical justification underlying the SME standard. For an example of this, see Appendix C of our BPG.

8c Do you agree that each IASB Standard for SMEs should include a statement of its objective, a summary and a glossary of terms?

If the SME standards are in a separate small printed volume, one overall statement of the objective and one glossary should suffice. We hope that if the simplification exercise is successful, there will be no need to include a summary of the standards!

9 Are there any other matters related to how the Board should approach its project to develop standards for SMEs that you would like to bring to the Board's attention?

Our major concern with this project is how the existence of an IASB SME standard would affect financial reporting in Australia. Although this issue is not directly relevant to the IASB's deliberations, your awareness of it may help you understand the stance that we have taken.

Under the AASB's obligation to comply with international accounting standards, if the IASB issues a standard for SMEs, the AASB will have to adopt that standard.

Given the similarity between the IASB's definition of an entity with public accountability and our definition of a reporting entity, such a standard would probably be drafted as applying to non-reporting entities. Our non-reporting entities range from substantial private companies, for which some formal financial reporting is quite appropriate, down to family businesses and sole traders for which an SME standard would be overkill. Such a standard would probably be largely ignored outside the larger accounting firms.

Given the size of Australia's economy, we suggest that our experience may be relevant to those developing countries, which this project is intended to help. For this reason, we are recommending a high degree of flexibility with regard to both measurement and disclosure. It is as a result of these considerations that we made the ICAA's Business Practice Guide guidance only. It is available for the small business that requires some formal financial reporting, but not to the level of full general purpose financial reports. Very small entities whose financial reporting is tax driven can ignore the BPG and prepare what they need for tax purposes.

If, however, the IASB's intention is that full IFRS should only apply to listed entities and that the IFRS for SMEs should apply to non-listed reporting entities, then that intention should be clearly spelt out.

Definition of the Reporting Entity

Prepared by the **Public Sector Accounting Standards Board** of
the **Australian Accounting Research Foundation** and by the
Accounting Standards Review Board

Issued by the **Australian Accounting Research Foundation** on behalf of the
Australian Society of Certified Practising Accountants and **The Institute of
Chartered Accountants in Australia** and by the **Accounting Standards
Review Board**

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STATEMENT OF ACCOUNTING CONCEPTS
SAC 1 "DEFINITION OF THE REPORTING ENTITY"

Citation

- 1 This Statement may be cited as Statement of Accounting Concepts SAC 1 "Definition of the Reporting Entity".

Application and Operative Date

- 2 This Statement applies to each reporting entity in relation to its first reporting period that ends on or after 31 August 1990, and in relation to subsequent reporting periods.

INTRODUCTION

- 3 The purpose of this Statement is to define and explain the concept of a reporting entity and to establish a benchmark for the minimum required quality of financial reporting for such an entity.¹ This Statement outlines the circumstances in which an entity or economic entity should be identified as a reporting entity. It also outlines the criterion for determining, for financial reporting purposes, the boundaries of a reporting entity.

¹ In the Discussion section of this Statement, the term "entity" should be read as referring also to an economic entity, except where the narrower meaning of the term is specified.

- 4 In relation to the benchmark for the minimum required quality of financial reporting, this Statement specifies that reporting entities shall prepare general purpose financial reports and that these are reports which comply with Statements of Accounting Concepts and Accounting Standards.
- 5 This Statement does not consider techniques of accounting for and the method of presentation of financial information about a reporting entity. Such considerations are included in Accounting Standards.

DEFINITIONS

- 6 For the purposes of this Statement:

"control" means the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in achieving the objectives of the controlling entity;

"economic entity" means a group of entities comprising a controlling entity and one or more controlled entities operating together to achieve objectives consistent with those of the controlling entity;

"entity" means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives; and

"general purpose financial report" means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs.

DISCUSSION

General Purpose Financial Reporting

- 7 Statement of Accounting Concepts SAC 2 "Objective of General Purpose Financial Reporting" states that general purpose financial reports are prepared to provide users with information about the reporting entity which is useful for making and evaluating decisions about the allocation of scarce resources (hereinafter "resources"). When general purpose financial reports meet this objective they will also be a means by which managements and governing bodies discharge their accountability to those users. If Statements of Accounting Concepts and Accounting Standards are to be effective in ensuring adequate disclosure of information to users of general purpose financial reports, it is necessary that all those entities which should report, do report. In addition, if the regulation of general purpose financial reporting is to be developed on a rational and efficient basis, it is equally important that those entities for which there is no justification to report are not required to report.
- 8 Financial reports which meet the objective of general purpose financial reporting are general purpose financial reports. General purpose financial reports should be prepared when there exists, in relation to an entity, users whose information needs have common elements, and those users cannot command the preparation of information to satisfy their individual information needs. Such reports will provide users with appropriate information for making decisions relating to the efficient allocation of resources.
- 9 Efficient allocation of resources is facilitated by ensuring that general purpose financial reports contain information of at least the minimum required quality. Accordingly, general purpose financial reports should be prepared in accordance with Statements of Accounting Concepts and Accounting Standards.

The Reporting Entity Concept

- 10 A number of alternative concepts of the reporting entity are implicit in existing legislation and regulations which specify the entities which should prepare general purpose financial reports. These concepts include the legal entity concept, which has been employed in legislation in the private sector, and a broad concept based on accountability of elected representatives and appointed officials, which has been employed in the public sector. In the private sector it has been common for entities to be required to report whenever they have had legal status (for example, companies have been so obliged). In the public sector the accent on accountability has seen widespread application of the fund concept of reporting, which implies a concern with reporting the results of individual funds. In other cases, the concept based on accountability of elected representatives and appointed officials has led to entities which have such representatives and/or officials preparing general purpose financial reports.

- 11 The concepts referred to in paragraph 10 do not give adequate consideration to user needs in identifying the reporting entity. In the private sector it is possible that users exist in respect of reporting entities which are not legal entities and for which legislation requiring the preparation of general purpose financial reports does not exist, for example, partnerships, most trusts, and associations. Similarly, in the public sector it is possible that users exist in respect of entities other than the fund or the electoral entity, for example, in respect of individual statutory authorities, departments and governments. If accounting concepts, developed within a framework which identifies users' information needs as primary, are to satisfy the objective of general purpose financial reporting, those concepts must be related to users' information needs.
- 12 This Statement adopts a concept of the reporting entity which is tied to the information needs of users and the nature of general purpose financial reports. The concept requires that individual reporting entities be identified by reference to the existence of users who are dependent on general purpose financial reports for information for making and evaluating resource allocation decisions. This means that a class of entity defined under another concept, such as the legal or fund concepts (for example, proprietary companies or special and general purpose funds), may include some entities which should be identified as reporting entities, by virtue of the existence of users dependent on general purpose financial reports prepared by the entity, and other entities which should not be so identified.
- 13 It should therefore be noted that the concept of the reporting entity adopted by this Statement is not dependent on the sector - public or private - within which the entity operates, the purpose for which the entity was created - business or non-business/profit or not-for-profit - or the manner in which the entity is constituted - legal or other. It is a concept which is tied to the objective of general purpose financial reporting and, as noted in paragraph 12, is a concept which requires all entities with users dependent on general purpose financial reports for information to prepare such reports.
- 14 The concept of the reporting entity and the identification of the boundaries of a reporting entity are related. For example:
- (a) if the concept of the reporting entity adopted was based on a class of legal entity (such as a company), this would imply identification of the boundaries of the entity by reference to legal considerations, which would mean that only entities of that legal class could be aggregated to form a reporting entity; and
 - (b) if the fund concept of the reporting entity was adopted, this would imply identification of the boundaries of the reporting entity by reference to the functional uses for which resources were designated and deployed. This would (unless more than one concept of the reporting entity was adopted) render illogical and inoperative the concept of aggregating separate funds to recognise the existence of a reporting entity.
- 15 However, the concept of the reporting entity established by this Statement is one linked to the information needs of users of general purpose financial reports in making and evaluating resource allocation decisions. The provision of

information for these purposes is the criterion used to determine the boundaries of a particular reporting entity.

- 16 The disclosure of the resources that an entity has the capacity to deploy, and the results of their deployment, will assist users to determine the performance and financial position of the entity. Such information will assist users in making resource allocation decisions and is necessary for the evaluation of past decisions. For these purposes, information about all resources able to be deployed by a reporting entity is relevant, whatever the legal or administrative structure established to manage those resources. Thus, where an entity controls other entities, there should be disclosed information regarding the resources of controlled entities as well as the resources of the controlling entity because all of these resources may be deployed by the controlling entity for its own advantage.
- 17 Accordingly, while in some instances a reporting entity will comprise an individual entity, in other instances a reporting entity will comprise a group of entities, some of which individually may be reporting entities. One of the entities within the group will control the other entities so that they operate together to achieve objectives consistent with those of the controlling entity. The group, which may be termed an economic entity, will be a reporting entity where there exist users dependent on general purpose financial reports for making and evaluating resource allocation decisions regarding the collective operation of the group of entities. Whether one entity has the capacity to control other entities, and therefore whether an economic entity exists, will depend on an evaluation of the circumstances of the particular entities. In determining whether control exists, the factors to be considered include the following: extent and implications of financial dependence, capacity to appoint or remove managements or governing bodies, and power to direct operations.
- 18 For the purposes of this Statement, an individual would normally constitute an entity as defined in paragraph 6. However, it should be noted that individuals with the capacity to deploy resources, but not in order to achieve their own objectives, will not meet the definition of an economic entity, for example: a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee, and a liquidator of an entity.

Identification of Whether Dependent Users Exist

- 19 For the purposes of this Statement, the identification of an entity as a reporting entity is linked to the information needs of users of general purpose financial reports. In many instances, it will be readily apparent whether, in relation to an entity, there exist users who are dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions. For those entities in respect of which it is not readily apparent whether such dependent users exist, the factors outlined in paragraphs 20 to 22 are identified as the primary factors to be considered in determining whether a reporting entity exists. These factors are indicative only, and are not the only factors that will be relevant in determining whether, in a particular circumstance, an entity is a reporting entity.

Separation of management from economic interest

- 20 The greater the spread of ownership/membership and the greater the extent of the separation between management and owners/members or others with an economic interest in the entity, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions.

Economic or political importance/influence

- 21 Economic or political importance/influence refers to the ability of an entity to make a significant impact on the welfare of external parties. The greater the economic or political importance of an entity, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions. Reporting entities identified on the basis of this factor are likely to include organisations which enjoy dominant positions in markets and those which are concerned with balancing the interests of significant groups, for example, employer/employee associations and public sector entities which have regulatory powers.

Financial characteristics

- 22 Financial characteristics that should be considered include the size (for example, value of sales or assets, or number of employees or customers) or indebtedness of an entity. In the case of non-business entities in particular, the amount of resources provided or allocated by governments or other parties to the activities conducted by the entities should be considered. The larger the size or the greater the indebtedness or resources allocated, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions.

Implications of Application of the Reporting Entity Concept

Implications of the criterion for identification of a reporting entity

- 23 As the concept of the reporting entity reflected in this Statement is related to the information needs of users, it is evident that the creation of a company, statutory authority or other organisational structure does not of itself mean that the entity or organisation will qualify as a reporting entity. Judgement will be required in determining whether an entity satisfies the criterion for being so classified.
- 24 For entities which operate in the public sector, the implications of the factors listed in paragraphs 20 to 22 are that most government departments and statutory authorities will be reporting entities. This arises by virtue of the separation between the parties with an economic interest in the activities undertaken in the sector and the parties responsible for the management of those activities. (Management is elected by the parties which have an economic interest in the activities, that is, members of the public, or is appointed by others who have been so elected.) It is fundamental that those who manage resources on behalf of others should account for their performance to those who have provided the resources. Thus, in the public sector, the practical use of the factors listed in paragraphs 20 to 22 will be to identify entities which are not reporting entities. For example, medical centres established and controlled by a hospital may not be considered to be reporting entities where, individually, the amount of resources allocated to each is very low relative to the total resource allocation to the hospital and, because of that and other factors, there do not exist users dependent on general purpose financial reports relating to each centre. In such circumstances, information about the medical centres controlled by the hospital would be incorporated into the general purpose financial report of the hospital. This does not mean that the hospital will not require financial information from each of the centres for making resource allocation decisions. Rather, the implication is that financial reports prepared for this purpose by the centres would not be in the nature of general purpose financial reports, but instead would be in the nature of special purpose financial reports.
- 25 An implication of applying the reporting entity concept in the public sector is that a government as a whole, whether at the Federal, State, Territorial or local government level, would be identified as a reporting entity because it is reasonable to expect that users will require general purpose financial reports to facilitate their decision-making in relation to the resource allocations made by, and the accountability of, those governments. At a lower level of reporting, a number of individual statutory authorities and departments (and the entities they

control) may also be defined as individual reporting entities because of their economic or political significance and/or their financial characteristics (for example, resources controlled and level of indebtedness). In some cases, these factors may also identify a ministerial portfolio as a reporting entity.

- 26 In the private sector, the factors listed in paragraphs 20 to 22 will identify as reporting entities all entities in which there is significant separation of ownership/membership and management, for example public companies and listed trusts. In contrast, entities in which the members and management are an identical group, as would be the case for most sole traders, partnerships and exempt proprietary companies, would usually not be identified as reporting entities on the basis of this factor. However, there will exist circumstances in which entities such as these ought to be regarded as reporting entities. For example, an entity which undertakes the raising of debt or equity funds from the public will become a reporting entity because there will exist potential resource providers who require general purpose financial reports as a basis for making resource allocation decisions. For similar reasons, undertaking to sell an entity may result in the identification of the entity as a reporting entity. Also, the size and/or economic significance of some entities to their suppliers, clients or employees or to the public may dictate that those entities are reporting entities even though the members manage the entity. Examples of this would be professional partnerships which service a very large number of customers or clients and which enjoy a special status in the community, and exempt proprietary companies which attract a special public interest because of their financial characteristics.
- 27 There will exist some entities which will not be regarded as reporting entities, but which form part of an economic entity which is a reporting entity. This would be the case, for example, where a company is a wholly-owned subsidiary of another entity in the economic entity, and the size and other economic characteristics of the company are such that there do not exist users dependent on general purpose financial reports as a source of information for making and evaluating resource allocation decisions about the wholly-owned company. Instead, users are interested in information about the collective operation of the company and the other entities comprising the economic entity. Similarly, a segment of an economic entity is unlikely to be regarded as a reporting entity because information about a segment is usually directed at improving the knowledge of users of the general purpose financial reports for the whole reporting entity, rather than catering for the needs of those users interested only in information about that segment.
- 28 Classification as a reporting entity may not be constant from one reporting period to the next. For example, a partnership or company established for the conduct of a family business may not, under normal circumstances, qualify as a reporting entity. However, where one or more partners or owners become distanced from the business or are in dispute with other participants, or where new non-family shareholders are admitted to the company, users dependent on general purpose financial reports may exist in respect of the financial reports for the periods during which disputes or non-family shareholdings occur. As such, the partnership or company would meet the conditions for classification as a reporting entity in respect of one or more reporting periods.

Groups of entities as reporting entities

- 29 The concept of control as the basis for identifying an economic entity has important implications. In the public sector, the entities making up the budget sector (that is, those entities which are heavily reliant on the budget for resources) may individually be identified as reporting entities. Because they are controlled by a government, those entities together with that government and the other entities that the government controls would, as an economic entity, meet the definition of a reporting entity. In preparing a general purpose financial report for this reporting entity, that is, for the government as a whole, it may be desirable to report detailed information regarding the operation of particular segments of the government as a whole, for example, the budget sector. This Statement does not, however, require the preparation of a separate general purpose financial report relating to the group of entities comprising the budget sector because, without their controlling entity (the government as a whole), they do not form an economic entity.
- 30 In the private sector, it has been common practice for groups of entities to be recognised as an economic entity only where the entities making up the group are established in the same legal form (for example, all are companies). An implication of the concept of control is that an economic entity may comprise entities which are established in a form different from that of the controlling entity, and such entities may be parts of, or a combination of, entities recognised for other purposes.
- 31 Because an economic entity, as defined in this Statement, comprises only the controlling entity and controlled entities, those entities which are significantly influenced, but not controlled, by a member of the economic entity do not form part of the economic entity. (Entities which are significantly influenced are termed associated entities.) This means that in preparing the general purpose financial report for the economic entity, additional information about an investment in an associated entity may be reported, possibly in a supplementary form, but it would not be reported on the basis of the associated entity forming part of the economic entity.
- 32 The focus on user needs as the basis for determining the existence of a reporting entity implies that the fact that an economic entity (for example, a corporate group or a government) may be a reporting entity does not affect whether the controlling entity or any of the controlled entities are reporting entities in their own right.

Implications of the reporting entity concept for current practice

- 33 It is likely that application of this Statement will result in substantial changes to current practice. For example, it will result in some partnerships, trusts, government departments, statutory authorities and other organisations that currently do not prepare general purpose financial reports being identified as reporting entities which therefore ought to prepare such reports in accordance with Statements of Accounting Concepts and Accounting Standards. Similarly, it will result in a government as a whole being identified as a reporting entity which therefore ought to prepare general purpose financial reports. Other entities, for example some private companies, which currently prepare general purpose

financial reports may not meet the criterion for identification as reporting entities. This Statement would not, therefore, require such entities to prepare general purpose financial reports. In this regard, however, it should be noted that the fact that this Statement may not require a particular entity to prepare general purpose financial reports does not preclude other parties, for example, regulatory authorities and financial institutions, from imposing a requirement on that entity to prepare general purpose financial reports.

Implications of the Reporting Entity Concept for Differential Reporting

- 34 Statements of Accounting Concepts and Accounting Standards are applicable to all entities which prepare general purpose financial reports. It is sometimes proposed that certain entities should be permitted to depart from all or certain of these Statements and Standards in the preparation of their financial reports. This notion is referred to as differential applicability of Statements of Accounting Concepts and Accounting Standards, or differential reporting.
- 35 Bases that have been proposed for identifying the entities which should be permitted to depart from these Statements and Standards are:
 - (a) the size of the entity - that is, entities classed as small in relation to certain size benchmarks, based on any combination of turnover, assets and number of employees, would be permitted to depart;
 - (b) ownership characteristics - for example, privately-owned entities would be permitted to depart, whereas publicly-owned entities would not be permitted to depart; and
 - (c) a combination of size and ownership characteristics - for example, privately-owned entities which are classed as small would be permitted to depart from the Statements and Standards.
- 36 In this Statement the need to prepare general purpose financial reports is linked to the existence of users dependent on those reports as a basis for making and evaluating resource allocation decisions. The existence of users dependent on general purpose financial reports is not determined by either the size or the ownership characteristics of an entity. Accordingly, the bases outlined in paragraph 35 are not supported by this Statement. However, the reporting entity concept enunciated herein embodies a concept of differential reporting in that certain entities will not be identified as reporting entities and thus would not be required to prepare general purpose financial reports or comply with Statements of Accounting Concepts and Accounting Standards in the preparation of other financial reports. The entities which need not prepare general purpose financial reports are those in respect of which it is reasonable to expect that users dependent upon information contained in general purpose financial reports for making and evaluating resource allocation decisions do not exist.
- 37 As paragraphs 24 to 28 outline, it is likely that some types of entities will be identified as reporting entities by this Statement, while others will not. Accordingly, in most instances the following private sector entities are unlikely to be required by this Statement to prepare general purpose financial reports: sole traders, partnerships, privately-owned companies and trusts other than those where funds are subscribed by the public. There may be some instances when it

is considered necessary or desirable that a general purpose financial report about an entity in these categories be prepared, for example when a privately-owned company intends to raise funds from the public. In these circumstances the report is required to comply with all Statements of Accounting Concepts and Accounting Standards. In the public sector, although most government departments and statutory authorities are likely to be required to prepare general purpose financial reports, the financial characteristics of some authorities and government agencies will mean that they will not be required by this Statement to prepare such reports. Types of entities which always would be identified as reporting entities and types of entities that are or are not likely to be identified as reporting entities are indicated in Professional Statement APS 1 "Conformity with Statements of Accounting Concepts and Accounting Standards", issued by the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia.

ACCOUNTING CONCEPTS

Discussion and Definitions

- 38 **The following concepts shall be interpreted in the context of paragraphs 1 to 37 of this Statement.**
- 39 **Paragraph 6 (definitions) shall be read as forming part of the accounting concepts set out in this Statement.**

Concept of the Reporting Entity

- 40 **Reporting entities are all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.**

Preparation of general purpose financial reports

- 41 **Reporting entities shall prepare general purpose financial reports. Such reports shall be prepared in accordance with Statements of Accounting Concepts and Accounting Standards.¹**

¹ Extracted from Accounting and Auditing Standards Plus April 1999 issue, SAC 1.

Objective of General Purpose Financial Reporting

Prepared by the **Public Sector Accounting Standards Board** of the **Australian Accounting Research Foundation** and by the **Accounting Standards Review Board**

Issued by the **Australian Accounting Research Foundation** on behalf of the **Australian Society of Certified Practising Accountants** and **The Institute of Chartered Accountants in Australia** and by the **Accounting Standards Review Board**

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STATEMENT OF ACCOUNTING CONCEPTS

SAC 2:"OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING"

Citation

- 1 This Statement may be cited as Statement of Accounting Concepts SAC 2 "Objective of General Purpose Financial Reporting".

Application and Operative Date

- 2 This Statement applies to each reporting entity in relation to its first reporting period that ends on or after 31 August 1990, and in relation to subsequent reporting periods.

INTRODUCTION

- 3 The purpose of this Statement is to establish the objective of general purpose financial reporting by reporting entities in the private and public sectors. The Statement identifies the users of general purpose financial reports, the common information needs of such users and the broad types of information, consistent with those needs, that general purpose financial reports should provide.
- 4 Although the specification of an objective will have implications for the type of information to be included in general purpose financial reports and for the manner in which such information is to be communicated to users, this Statement contains no conclusions regarding the particular qualities that information should possess to meet this objective, the number, nature and form of the financial statements to be prepared, and the nature and measurement of the elements of such statements. These matters are the subject of other Statements of Accounting Concepts.

DEFINITIONS

- 5 For the purposes of this Statement:

"accountability" means the responsibility to provide information to enable users to make informed judgements about the performance, financial position, financing and investing, and compliance of the reporting entity;

"compliance" means adherence to those statutory requirements, regulations, rules, ordinances, directives or other externally-imposed requirements in respect of which non-compliance may have, or may have had, a financial effect on the reporting entity;

"financial position" means the economic condition of a reporting entity, having regard to its control over resources, financial structure, capacity for adaptation and solvency;

"financing and investing" means those activities of a reporting entity that relate to the financing of its operations and the investment of its resources;

"general purpose financial report" means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs;

"performance" means the proficiency of a reporting entity in acquiring resources economically and using those resources efficiently and effectively in achieving specified objectives; and

"reporting entity" means an entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.

DISCUSSION

Scope and Applicability

- 6 The objective specified in this Statement applies to general purpose financial reporting by all reporting entities.
- 7 General purpose financial reporting focuses on providing information to meet the common information needs of users who are unable to command the preparation of reports tailored to their particular information needs. These users must rely on the information communicated to them by the reporting entity.
- 8 Some users have specialised needs and will possess the authority to obtain the information to meet those needs. Examples of such users are taxation authorities, central banks and grants commissions. Although such users may make use of the information contained in general purpose financial reports, because they have the authority to command the information they require they do not need to rely on information provided to other groups. Special purpose financial reports directed at the needs of such users are beyond the scope of this Statement.
- 9 This Statement encompasses general purpose financial reporting by business and non-business reporting entities in the public and private sectors. It covers general purpose financial reporting by all types of reporting entities, whether legal, administrative or economic entities, and therefore encompasses all types of government entities, including government departments, statutory authorities, and, as a whole, Federal, State, Territorial and local governments; investor-owned entities, including companies and unit trusts; mutual co-operative entities, including building societies and credit unions; human service entities, including churches, foundations, professional associations and charities; superannuation plans; partnerships; and sole proprietorships.
- 10 Financial reporting encompasses the provision of financial statements and related financial and other information. Financial reports, comprising financial statements, notes, supplementary schedules and explanatory material intended to be read with the financial statements, are the principal means of communicating financial information about a reporting entity to users. However, other information can best be provided, or can only be provided, outside financial reports. Financial reports are not the only source of relevant information about a

reporting entity, and users of financial reports may need to consult other sources to satisfy their information needs. This Statement does not attempt to draw a clear distinction between financial reports and financial reporting, nor does it attempt to define the boundaries of general purpose financial reporting. Distinctions will be made and boundaries drawn, as required, in other Statements of Accounting Concepts and in Accounting Standards.

Purpose of General Purpose Financial Reporting

- 11 General purpose financial reporting is not an end in itself, but is a means of communicating relevant and reliable information about a reporting entity to users. The objective specified in this Statement derives from the information needs of those identified as the users of general purpose financial reports. Those needs depend, in turn, on the activities of reporting entities and the decisions users make about them.
- 12 Reporting entities control resources and influence members of the community through providing goods and services, levying prices, charges, rates and taxes, and acquiring and investing resources. The community interest is best served if scarce resources controlled by reporting entities are allocated to those entities which will use them in the most efficient and effective manner in providing goods and services. Efficient use of resources raises output, has desirable macroeconomic effects by enhancing employment and the standard of living, and enables social policy objectives to be achieved at the lowest cost. Members of the community make resource allocation decisions in respect of reporting entities - that is, they make reasoned choices among alternative uses of scarce resources. For example, investors decide whether to invest in an entity; creditors decide whether to lend resources to an entity; governments and parliaments decide, on behalf of constituents, whether to fund particular programmes for delivery by an entity; taxpayers decide who should represent them in government; donors decide whether to donate resources to an entity; individuals decide whether to contribute to a superannuation plan; employees decide whether to sell their services to a particular entity; owners/members of reporting entities decide whether they should contribute resources to the entity and who should manage the entity on their behalf; and ratepayers decide whether they should support the particular programmes of their local government and who should represent them on the local government council.
- 13 Efficient allocation of scarce resources will be enhanced if those who make resource allocation decisions, such as those groups identified above, have the appropriate financial information on which to base their decisions. General purpose financial reporting aims to provide this information.
- 14 General purpose financial reporting also provides a mechanism to enable managements and governing bodies to discharge their accountability. Managements and governing bodies are account-able to those who provide resources to the entity for planning and controlling the operations of the entity. In a broader sense, because of the influence reporting entities exert on members of the community at both the microeconomic and macroeconomic levels, they are accountable to the public at large. General purpose financial reporting provides a means by which this responsibility can be discharged.

- 15 Although the subsequent discussion of users and their information needs at times distinguishes between business and non-business entities, the common objective specified in this Statement reflects the inherent similarities between the two types of entities. While business entities seek to earn profits or desired rates of return and non-business entities pursue primarily non-financial objectives, both types of entities provide goods and services to the community and use scarce resources in the process; both obtain these resources from external sources and are accountable to the providers of the resources or their representatives; both control stocks of resources; both incur obligations; and both must be financially viable to meet their operating objectives.

Users of General Purpose Financial Reports

- 16 Many individuals and organisations base resource allocation decisions on their relationship with and knowledge about reporting entities and are therefore potentially interested in the information provided in general purpose financial reports. The following three categories of user groups are identified as the primary users of general purpose financial reports, and those whose common information needs should dictate the type of information to be disclosed by such reports: resource providers, recipients of goods and services, and parties performing a review or oversight function.

Resource providers

- 17 Providers of resources include those who may be compensated either directly or indirectly for the resources they provide. The former category includes employees, lenders, creditors, suppliers and, in the case of business entities, investors and contributors. The latter category includes donors, members of non-business entities such as clubs, societies and professional bodies, and, in the case of public sector bodies, parliament, taxpayers and ratepayers.

Recipients of goods and services

- 18 Recipients of goods and services are those who consume or otherwise benefit from the goods and services provided by the reporting entity. This category comprises customers and beneficiaries. In many non-business entities recipients of goods and services include resource providers, for example, ratepayers, taxpayers and members of professional associations.

Parties performing a review or oversight function

- 19 Certain parties, including parliaments, governments, regulatory agencies, analysts, labour unions, employer groups, media and special interest community groups, perform oversight or review services on behalf of the community. Members of this group tend to have indirect or derived interests in general purpose financial reports since they advise or represent those who have direct interests.

Managements and governing bodies

- 20 Managements and governing bodies are another category of user interested in the information provided in general purpose financial reports. However, managements and governing bodies need, in addition to the information contained in general purpose financial reports, management accounting and other information to carry out their planning and control responsibilities. Since this type of reporting has to be tailored to meet the specialised needs of these users, and since they will have the ability to determine the form and content of any such reports, this reporting is in the nature of special purpose financial reporting and is therefore beyond the scope of this Statement.

Purposes for which User Groups Require Financial Information

Resource providers

- 21 Providers of resources want to know whether the reporting entity is achieving the objectives which formed the reason for the provision of resources in the past and is operating economically and efficiently and using resources as prescribed. In the case of investor-owned business entities, investors and other resource providers will want to know whether the entity is operating profitably and generating favourable cash flows in the process, since their decisions relate to amounts, timing and uncertainties of expected cash flows. In the case of public sector entities and non-business entities in the private sector, taxpayers (and ratepayers) and contributors, respectively, want to know whether the entity is delivering the services expected of it, that is, whether it is achieving its objectives, and is doing so economically and efficiently. Other providers of resources to public sector entities and non-business entities in the private sector, for example, employees, suppliers, creditors and lenders, will principally be interested in the entity's ability to generate cash flows for timely payment of the entity's obligations to them. However, they will be indirectly concerned about the extent to which the entity is achieving its objectives since the ability of the entity to generate future cash flows will depend on its performance in this regard. Information provided in general purpose financial reports to enable resource providers to make these assessments will assist them in determining whether continued support of the entity's activities is warranted and in predicting the level of resources necessary to support those activities.

Recipients of goods and services

- 22 Recipients of goods and services may want to assess the ability of the reporting entity to continue to provide goods and services in the future, the likely level at which the goods and services will be provided and the likely cost of the goods and services. In this regard, as with resource providers, they want to know whether the entity is achieving its objectives and is operating economically and efficiently in the provision of the goods and services.
- 23 In the case of business entities, the focus of this user group is on the ability of the entity to generate favourable cash flows, since only by obtaining sufficient cash to pay for the resources it uses and to meet its other obligations will the entity be able to continue to provide the goods and services in the future. Assessments by these users will affect their decisions to seek alternative suppliers of the goods and services.
- 24 In the case of non-business entities, and to an extent public sector business entities, the focus of this user group is on the extent to which the entity is using resources in their interests. Assessments made by this category of users in relation to public sector entities may influence their voting preferences and representations made to parliamentary and other representatives, and may lead to the continuation, expansion, contraction or even cessation of the entity's activities. Assessments made by this category of users in relation to private sector non-business entities may influence their voting preferences concerning the existing management or governing body of the entity and their decisions as to whether to continue to obtain the goods and services provided by the entity.

Parties performing a review or oversight function

- 25 Parties performing review or oversight services of interest to members of the community want to know whether the reporting entity has been operating in the interests of such members. Like resource providers and recipients of goods and services, they want to know whether the entity is achieving its objectives and is operating economically and efficiently in carrying out its operations. Assessments by these users of the extent to which the entity is operating satisfactorily in these respects will influence the decisions they make about the activities of the entities and, in respect of the advice they give to their constituents, will affect the decisions of those constituents. These users may have specific guidelines against which to assess the operations of the entity, and some may be able to demand special purpose financial reports to enable them to carry out this function.

Objective of General Purpose Financial Reporting

- 26 In view of the information needs of the users of general purpose financial reports identified in the preceding paragraphs, the position adopted in this Statement is that the objective of general purpose financial reporting is to provide information to users that is useful for making and evaluating decisions about the allocation of scarce resources.
- 27 When general purpose financial reports meet this objective they will also be the means by which managements and governing bodies discharge their

accountability to the users of the reports. The provision of information for accountability purposes is an important function of the process of general purpose financial reporting, particularly in relation to public sector entities and non-business entities in the private sector. However, the rendering of accountability by reporting entities through general purpose financial reporting is encompassed by the broader objective of providing information useful for making and evaluating decisions about the allocation of scarce resources, since users will ultimately require the information for resource allocation decisions.

Types of Information Relevant to Users' Needs

- 28 The particular information users require for making and evaluating resource allocation decisions will overlap since all users will be interested, to varying degrees, in assessing whether the reporting entity is achieving its objectives and is operating economically and efficiently in the process, in assessing the ability of the entity to continue to provide goods and services in the future, and in confirming that resources have been used for the purposes intended. General purpose financial reports can provide information useful for these purposes by disclosing information about the performance, financial position, and financing and investing of the reporting entity, including information about compliance. The information useful for these purposes may be both historical and prospective in nature. Paragraphs 29 to 40 provide examples of information that users may require for making and evaluating decisions about the allocation of scarce resources.

Performance

- 29 Aspects of the performance of a reporting entity can be measured in financial and non-financial terms. Disclosure of the revenues generated by the entity during the reporting period and the expenses incurred in generating this revenue, together with the assets, liabilities and equity of the entity at the end of the reporting period, will provide users with information to assist them to assess the financial performance of the entity over the reporting period. The information will be useful in determining the cost of providing goods and services and the change in the entity's control over resources during the reporting period. In relation to business entities, users will be able to evaluate the change in the entity's control over resources by reference to the resources or funds employed by the entity in achieving the change. In terms of the purposes for which users require information, as identified in paragraphs 21 to 25, this information is relevant to the users of general purpose financial reports of business entities in predicting both the capacity of the entity to generate cash from its existing resource base and the effectiveness with which it would employ additional resources. In relation to non-business entities, the information is useful in assessing the resources necessary to enable the entity to continue to provide services in the future and the likely cost of those services.
- 30 Non-financial measures of performance may also be relevant to users for the purposes identified, particularly in relation to non-business entities. The absence of a profit or rate of return objective for these entities means that financial measures of performance are unlikely to be sufficient to assess fully the extent to which those entities have achieved their objectives, which typically include social as well as financial dimensions. The extent to which non-financial performance

measures can be considered to fall within the scope of general purpose financial reporting will be the subject of a separate Statement of Accounting Concepts.

- 31 In the public sector, information about government policies that affect a reporting entity's operations may be relevant to assessments of performance. For example, it may be relevant that an entity is subject to a government policy of break-even pricing or a stipulated target rate of return on assets.

Financial position

- 32 Disclosure of information about the financial position of the reporting entity involves disclosure of information about its control over resources, financial structure, capacity for adaptation and solvency.
- 33 The disclosure of information about the resources over which the entity has control, that is, disclosure of its assets, is relevant to users for making and evaluating decisions about the allocation of scarce resources. In terms of the purposes for which users require information, as identified in paragraphs 21 to 25, the information is useful in predicting the ability of the entity to continue to meet its objectives, whether these relate to the generation of positive cash flows in the future or the continued provision of goods and services.
- 34 The disclosure of information about the financial structure of the entity, that is, the sources, types and time patterns of finance, whether debt or equity, and the types of assets used by the entity, is relevant to users for making and evaluating decisions about the allocation of scarce resources. In particular, it is useful in predicting the future distribution of cash flows among providers of resources and the ability of the entity to attract resources in the future, and in assessing the extent to which restrictions and limitations on the uses to which the entity's resources can be put will affect the ability of the entity to meet its objectives.
- 35 The disclosure of information about the capacity of the reporting entity to modify the composition of the resources under its control is relevant to making and evaluating decisions about the allocation of scarce resources. Such modification may be required by changes in the environment within which the entity operates or in response to directives from controlling bodies. In this respect, disclosure of information on the location, realisable value and current state of repair of the entity's assets would be relevant to users, as would disclosure of any restrictions that may have been imposed on the entity regarding its use of the assets.
- 36 Information about the solvency of the entity, that is, information about the availability of assets to meet financial commitments as they fall due, is relevant for making and evaluating decisions about the allocation of scarce resources. This information, such as disclosure of the liquidity of the entity's assets and the availability of cash from sources external to the entity, is useful in predicting the ability of the entity to meet its financial commitments as they fall due and, therefore, in predicting the ability of the entity to continue to provide goods and services in the future.
- 37 In the public sector, the ability of an entity to continue to provide goods and services in the future will, in addition to the dimensions of financial position outlined in paragraph 32, be influenced by government policy objectives.

Financing and investing

- 38 Information about financing and investing, for example, disclosure of the sources and applications of funds during the reporting period, is relevant for making and evaluating decisions about the allocation of scarce resources. This information indicates the way in which the reporting entity has financed its operations and invested its resources during the reporting period. It is useful to users in confirming that resources have been used for the purposes intended and, as an input to assessing the solvency of the entity and analysing the change in the entity's financial position, it is useful in assessing the ability of the reporting entity to continue to provide goods and services in the future and in assessing whether the reporting entity is achieving its objectives.

Compliance

- 39 Information about compliance is relevant to making and evaluating decisions about the allocation of scarce resources because knowledge of non-compliance with externally-imposed requirements governing the reporting entity's operations may affect users' assessments of the reporting entity's performance, financial position, or financing and investing. For example, information about compliance with the following types of externally-imposed requirements may be relevant to users: conditions imposed by borrowing agreements, licencing agreements and grant arrangements; memorandum and articles of association and/or enabling legislation; spending mandates and borrowing limits; equal employment opportunity legislation; occupational health and safety legislation; environmental protection legislation; requirements to provide particular types or levels of service under a government grant programme or specific government directive; and requirements to observe specified tendering procedures for significant expenditures. Users should be able to presume that, in the absence of disclosures to the contrary, the reporting entity has complied with all externally-imposed requirements in respect of which non-compliance is relevant to assessments of the reporting entity's performance, financial position, or financing and investing. Information about compliance is relevant to users irrespective of the sector in which the reporting entity operates or whether the reporting entity is of a business or non-business nature.
- 40 The concept of compliance appropriate for general purpose financial reporting depends substantially on the types of information which are identified as being encompassed by general purpose financial reporting. If general purpose financial reports include non-financial information about an entity's performance, information about non-financial dimensions of compliance would be relevant to users. Because the boundaries of general purpose financial reporting will continue to evolve, the concept of compliance currently adopted in this Statement is consistent with the boundaries of general purpose financial reporting reflected in the current reporting practices of most reporting entities. Accordingly, the definition of compliance included in this Statement refers to adherence to externally-imposed requirements in respect of which non-compliance may have, or may have had, a financial effect on the reporting entity. As such, reporting about compliance as defined in paragraph 5 would entail disclosure of the nature and probable financial effect of any non-compliance by the reporting entity with externally-imposed requirements which has occurred and which is relevant to

assessments of the reporting entity's performance, financial position, or financing and investing.

ACCOUNTING CONCEPTS

Discussion and Definitions

- 41 **The following concepts shall be interpreted in the context of paragraphs 1 to 40 of this Statement.**
- 42 **Paragraph 5 (definitions) shall be read as forming part of the accounting concepts set out in this Statement.**

Objective of General Purpose Financial Reporting

- 43 **General purpose financial reports shall provide information useful to users for making and evaluating decisions about the allocation of scarce resources.**

Accountability

- 44 **Managements and governing bodies shall present general purpose financial reports in a manner which assists in discharging their accountability.**

Information disclosures

- 45 **General purpose financial reports shall disclose information relevant to the assessment of performance, financial position, and financing and investing, including information about compliance.²**

² Extracted from Accounting and Auditing Standards Plus April 1999 issue, SAC 2.