Australian Government
Australian Accounting Standards Board

# Staff Paper

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| **Project:** | **Not-for-Profit Private Sector Financial Reporting Framework** | **Meeting:** | M186 |
| **Topic:** | **Tier 3 – Impairment** | **Agenda Item:** | 4.2 |
| | | **Date:** | 22 March 2022 |
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## Objective of this paper

1 The objective of this staff paper is for the Board to **decide** its preliminary views on a possible impairment model for non-financial assets for Tier 3 not-for-profit (NFP) entities for inclusion in the forthcoming Discussion Paper (DP).

## Background and reasons for bringing this paper to the Board

2 At its 4 August 2021 meeting, the Board decided to consider possible impairment requirements for Tier 3 entities at a future meeting. Addressing impairment in the forthcoming DP recognises the complexities associated with impairment testing and the importance of ensuring that assets are not carried at too high a value. Developing preliminary views in this regard will help the Board obtain feedback on whether its preliminary views should be further developed as part of a future Exposure Draft.

3 This paper is limited to considering impairment testing of non-financial assets. Impairment testing of financial assets will be addressed separately at a future Board meeting.

4 Staff have not addressed impairment-related disclosures in any detail in this paper. Staff suggest that disclosure requirements are contingent on the Board's preliminary views on possible Tier 3 requirements for impairment testing of non-financial assets.

## Structure of this paper

5 This paper is structured as follows:

(a) Summary of staff recommendations (paragraph 6);

<u>*Current accounting requirements and whether there is a reason for the Board to address*</u>

(b) Current requirements under Australian Accounting Standards (paragraphs 7-20;

(c) Summary of approaches taken by selected other jurisdictions (paragraphs 21);

(d) IASB Review of the *IFRS for SMEs* Standard (paragraph 22);

(e) IFR4NPO Consultation Paper (paragraphs 23-25)

(f) Feedback from Australian stakeholders (paragraph 26);

(g) Findings from academic research and other literature (paragraph 27-28);

(h) Findings from staff review of a sample of financial statements (paragraphs 29-32);

*Considering options for simplifications and staff analysis*

(i) Options for Tier 3 requirements (paragraphs 33-39);

(i) Is an impairment model required for non-financial assets for Tier 3 entities? (Table 1);

(A) Evaluation of options against the Tier 3 principles – Is an impairment model required for non-financial assets for Tier 3 entities? (paragraph 40)

(B) Staff recommendation (paragraph 41)

(ii) Scope – which non-financial assets should be subject to impairment testing? (Table 1a);

(iii) Timing – when should in-scope non-financial assets be assessed/tested for impairment? (Table 1b);

(iv) Methodology – how should the recoverable amount be determined for in-scope non-financial assets? (Table 1c);

(A) Evaluation of options against the Tier 3 principles – scope, timing and methodology of an impairment model (paragraph 43)

(B) Staff recommendations (paragraphs 44-46); and

(j) Other matters to consider (paragraphs 47-51).

## Summary of staff recommendations

6 **Staff recommendations for Tier 3 reporting requirements:**

(a) in respect of inventories and inventories held for distribution, that Tier 3 requirements are consistent with Tier 2 requirements. That is, an entity is required to ensure that items of inventory are measured at the lower of cost and net realisable value, and items of inventory held for distribution are measured at cost adjusted for a loss of service potential;[1]

(b) for non-financial assets other than inventory, an impairment model is required with the following approach:

(i) only non-financial assets subsequently carried at cost or deemed cost be assessed for impairment;

(ii) the impairment model does not specify when assets are assessed for indicators of impairment;

(iii) the recoverable amount of an asset is determined using the approach in AASB 136 *Impairment of Assets*;

(iv) the impairment model allows assets to be grouped where they do not generate independent cash flows (i.e. cash-generating units (CGUs)); and

(v) the impairment model is silent about accounting for reversing previously recognised impairment losses.

1 The initial measurement of donated assets including inventory is being considered in Agenda Paper 4.3, and this may affect the Board's decisions about impairment.

## Current requirements under Australian Accounting Standards

7 Below is a high-level summary of the impairment testing requirements of Australian Accounting Standards as they apply to non-financial assets. As noted in paragraph 3, impairment testing of financial assets will be addressed separately at a future Board meeting.

8 The most common non-financial assets NFP entities are expected to hold include inventories (both held for sale and held for distribution); property, plant and equipment; investment properties and intangible assets (e.g. capitalised software and right of use assets associated with leases).

*AASB 136 – a high-level summary*[2]

9 AASB 136 applies to most non-financial assets, with some exceptions.[3] AASB 136 applies to assets carried at cost and revalued amounts.

10 The objective of AASB 136 is to ensure that assets are not carried in excess of their recoverable amounts. If an asset's carrying amount exceeds its recoverable amounts, the asset is considered impaired, and the entity must recognise an impairment loss.

11 AASB 136 includes a general requirement to assess whether impairment indicators are present at each reporting date. If an indicator exists, an entity is required to perform an impairment test by determining the asset's recoverable amount. The recoverable amount of an asset is the higher of its fair value less costs of disposal, and its value in use. There are also certain assets that an entity must test for impairment annually, regardless of whether an impairment indicator is present.

12 AASB 136 acknowledges that some assets do not generate cash flows independently of other assets. In this case, assets are grouped into CGUs, and each CGU is tested for impairment.

13 AASB 136 also includes requirements outlining how an entity allocates an impairment loss and when a previously recognised impairment loss can be reversed.

14 AASB 136 acknowledges that many NFP entity assets are not primarily held for their ability to generate net cash inflows as some assets are specialised and held for continuing use or their service capacity. As these assets are rarely sold, their cost is expected to be materially the same as their fair value (AASB 136 paragraph 13). If an asset is regularly revalued to fair value under AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets*, then AASB 136 does not apply. However, if an asset is accounted for at cost under AASB 116 or AASB 138, AASB 136 does apply (AASB 136 paragraph Aus5.1).

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2 Refer to Agenda Paper 4.2.1 for a more detailed summary of the requirements of AASB 136.

3 Exceptions include inventories (addressed in AASB 102 *Inventories*), contract assets and assets arising from costs to obtain or fulfil a contract that are recognised in accordance with AASB 15 *Revenue from Contracts with Customers*; deferred tax assets, assets arising from employee benefits, investment properties carried at fair value, biological assets related to agricultural activities within the scope of AASB 141 *Agriculture*; deferred acquisition costs and intangible assets arising from an insurer's contract rights under insurance contracts with the scope of AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*; and non-current assets (or disposal groups) classified as held for sale in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*. AASB 136 also applies to financial assets classified as subsidiaries (in accordance with AASB 10 *Consolidated Financial Statements*), associates (in accordance with AASB 128 *Investments in Associates and Joint Ventures*) and joint ventures (as defined in AASB 11 *Joint Arrangements*).

*AASB 102 – high-level summary*

15 NFP entities can have two 'types' of inventories, and the measurement basis will differ.[4,5] AASB 102 requires that inventories are measured at lower of cost and net realisable value (NRV). NRV is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale. AASB 102 provides guidance about the estimation of NRV.

16 Inventories held for distribution[6] are recognised at cost and adjusted for any loss of service potential. Judgement is required when assessing whether there is a loss of service potential for inventories held for distribution. For many inventories held for distribution, a loss of service potential would be identified and measured based on the existence of a current replacement cost that is lower than the original acquisition cost or other subsequent carrying amount. For other inventories held for distribution, a loss of service potential might be identified and measured based on a loss of operating capacity due to obsolescence. Different bases for determining whether there has been a loss of service potential and the measurement of that loss may apply to different inventories held for distribution within the same entity.

17 Initial stakeholder feedback did not identify any concerns with the current accounting requirements for impairment of inventory, nor the need for any possible Tier 3 simplifications or alternative options. Therefore, staff do not recommend any simplifications to the impairment requirements for inventories for Tier 3 entities.

**Question to Board members:**

Q1 Do Board members support, for the purposes of the DP, the staff recommendation in paragraph 17 that, in respect of inventories and inventories held for distribution, Tier 3 requirements are consistent with Tier 2 requirements? That is, an entity is required to ensure that:

(a) items of inventory are measured at the lower of cost and NRV; and

(b) items of inventory held for distribution are measured at cost adjusted for a loss of service potential?

If not, what approach do Board members support?

*AASB 1060* General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities – *Tier 2 disclosures*

18 An entity shall disclose impairment information for each of the following classes of assets (excluding inventory):

(a) property, plant and equipment;

(b) investment property accounted for by the cost method;

(c) goodwill;

(d) intangible assets other than goodwill;

4 Inventories are assets: (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (AASB 102.9).

5 This paper does not consider manufactured inventories.

6 In respect of not-for-profit entities, inventories held for distribution are assets: (a) held for distribution at no or nominal consideration in the ordinary course of operations; (b) in the process of production for distribution at no or nominal consideration in the ordinary course of operations; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services at no or nominal consideration (AASB 102 Appendix A paragraph Aus6.1).

(e) investments in associates; and

(f) investments in joint ventures.

19 The information required to be disclosed is the amount of:

(a) impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the statement of profit or loss, if presented) in which those impairment losses are included; and

(b) reversals of impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the statement of profit or loss, if presented) in which those impairment losses are reversed.

*AASB domestic agenda consultation*

20 To date, staff are not aware of any significant issues being raised during the AASB's domestic agenda consultation process.

## Summary of approaches taken by selected other jurisdictions

21 Although there are some differences in the terminologies used, the impairment testing principles in most jurisdictions analysed in preparing this staff paper are principally consistent with Australian Accounting Standards.[7] However, staff noted some exceptions as summarised below:

(a) The NZ Tier 3 Standard is drafted in a much more simplistic manner, is more prescriptive and doesn't provide explicit guidance about how to calculate the recoverable amount of affected assets.

(b) The UK Charities SORP contains specific guidance to address situations where assets are specialised in nature and held for service potential.[8]

(c) The Canada ASNPO Standard permits an NFP to choose either fair value or replacement cost (the amount that would be needed currently to acquire an equivalent asset) to measure the write-down of a tangible asset.

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7 For the purposes of this staff paper, the impairment requirements in the following pronouncements were considered:

(a) International Financial Reporting Standard for Small and Medium-sized Entities (*IFRS for SMEs* Standard).
(b) Canada Accounting Standards for Not-for-Profit Organisations (Canada ASNPO).
(c) New Zealand Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit) (NZ Tier 3 Standard).
(d) Financial Reporting Standard 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* (UK FRS 102).
(e) Financial Reporting Standard 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* (UK FRS 105).
(f) Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (UK Charities SORP).
(g) Singapore Charities Accounting Standard (Singapore CAS).
(h) Hong Kong Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (HK SME-FRF & SME-FRS).

8 The UK SORP notes that, "Where an asset is primarily held for its service potential to beneficiaries, it would be inappropriate to measure value in use by reference to its cash flow. In such circumstances, it is more appropriate to regard value in use as the present value of the asset's service potential rather than the present value of its cash flow". Further, "Value in use measured on the basis of an asset's service potential will have particular relevance for specialist assets used by a charity. The market value of a specialist asset may not reflect the cost that a charity avoids by using that asset in providing services. For example, the market value of a specialist building may be less than its recent construction cost. However, provided the building continues to meet its intended service potential then its value in use would be better reflected by its replacement cost (its construction cost) rather than the amount for which it could be sold in the market".

(d) The Singapore CAS Standard does not require entities to assess items of property, plant and equipment or intangible assets for impairment.[9]

### IASB Review of the *IFRS for SMEs* Standard

22 Staff note that the IASB is currently undertaking its second comprehensive review of the *IFRS for SMEs* Standard. The Request for Information's consideration of impairment-related matters is limited to disclosures only.

### IFR4NPO Consultation Paper

23 In January 2021, The Chartered Institute of Public Finance and Accountancy issued the IFR4NPO Consultation Paper.

24 The Consultation Paper identified that the measurement of tangible and intangible assets held for use in delivering the non-profit organisations (NPO's) objectives and not for a financial return is an issue for NPO's. This includes whether there is a need to impair them. The paper also identifies that:

(a) the value to an NPO from services that are supported by the assets may reduce if they become damaged or deteriorate (i.e. this may indicate that an asset is impaired); and

(b) it may be difficult to measure impairments where an NPO uses assets for their service potential rather than to maximise economic returns.

25 The Consultation Paper also identified the following impairment-related financial reporting issues impacting the NFP sector:

(a) assets that might be measured at 'highest and best use' could exceed their operational value to an NFP entity, and that measurement using the revaluation model may also raise questions of how depreciation should be charged and how impairment can be identified and measured, particularly where the overall value of an asset is increasing. Similar measurement issues may arise for intangible assets; and

(b) an annual impairment review is needed where there are indicators of impairment irrespective of whether the cost or revaluation model is used to assess whether the asset has a value lower than its carrying amount. An NPO may have difficulty measuring the impairment as it may not have cash flow information from which impairments may be estimated. Where an NPO uses the revaluation model and can measure its value in use under that model, impairments are likely to be reflected through a deterioration in the service potential. This may require significant judgements by NPO management and is likely to require experts to provide these measurements.

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9 Staff are unsure why property, plant and equipment and intangible assets are not assessed for impairment as the Singapore CAS Standard does not include a Basis for Conclusions. Further, the Financial Reporting Framework for Charities Statement of Applicability, which provides some information about the implementation of the standard and a Q&A section on the application of the Financial Reporting Standards or the Singapore CAS Standard, is also silent on this matter. Subsequent to initial recognition items of property, plant and equipment are not revalued, but are subject to depreciation. Intangible assets are carried at cost less accumulated amortisation.

## Feedback from Australian stakeholders

26 The AASB NFP Project Advisory Panel discussed the impairment of non-financial assets (including inventories) at its 8 March 2022 meeting. At this meeting:

(a) Panel members generally indicated that NFP entities are unlikely to recognise impairment losses. However, if impairment losses are recognised, they typically relate to tangible assets. Reasons for not recognising impairment may include:

(i) NPF entities are likely to carry items of property, plant and equipment that are held for ten years or more at cost, so the value of those assets are likely to be more stable;

(ii) Write-downs are unlikely to occur except for obvious events such as the demolition of a building;

(iii) Entities currently preparing special purpose financial statements may not have considered impairment; and

(iv) NFP entities may only consider impairment triggers where there has been a significant event such as fire or flood).

(b) While one panel member questioned whether impairment testing under AASB 136 should be required if another Standard could achieve a similar outcome (e.g. AASB 116), almost all panel members agreed that impairment testing should continue to be required for Tier 3 entities. Panel members also agreed that only non-financial assets carried at cost or deemed cost should be subject to impairment considerations. They did not consider it necessary to distinguish between current and non-current assets.

(c) Acknowledging that it may be difficult for smaller NFP entities to determine when to perform impairment testing, panel members considered that Tier 3 requirements should provide guidance on how impairment testing should be undertaken with potential examples of different scenarios. However, impairment testing requirements should not be restricted to specific rules.

(d) All panel members agreed that the current requirements for impairment of inventory (in AASB 102) are working well and suggested that no simplifications were necessary for Tier 3 entities.

## Findings from academic research and other literature

27 AASB Research Report 9 *Perspectives on IAS 36: A Case for Standard Setting Activity* (March 2019) considered the requirements of IAS 36 in the context of the IASB considering targeted improvements to the impairment test. Research Report 9 concluded that IAS 36 requires holistic reconsideration rather than piecemeal changes focussed on disclosure. The overarching recommendation in the research report is that IAS 36 be reconsidered in its entirety for issuance as a new Standard. Staff note this research supports the view that application of AASB 136 (IAS 36) is complex. However, the recommendations in the research report are not specific to NFP entities; instead, they highlight more fundamental concerns with the Standard and its requirements.

28 Staff note that AASB Research Report 11 *Review of Special Purpose Financial Statements: Large and Medium-Sized Australian Charities* (August 2019) examined 407 large and medium-sized charities that submitted special purpose financial statements for the 2016 financial year. Research Report 11 noted that around 43 percent of charities had reference to the words

'impairment', 'decline/reduction in value,' or 'recoverable amount.'[10] Acknowledging the findings in Research Report 11 and the complexities associated with impairment testing, staff consider there is an opportunity to develop simplified requirements for financial reporting that meet the needs of users for smaller NFP entities.

## Findings from staff review of a sample of financial statements

29 To understand the types of non-financial assets held by Tier 3 entities and how frequently impairment losses are recognised, staff reviewed a random non-representative sample (20) of 2020 financial statements of NFP entities with reported revenues between $500,000 and $3 million. The financial statements reviewed included both those described as general purpose financial statements and those described as special purpose financial statements.

30 From the financial statements reviewed:[11]

(a) none of the entities disclosed impairment losses or accumulated impairment losses in the current or prior years;

(b) 15 of the 20 entities disclosed impairment accounting policies;

(c) 18 of the 20 entities disclosed non-financial assets. The most common non-financial assets disclosed were:

(i) 16 entities disclosed property, plant and equipment, with six entities disclosing an accounting policy addressing the accounting for contributed/donated assets;

(ii) three entities disclosed inventory, with one entity disclosing donated items of inventory held for distribution;

(iii) ten entities disclosed prepayment and accrued income;

(iv) five entities disclosed right of use assets; and

(v) four entities disclosed other intangible assets.

31 The review of financial statements suggests that recognising impairment losses is not expected to be common for Tier 3 NFP private sector entities.

32 Further, while many of these entities have disclosed impairment-related accounting policies, it is unclear whether they considered or performed any impairment test in practice, as from staffs' review, the accounting policy disclosures appear to be boilerplate. However, these findings should be interpreted with caution due to the limited sample size.

## Options for Tier 3 requirements

33 When considering possible Tier 3 requirements, any references to non-financial assets in the following sections of this staff paper **exclude** items of inventory.

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10 Although Research Report 11 suggests this indicates an impairment had been considered during the year, staff note that Research Report 11 did not assess the extent of a charity's compliance or otherwise with impairment-related disclosures. Staff are conscious of the possibility that the impairment-related accounting policies disclosures were boilerplate disclosures.

11 The disclosures in some financial statements were not sufficiently detailed for staff to ascertain whether or not the entity recognised an impairment loss, recognised non-financial assets or complied with Australian Accounting Standards.

34 The discussion in this section uses language that is consistent with AASB 136 (e.g. recoverable amount and assess assets for impairment).[12]

35 Staff considered the flowchart in Agenda Paper 4.1 (Appendix A)[13] for this meeting when considering possible Tier 3 impairment requirements.

36 With reference to the flowchart in Agenda Paper 4.1 (Appendix A), staff have identified the following options for a Tier 3 impairment model for non-financial assets:

(a) **Option 1**: include an impairment model for Tier 3 NFP private sector entities; and

(b) **Option 2**: do not require Tier 3 NFP private sector entities to consider impairment.

37 Should the Board decide to include an impairment model for Tier 3 entities (option 1), staff considered the following possible options:

(a) **Scope** – which non-financial assets should be subject to impairment testing?

(i) **Option S1**: all non-financial assets should be subject to impairment testing (i.e. those subsequently carried at cost, deemed cost and fair value);

(ii) **Option S2:** only non-financial assets subsequently carried at cost or deemed cost should be subject to impairment testing; and

(iii) **Option S3**: only non-current non-financial assets should be subject to impairment testing;

(b) **Timing** – when should impairment testing be required?

(i) **Option T1:** all in-scope assets should be assessed for impairment indicators **annually**, then if an impairment indicator exists, perform an impairment test and determine the assets' recoverable amount;

(ii) **Option T2:** all in-scope assets should be assessed for impairment indicators **periodically**, then if an impairment indicator exists, perform an impairment test and determine the assets' recoverable amount; and

(iii) **Option T3:** do not include a requirement for when in-scope assets should be assessed for impairment;

(c) **Methodology** – how should the recoverable amount be determined?

(i) **Option M1:** adopting the approach in AASB 136 (i.e. compare the assets recoverable amount to the carrying amount, where the recoverable amount is the higher of fair value less costs of disposal and value in use or replacement cost);

(ii) **Option M2:** determining an asset's recoverable amount using an alternative to AASB 136; and

(iii) **Option M3:** not specifying how to determine the recoverable amount of in-scope assets.

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12 Staff note there is an opportunity to use alternative language when drafting the Tier 3 requirements. For example, the Tier3 requirements could use language such as a recoverable amount test and recoverable amount write-downs instead of an impairment test and an impairment loss. As this paper focuses on the possible simplification for recognition and measurement requirements, staff have not adequately explored these options yet. Depending on the Board's further deliberation of the broader NFP financial reporting framework project, staff will further analyse other possible simplification alternatives at a future meeting.

13 The primary objective of Tier 3 reporting requirements is to develop simplified requirements for financial reporting that meet the needs of users for smaller NFP entities. The flowchart outlines the approach staff will take when developing simplification options against this objective and the agreed principles when forming the staff recommendation on the Tier 3 reporting requirements.

38 All of the options identified in Table 1 could be supplemented with additional guidance and illustrative examples.

39 Staff wish to highlight that, in considering possible Tier 3 impairment requirements, staff have not distinguished between assets held to generate cash flows and assets held for their service potential. Whilst staff acknowledge that there might be some differences when considering impairment of the different 'types' of assets (e.g. depending on the methodology used to determine an asset's recoverable amount), staff suggest the practical impact on impairment testing is expected to be limited. Further, it might also be challenging for Tier 3 entities to discern the purpose for which they are holding their assets.

**Table 1 Is an impairment model required for non-financial assets for Tier 3 entities?**

| Possible options | Support for the approach | Arguments against the approach |
|---|---|---|
| **Option 1: include an impairment model for Tier 3 NFP private sector entities** | • Considering whether an impairment indicator exists or an impairment loss has occurred is an important part of financial reporting to ensure that assets are not carried in excess of their recoverable amounts.<br>• Consistent with existing Australian Accounting Standards and all other jurisdictions considered, and allows preparers and auditors to more easily move between entities given the consistency with the Tier 2 reporting requirements.<br>• Most panel members indicated that an impairment model for Tier 3 entities is necessary.<br>• Information about impairment is expected to be useful to financial statement users.<br>• Preparers are expected to prefer a clear 'framework' (i.e. requirements in Australian Accounting Standards) from which to develop their impairment accounting policies. A clear framework, in turn, assists auditors with performing the audit as an entity's accounting policies are part of the criteria against which the auditor audits the financial statements. Additionally, the ability to obtain audit evidence may be improved with a clear framework in place. However, this is already a challenge in an NFP environment where there may not be a market to value certain assets. | • Impairment losses do not appear to be common for Tier 3 entities, so the possible costs of requiring Tier 3 entities to consider impairment outweigh any possible benefits. However, it has been suggested that some Tier 3 entities might not be recognising impairment losses as they might be preparing special purpose financial statements and may not be complying with recognition and measurement requirements in Australian Accounting Standards, rather than impairments not being required.<br>• An impairment model is not needed for Tier 3 entities as other Australian Accounting Standards contain requirements that achieve similar outcomes (see option 2). |
| **Option 2: do not require Tier 3 NFP private sector entities to consider impairment**[14]<br>Requirements of other Australian Accounting Standards (e.g. AASB 116) require entities to assess whether an asset's useful live has declined at the end of each reporting period. Where the useful of an asset has declined the asset's carrying amount is depreciated | • This option acknowledges that impairments in the Tier 3 space are not expected to be common and would balance any possible costs of considering impairment by Tier 3 entities with minimal expected benefits.<br>• Some panel members indicated support for this approach acknowledging that the recognition of impairment losses by Tier 3 entities are not expected to be common. Further, feedback from panel members indicated that if an impairment loss is recognised, it is usually because of a significant event (e.g. fire or flood) rather than a decline in market value.<br>• Anecdotally, staff understand that, due to the nature of non-financial assets held by Tier 3 entities, asset values do not often decrease. Therefore, if an asset's value has declined, it might be reasonable to assume that the decline in value has also affected its useful life. Under this option, an impairment model is not required as the requirements in other Australian Accounting Standards (e.g. AASB 116, AASB 138 and AASB 140) for entities to reassess the useful lives of their assets at the end of each reporting period are sufficient. | • Although requirements in other Australian Accounting Standards may achieve similar outcomes as impairment, they may not capture all scenarios (e.g. there could be a scenario where a decline in an asset's value doesn't affect the asset's useful life, so an impairment might not be picked up). For example, if an immediate write down in an asset's value is required (because of a decline in value), the model in AASB 116 (as an example) will not reflect this immediate decline. This is because the asset's carrying amount would be depreciated over the remaining useful life (i.e. any decline in value would be recognised over the remaining useful life of the asset). This could be mitigated by requiring a 'catch up' adjustment with the effect that any decline in an asset's value is recognised in the P&L immediately, rather than the decline in value being spread over the assets remaining useful life. |

14 The Board could also consider treating impairment as an omitted topic. The Board previously decided at its 8-9 September 2021 Board meeting to propose that entities in the scope of Tier 3 should apply the requirements of a higher tier of Australian Accounting Standards in full for transactions not covered by the Tier 3 reporting requirements. Refer to the meeting minutes.

| Possible options | Support for the approach | Arguments against the approach |
| --- | --- | --- |
| over the remaining (shorter) useful life.<br>Where the decline in an asset's useful life also affects its value these requirements may achieve a similar outcome to impairment. | For example, if a fire destroys a building, the event (the fire) would affect the useful life of the building, so the 'decline in value' would be picked up at the end of the reporting period, and the building would be derecognised.<br>Whilst the 'decline in value' might be described in the financial statements as something other than an impairment expense, the outcome is that the statement of financial position is not overstated. | • Non-recognition of the impairment may represent a loss of important information for users (and additional disclosures maybe need to offset this).<br>• Will impact the comparability of financial statements against entities in other reporting tiers and possibly create consolidation issues, as this requirement would apply only to entities applying Tier 3 reporting requirements.<br>• No other jurisdiction adopts this approach.<br>• Some legislative (and other) financial reporting requirements require an entity's financial statements to provide a true and fair view of an entity's financial performance or position or present fairly an entity's financial position and performance. If an entity is not required to assess whether non-financial assets are impaired, staff consider there might be some challenges for preparers when preparing the financial statements and auditors when opining on whether the financial statements present fairly, for example, if an entity is not required to consider whether their non-financial assets are carried at too high a value. |

### *Evaluation of options against the Tier 3 principles – Is an impairment model required for non-financial assets for Tier 3 entities?*

40 With reference to the flowchart in Agenda Paper 4.1 (Appendix A) for this meeting and the analysis in Table 1 above, staff also analysed each of the proposed options against the tentative Tier 3 principles previously agreed to by Board members. Staff consider that the proposed options are broadly equally aligned with the Tier 3 principles, except for those listed below:

| Principle | Discussion |
| --- | --- |
| Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of the financial statements | Not requiring Tier 3 entities to consider impairment will not provide relevant and reliable information, and assets may be overstated. As such, the usefulness and relevance of the information provided in the financial statements would suffer. |
| Consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable but might not always be warranted, since Tier 3 requirements are being developed as a proportionate response to the costs incurred by certain entities whilst still meeting the needs of users of the financial statements for this cohort of entities | While Option 2 does not align with Tier 2 accounting principles as there is no requirement to recognise any impairment, staff think departure may be justified having regard to less well-resourced Tier 3 entities that may have difficulties considering impairment. Also, it does not appear to be common for Tier 3 entities to incur impairment losses, so the possible costs of requiring Tier 3 entities to consider impairment outweigh any possible benefits. |

### *Staff recommendation*

41 On balance, staff recommend an impairment model for non-financial assets for Tier 3 entities (Option 1). Although impairment does not appear to be common for Tier 3 entities, staff do not consider there are significant or compelling reasons to warrant not requiring Tier 3 entities to consider impairment of non-financial assets. In forming this view, staff considered:

(a) that impairment is an important consideration in financial reporting given the requirements of almost all the other jurisdictions reviewed when preparing this paper consider impairment of non-financial assets. Considering impairment of non-financial assets also ensures that the value of any assets held by an entity are faithfully represented within the balance sheet and provide relevant information to financial statement users; and

(b) feedback from most panel members that supported requiring Tier 3 entities to consider impairment of non-financial assets. This approach also maintains consistency with existing Tier 1 and Tier 2 accounting requirements.

**Question to Board members:**

Q2 Do Board members support, for the purpose of the DP, the staff recommendation in paragraph 41 that Tier 3 accounting requirements should include an impairment model?

If not, what approach do Board members support?

42 Subject to Board members supporting the staff recommendation in paragraph 41 that Tier 3 reporting requirements should include an impairment model for non-financial assets, staff considered the following possible options:

(a) Scope – which non-financial assets should be subject to impairment testing? (Table 1a);

(b) Timing – when should in-scope non-financial assets be assessed/tested for impairment? (Table 1b); and

(c) Methodology – how should the recoverable amount be determined for in-scope non-financial assets? (Table 1c).

**Table 1a Scope – which non-financial assets should be subject to impairment testing?**

| Possible options | Support for the approach | Arguments against the approach |
|---|---|---|
| **Option S1:**<br>**All non-financial assets should be subject to impairment testing (i.e. those subsequently carried at cost, deemed cost and fair value).** | • From the sample of financial statements reviewed, the recognition of impairment losses by Tier 3 entities does not appear to be common. Further, feedback from panel members indicated that if an impairment loss is recognised, it is usually because of a significant event (e.g. fire or flood) rather than a decline in market value. Therefore, any incremental cost savings from adopting an alternative approach to this option are likely to be minimal.<br>• Having one impairment model that applies consistently to all Tier 3 entity assets is likely to be helpful to users as their impairment considerations would be consistent across all non-financial assets the entity holds.<br>• Consistent with existing Australian Accounting Standards and other jurisdictions (except for Singapore CAS, which does not require property, plant and equipment, or intangible assets to be assessed for impairment). | • Assets carried at fair value are less likely to be impaired given they are regularly fair valued. Therefore, requiring assets carried at cost/deemed cost to be assessed for impairment focuses resources on non-financial assets that are less likely to be impaired. Staff noted that Tier 3 entities are unlikely to measure property, plant and equipment using the revaluation model.[15]<br>• Adopting this approach would disadvantage Tier 3 entities that are not currently required to assess certain non-financial assets for impairment (i.e. AASB 136 does not require NFP entity assets held for continuing use of their service capacity and that are regularly revalued to fair value to be assessed for impairment). |
| **Option S2:**<br>**Only non-financial assets subsequently carried at cost or deemed cost should be subject to impairment testing.** | • Any decrease in the value of an asset carried at fair value would already be reflected in the financial statements, even though it is not necessarily disclosed as an impairment loss.<br>• Reduces effort and concentrates resources on the non-financial assets that are more likely to be impaired (i.e. assets that are not regularly revalued to fair value) and that could misstate the statement of financial position because they are held at historical cost, which might exceed the current recoverable amount.<br>• Extends the principal in AASB 136, whereby NFP entity assets held for continuing use of their service capacity and that are regularly revalued to fair value are not required to be assessed for impairment to other non-financial assets that are also regularly revalued to fair value. | • Incremental cost savings are likely to be limited, based on observations from the sample of financial statements reviewed by staff that most non-financial assets were carried at cost.<br>• Most material non-financial assets carried at cost were items such as property, plant and equipment that are likely to have appreciated in value since their acquisition; therefore, impairment losses are unlikely unless a significant event occurs (e.g. fire or flood).<br>• Will impact the comparability of financial statements against entities in other reporting tiers and possibly create consolidation issues, as this requirement would apply only to entities applying Tier 3 reporting requirements.<br>• No other jurisdiction adopts this approach. |
| **Option S3:**<br>**Only non-current non-financial assets should be subject to impairment testing.** | • Current assets are expected to be recovered/consumed within 12 months. Therefore, there is a lower risk of impairment.<br>• Reduces effort and concentrates resources on the non-financial assets that are more likely to be impaired (i.e. assets that will be held for more than 12 months). | • Would introduce different accounting requirements for current and non-current non-financial assets. Having one impairment model that applies consistently to all Tier 3 assets might be helpful for users as their impairment considerations could be consistent across all non-financial assets an entity holds.<br>• Inconsistent with existing Australian Accounting Standards and other jurisdictions. |

15 Some of the reasons could be that: i) the cost model may be more cost-effective and simpler than the revaluation model; and ii) the property, plant and equipment of these entities generally consist of motor vehicles or office equipment rather than land and/or buildings, where using the cost model would more appropriate when measuring these types of assets.

**Table 1b Timing – when should in-scope non-financial assets be assessed/tested for impairment?**

| Possible options | Support for the approach | Arguments against the approach |
|---|---|---|
| **Option T1:**<br><br>**All in-scope assets should be assessed for impairment indicators annually, then, if an impairment indicator exists, perform an impairment test and determine the assets' recoverable amount.** | • Consistent with existing Australian Accounting Standards and other jurisdictions.<br>• From the sample of financial statements reviewed, the recognition of impairment losses by Tier 3 entities does not appear to be common. Therefore, any incremental costs savings from adopting an alternative approach to this option are likely to be minimal.<br>• Preparers are expected to prefer a clear 'framework' (i.e. requirements in Australian Accounting Standards) from which to develop their impairment accounting policies. A clear framework, in turn, assists auditors with performing the audit as an entity's accounting policies are part of the criteria against which the auditor audits the financial statements. Additionally, the ability to obtain audit evidence may be improved with a clear framework in place. However, it is noted that this is already a challenge in an NFP environment where there may not be a market to value certain assets. | • Impairment losses do not appear to be common for Tier 3 entities, so the possible costs of requiring Tier 3 entities to consider impairment indications each year outweigh any possible benefits. |
| **Option T2:**<br><br>**Assess all in-scope assets for impairment indicators periodically (e.g. every X years or on the occurrence of a significant event or when they are affected by physical damage or technological obsolescence). The Standard would provide examples of what significant events might be. If an impairment indicator exists, perform an impairment test and determine the assets' recoverable amount.** | • From the sample of financial statements reviewed, the recognition of impairment losses by Tier 3 entities does not appear to be common, therefore:<br>○ considering impairment indicators less frequently may not result in a material overstatement of non-financial assets; and<br>○ asset values do not appear to change significantly from year to year; therefore, requiring a less frequent assessment of impairment indicators reduces the effort for preparers. | • Inconsistent with existing Australian Accounting Standards and other jurisdictions. However, this approach is similar to the revaluation approach in AASB 116, which notes that revaluations of assets might not be required annually if there are only insignificant changes in value.<br>• Where this is the case, it may be necessary to revalue the item only every three to five years.<br>• Assessing whether or not an impairment indicator exists is not expected to be onerous; therefore, incremental cost savings are likely to be minimal.<br>• There is a risk that an impairment loss may not be recognised if an entity is not required to consider the presence of impairment indicators annually. |
| **Option T3:**<br><br>**Do not include a requirement for when in-scope assets should be assessed for impairment.** | • As outlined above for option T2.<br>• However, option T3 would provide Tier 3 entities with more flexibility as considering impairment indicators would only be required when determined necessary by the entity. This further reduces the burden on Tier 3 entities. | • As outlined for option T2.<br>• No other jurisdictions adopt this approach, except for the NZ Tier 3 Standard, which is drafted in a much more simplistic and prescriptive manner (and does not provide explicit guidance about calculating the recoverable amount of affected assets).<br>• There would be no bright lines for when impairment indicators should be assessed. Instead, this option applies the principle that in-scope assets should not be carried in excess of their recoverable amounts, so |

| Possible options | Support for the approach | Arguments against the approach |
| --- | --- | --- |
| | | an entity should assess for impairment indicators as needed. Some legislative (and other) financial reporting requirements require an entity's financial statements to provide a true and fair view of an entity's financial performance or position or present fairly an entity's financial position and performance. If there are no minimum requirements for how often an entity is required to assess whether non-financial assets are impaired, staff consider there might be some challenges for preparers when preparing the financial statements and auditors when opining on whether the financial statements present fairly. For example, if there is no minimum requirement regarding when or how frequently an entity is required to consider whether their non-financial assets are carried at too high a value. |

**Table 1c Methodology – how should the recoverable amount be determined for in-scope non-financial assets?**

| Possible options | Support for the approach | Arguments against the approach |
|---|---|---|
| **Option M1**<br>**Adopt the approach in AASB 136 (i.e. compare the assets' recoverable amount to the carrying amount, where the recoverable amount is the higher of fair value less costs of disposal and value in use or replacement cost) and provide guidance to assist entities determining whether there is any impairment indicator and determines the recoverable amount.**<br>**The guidance would be provided as a rebuttable assumption.** | • From the sample of financial statements reviewed, the recognition of impairment losses by Tier 3 entities does not appear to be common. Therefore, any incremental costs savings from adopting an alternative approach to this option are likely to be minimal.<br>• The option adopted in AASB 136 is robust.<br>• Consistent with existing Australian Accounting Standards requirements and most other jurisdictions. | • The approach adopted in AASB 136 can be complex to apply; therefore, the possible costs of requiring Tier 3 entities to apply this approach to impairment are expected to outweigh any possible benefits. |
| **Option M2**<br>**Determine an asset's recoverable amount on an alternative basis to AASB 136 (e.g. the recoverable amount could be determined using 'replacement cost' or 'replacement cost adjusted for already consumed benefits' or 'replacement value'). The basis that is selected would be defined in the Tier 3 Standard and have a clear meaning for Tier 3 entities.**<br>**(Staff will bring further analysis to a future meeting for Board considerations on the alternative basis if the Board decides to adopt this approach for the DP.)** | • Determining fair value less costs of disposal or value in use can be complex; therefore, an alternative approach could reduce effort and concentrate resources on other areas of Tier 3 accounting.<br>• This option is similar in principle to some other jurisdictions (i.e., prescribing the basis on which the recoverable amount should be determined).<br>• Staff noted that Canad ASNPO permits entities to choose between fair value or replacement value; replacement value is "the amount that would be needed currently to acquire an equivalent asset." | • Inconsistent with Tier 1 and Tier 2 NFP entities.<br>• The Board tentatively decided that an entity that chooses to carry property, plant and equipment or investment properties at fair value must use AASB 13 *Fair Value Measurement* rather than allow entities to use another measurement basis due to possible assurance implications and to ensure faithful representation and a robust, fair value amount as discussed at the February 2022 Board meeting (refer to Action Alert 212). Introducing an alternative measurement basis for determining an asset's recoverable amount could be perceived as inconsistent with this approach.<br>• Inconsistent with existing Australian Accounting Standards. |
| **Option M3**<br>**Do not specify how to determine the recoverable amount of in-scope assets.** | • Allowing Tier 3 entities the flexibility to determine the recoverable amount of an asset using a methodology that they consider the most relevant will reduce the burden for entities.<br>• The NZ Tier 3 Standard adopts this approach. | • Allowing entities too much flexibility in determining the recoverable amount of an asset might reduce consistency and comparability.<br>• Inconsistent with existing Australian Accounting Standards and most other jurisdictions. |

### *Evaluation of options against the Tier 3 principles – scope, timing and methodology of an impairment model*

43 With reference to the flowchart in Agenda Paper 4.1 (Appendix A) for this meeting and the analysis in Tables 1a – c above, staff also analysed each of the proposed options against the tentative Tier 3 principles previously agreed to by Board members. Staff consider that the proposed options are broadly equally aligned with the Tier 3 principles, except for those listed below:

| **Principle** | **Discussion** |
|---|---|
| Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of the financial statements | Staff suggest that some of the options identified in the tables above may not provide useful information to the users of financial statements. Where this is the case, staff have noted this as an argument against the relevant option. |
| Consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable, but might not always be warranted, since Tier 3 requirements are being developed as a proportionate response to the costs incurred by certain entities whilst still meeting the needs of users of the financial statements for this cohort of entities. | Staff note that many of the options identified in the tables above are not consistent with Tier 2 requirements.<br>However, staff suggest that the departure from Tier 2 requirements may be justified having regard to the complexities associated with applying Tier 2 impairment requirements and the burden this could impose on less well resourced Tier 3 entities.<br>Although from the sample of financial statements review, the recognition of impairment losses by Tier 3 entities are not common, staff consider that requiring Tier 3 entities to apply Tier 2 requirements may impose disproportionate costs on preparers compared to benefits of the information. |

### *Staff recommendations*

44 On balance, subject to Board members supporting the staff recommendation in paragraph 41 that an impairment model is necessary for non-financial assets, staff recommend the following approach for:

(a) **Scope** – assessment for impairment is only required for those non-financial assets subsequently carried at cost or deemed cost should be assessed for impairment (Option S2);

(b) **Timing** – do not include a requirement for when in-scope assets should be assessed for impairment (Option T3); and

(c) **Methodology** – adopt the approach in AASB 136 (i.e. compare the assets' recoverable amount to the carrying amount, where the recoverable amount is the higher of fair value less costs of disposal and value in use or replacement cost) and provide guidance to assist entities determines whether there is any impairment indicator and determines the

recoverable amount. The guidance would be provided as a rebuttable assumption (Option M1).

45 Staff note that the Board has previously contemplated that a Tier 3 entity should be able to prepare Tier 1 or Tier 2 general purpose financial statements if it elects to do so. Consequently, any Tier 3 subsidiary entities needing to consolidate may prepare such financial statements instead.[16]

46 Staff consider that providing Tier 3 entities with too much flexibility regarding impairment testing could lower the quality of the resulting financial statements if the impairment model is not sufficiently robust. Staff suggest that the possible requirements outlined in paragraph 44 appropriately balance the needs of Tier 3 preparers users of their financial statements and will result in consistent and comparable Tier 3 financial statements.

**Question to Board members:**

Q3 Subject to Board member support that an impairment model is required for Tier 3 entities, do Board members support, for the purposes of the DP, the staff recommendation in paragraph 44 that an impairment model is required for Tier 3 entities with the following approach:

(a) **Scope** – assessment for impairment is only required for those non-financial assets subsequently carried at cost or deemed cost should be assessed for impairment (Option S2);

(b) **Timing** – do not include a requirement for when in-scope assets should be assessed for impairment (Option T3); and

(c) **Methodology** – adopt the approach in AASB 136 (i.e. compare the assets' recoverable amount to the carrying amount, where the recoverable amount is the higher of fair value less costs of disposal and value in use or replacement cost) and provide guidance to assist entities determines whether there is any impairment indicator and determines the recoverable amount. The guidance would be provided as a rebuttable assumption (Option M1).

If not, what approach do Board members support?

### *Other matters to consider*

47 Staff suggest it may be relevant for the Board to develop high-level views on related matters, including accounting for assets that do not generate cash flows independently and whether to allow reversing of previously recognised impairment losses.

**Assets that do not generate cash flows independently**

48 Although it might not be common, a group of assets might support the generation of cash flows when used together. For this reason, the ability for Tier 3 entities to group assets together into CGU is important.

16 At its 8-9 September 2021 meeting, the Board decided to seek feedback as part of the discussion paper whether to allow an entity preparing Tier 3 financial statements to opt-up to the accounting policies permitted under Tier 1 or Tier 2 reporting requirements for the topics covered by Tier 3 requirements. The Board decided not to form a preliminary view in this regard for the purposes of the discussion paper.

***Staff recommendation:***

49 Staff, therefore, recommend that requirements permitting Tier 3 entities to group assets are needed.

**Reversing previously recognised impairment losses**

50 Whilst there may be merit in permitting Tier 3 entities to reverse previously recognised impairment losses, as noted earlier, from the sample of financial statements reviewed, the recognition of impairment losses by Tier 3 entities does not appear to be common. Therefore, the reversal of any previously recognised impairment losses is expected to be less common. Further, feedback from panel members indicated that when impairment losses are recognised, they are typically for significant events that will not reverse (e.g. flood damage).

***Staff recommendation:***

51 Staff recommend that Tier 3 requirements do not include specific requirements relating to the reversal of impairment losses. Instead, staff recommend that Tier 3 reporting requirements are 'silent.' This approach does not prohibit entities from reversing impairment losses and applying the requirements of another Standard by analogy.

**Question for Board members:**

Q4 Subject to Board member support that an impairment model is required for Tier 3 entities, do Board members support, for the purposes of the DP, the staff recommendations in paragraphs 49 and 51 that the impairment model, if required, should:

(a) allow assets to be grouped where they do not generate independent cash flows (i.e. CGUs); and

(b) not include requirements about the reversal of previously recognised impairment losses.