



<b>Project:</b>	<b>Not-for-Profit Framework Project</b>	<b>Meeting:</b>	200
<b>Topic:</b>	<b>Tier 3 Exposure Draft Proposals – consolidation, separate financial statements, associates and joint ventures, and related party disclosures</b>	<b>Agenda Item:</b>	5.2
		<b>Date:</b>	13 November 2023
<b>Contact(s):</b>	Maggie Man mman@asb.gov.au  Fridrich Housa fhousa@asb.gov.au	<b>Project Priority:</b>	High
		<b>Decision-Making:</b>	High
		<b>Project Status:</b>	Developing Exposure Draft

### Objective of this paper

- The objective of this paper is for the Board, in relation to the feedback received on the Discussion Paper *Development of Simplified Accounting Requirements (Tier 3 Not-for-Profit Private Sector Entities)*:
  - to consider** staff analysis of the feedback on the Board's preliminary views about the Tier 3 requirements on:
    - the approach to consolidation;
    - separate financial statements of the parent entity;
    - associates and joint ventures; and
    - related party disclosures; and
  - to decide** on the staff recommendations of the abovementioned matters for the purpose of drafting the Tier 3 Exposure Draft (ED).

### Structure of this paper

- This paper is structured as follows:
  - Summary of staff recommendations (paragraph 3);
  - Background and reasons for bringing this paper to the Board (paragraphs 4 – 7);
  - Additional feedback from Not-for-Profit (NFP) Project Advisory Panel (PAP) members on matters in this paper (paragraph 8);
  - Staff analysis and recommendations regarding the following matters arising from the consideration of stakeholder feedback on the Discussion Paper (DP) proposals regarding:
    - Issue 1:** Whether the Tier 3 Standard should allow a parent entity an accounting policy choice to present consolidated or separate financial statements (paragraphs 9 – 19);

- (ii) **Issue 2:** Tier 3 requirements for a parent entity preparing separate financial statements for:
  1. Matter 1: the definition of ‘significant relationships’ (paragraphs 20 – 34);
  2. Matter 2: the disclosure requirements of the parent entity’s significant relationships (paragraphs 35 – 43);
  3. Matter 3: the measurement of the parent entity’s investments in entities representing significant relationships (or subsidiaries if the parent prepares consolidated financial statements) in its separate financial statements (paragraphs 44 – 53);
- (iii) **Issue 3:** Tier 3 requirements for investments in associates and joint ventures for:
  4. Matter 1: a parent that does not consolidate and prepares separate financial statements – (associates only) (paragraphs 54 – 68);
  5. Matter 2: an investor that does not have any subsidiaries (paragraphs 69 – 74) or a parent that prepares consolidated financial statements (paragraph 75);
  6. Matter 3: exemptions and exceptions to apply the equity method (paragraphs 78 – 80); and
- (iv) **Issue 4:** Tier 3 requirements for disclosure of related party transactions (paragraphs 81 – 98).
- (e) **Appendix A:** Extract from May 2023 Agenda Paper 3.1.1 *Staff preliminary analysis of the feedback on the Discussion Paper and suggested next steps.*

### Summary of staff recommendations

- 3 Staff recommend that the Tier 3 requirements for the purpose of drafting the ED should:
  - (a) provide a parent entity the option to prepare separate financial statements that disclose its significant relationships, as an alternative to preparing consolidated financial statements;
  - (b) define a ‘significant relationship’ to exist when a parent entity has significant influence over another entity that is not an associate;
  - (c) for each entity with which the parent entity has a significant relationship (‘significant relationship entity’), make the following disclosures:
    - (i) the name of the entity;
    - (ii) a description of the nature and operations of the entity;
    - (iii) the relationship with the parent entity;
    - (iv) whether the significant relationship entity prepares audited financial statements;
    - (v) total income;
    - (vi) total expenses;
    - (vii) profit or loss;
    - (viii) total assets;
    - (ix) total liabilities;
    - (x) details of any restrictions, by major category, on the resources of the entity;
    - (xi) significant differences in accounting policies from those followed by the parent entity; and

- (xii) further breakdowns or disaggregations of the categories in paragraph 3c(v) – 3c(xi) may be provided, for example, a breakdown of current and non-current assets and liabilities with the objective to provide a breakdown that gives the most useful information to users of the financial statements;
- (d) allow an accounting policy choice for a parent entity preparing separate financial statements either in addition to consolidated financial statements or as its only financial statements, to measure its investments in subsidiaries or other significant relationship entities at cost or, subject to the Board’s decision in Agenda Paper 5.3 at this meeting, fair value either through profit or loss or other comprehensive income, or by applying the equity method;
- (e) allow an accounting policy choice to measure at cost or, subject to the Board’s decision in Agenda Paper 5.3 at this meeting, fair value either through profit or loss or other comprehensive income, or by applying the equity method, for:
  - (i) a parent entity that presents consolidated financial statements measuring its investment in associates and joint ventures;
  - (ii) a parent entity that presents separate financial statements as its only financial statements measuring its investments in associates; and
  - (iii) an investor without subsidiaries presenting either individual/ equity accounted financial statements or separate financial statements as its only financial statements measuring its investments in associates and joint ventures;
- (f) exempt an investor's individual financial statements from applying the equity method for its investments in associates and joint ventures where the investor is a venture capitalist or similar entity; and
- (g) maintain the related party disclosure requirements consistent with AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* with simplification of the language, except that disclosure should not be required of donations received by a NFP entity from a related party without attached conditions unless there is evidence indicating the donations influenced the NFP entity's activities or use of resources.

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

- 4 The Board decided at its May 2023 meeting to proceed with the development of an ED on a Tier 3 Accounting Standard with simplified recognition, measurement and disclosure requirements for smaller NFP private sector entities.
- 5 The Board considered the summarised feedback on the DP, staff preliminary analysis and suggested actions for the next steps in [Agenda Paper 3.1.1](#) of the May 2023 Board meeting. At that meeting, the Board noted the categorisation to distinguish the suggested action for the next steps presented in [Agenda Paper 3.1](#) on the topics that staff will need to bring back for further discussions and incorporate changes to the Board's preliminary views for consideration in future meetings.<sup>1</sup>
- 6 The Board also decided on the approach to drafting the Tier 3 ED, as presented in Appendix B in Agenda Paper 5.1 for this meeting to the extent consistent with the project objective to develop simplified and proportionate requirements for smaller NFP private sector entities in line with the principles the Board applies in this regard.

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1 Agenda Paper 3.1 of the May 2023 Board meeting presented three main categories to distinguish the suggested action for next steps based on the feedback on the DP. The three categories were:

- (1) Category A (ED drafting based on DP proposals with minor issues to be resolved);
- (2) Category B (ED drafting based largely on DP proposals with some potential changes); and
- (3) Category C (further analysis and direction required).

7 Therefore, in this paper, staff are bringing their analysis of the feedback on the DP and seeking the Board's direction on the matters below according to the project timeline presented in [Agenda Paper 3.1](#) at the August 2023 Board meeting:

- (a) **Issue 1:** whether the Tier 3 Standard should allow a parent entity an accounting policy choice to present consolidated or separate financial statements;
- (b) **Issue 2:** Tier 3 requirements for a parent entity preparing separate financial statements;
- (c) **Issue 3:** Tier 3 requirements for investments in associates and joint ventures; and
- (d) **Issue 4:** Tier 3 requirements for disclosure of related party transactions.

#### **Additional feedback from NFP PAP members on matters in this Staff Paper**

8 Staff gathered further feedback from the NFP PAP meeting held on 20 September 2023.<sup>2</sup> One PAP member also provided comment outside the PAP meeting. PAP members:

- (a) mainly were supportive of providing a parent entity the option to prepare separate financial statements that disclose its significant relationships, as an alternative to preparing consolidated financial statements. However, a few members were concerned that allowing the choice to not prepare consolidated financial statements and allowing separate financial statements to be prepared instead may deviate from the concept of general purpose financial statements (GPFS);
- (b) expressed mixed views about, but were generally in agreement with, not developing a new definition of significant relationships and preferred a parent assesses whether it has subsidiaries by applying AASB 10 *Consolidated Financial Statements* or develop the definition based on AASB 124 *Related Party Disclosures*, given some entities would already be required to comply with AASB 124 for regulatory purposes. A few members also considered another option is to narrow the entities captured as 'significant relationship entities' to only related entities to which the entity has financial obligations to fund or settle their liabilities;
- (c) mainly disagree with the proposed disclosure presented in paragraph 43(a) to 43(k) and only one member indicated explicit agreement. Some members did not support requiring financial information as part of the disclosures of significant relationships unless that financial information can easily be accessed and reliable; otherwise, there may be assurance implications. Some PAP members consider narrative information about the relationships, restrictions, risk and commitments between entities is more useful to users than financial information;
- (d) supported allowing an accounting policy choice to measure at cost or fair value through other comprehensive income or apply the equity method for investments in:
  - (i) subsidiaries, joint ventures or associates by a parent preparing separate financial statements in addition to consolidated financial statements;
  - (ii) significant relationship entities and associates for a parent presenting separate financial statements as its only financial statements; and
  - (iii) associates or joint ventures for an investor that is not a parent preparing either equity-accounted financial statements or separate financial statements as its only financial statements;
- (e) supported continuing to require related party disclosures consistent with the current Tier 2 requirements, except that disclosure should not be required of donations received by a NFP

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2 Refer to Agenda Paper 5.4 NFP PAP minutes from 20 September 2023 for this meeting.

entity from a related party without attached conditions that could require the NFP entity to significantly alter the nature of its existing activities.

## Matters to be addressed based on feedback on the DP proposals

### Issue 1: Whether the Tier 3 Standard should allow a parent entity an accounting policy choice to present consolidated or separate financial statements

#### Background

- 9 As detailed in paragraph 5.38 of the DP, the Board's preliminary view is to develop requirements that allow a parent entity the choice of presenting:
- (a) consolidated financial statements; or
  - (b) separate financial statements as its only set of financial statements with disclosures about the parent entity's significant relationships.
- 10 The Board did not discuss the form or extent of the disclosures about the parent entity's significant relationships when developing the DP, because the Board was seeking feedback about its preliminary view to allow a parent to elect not to present consolidated financial statements.
- 11 To gather feedback on the Board's proposal, the DP included the following question:

#### **Question 17**

**Paragraphs 5.34 to 5.47 discusses the Board's preliminary view to allow an entity to present either:**

- (a) separate financial statements as its only financial statements, even if it has subsidiaries, however, require information on the parent's significant relationships; or**
- (b) consolidated financial statements consolidating all its controlled entities.**

**Do you agree? Why or why not? If you disagree with the Board's view, do you prefer any other alternative requirements, for example Tier 3 accounting requirements should require an entity with subsidiaries to prepare consolidated financial statements in accordance with AASB 10? Please specify and explain why.**

#### Summary of feedback on DP and from further stakeholder outreach

- 12 As presented in Agenda Paper 3.1.1 at the May 2023 Board meeting, while many stakeholders (70%) supported the Board's proposed Tier 3 requirements on consolidation in paragraph 9, some stakeholders (11%) do not support allowing an accounting policy choice to prepare consolidated financial statements even if supplemented by disclosures.<sup>3</sup> For the stakeholders that disagree, the detailed analysis of the feedback presented in Agenda Paper 3.1.1 at the May 2023 Board meeting highlighted the following:
- (a) users consider financial statements important in providing transparency about the resources available and the financial risk associated with the entity as a whole. A user suggested whether a material parameter could be provided to mandate preparation of consolidated financial statements (e.g. if revenue, expenses or assets of the parent entity is greater than 10% of the controlled group); and
  - (b) auditors consider allowing an accounting policy choice may undermine the usefulness and comparability between similar NFP groups and may lead to a lack of transparency for funding providers that may not be able to see how much funding the group receives from all sources on a consolidated basis. The choice may lead to abuse by NFP parent entities restructuring to transfer assets and liabilities into subsidiaries to achieve reporting outcomes otherwise

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3 19% responded 'not applicable' to the question in the DP.

unachievable under the Tier 1 or Tier 2 general purpose financial reporting framework. One stakeholder also considers an alternative approach should be establishing simpler principles to enable smaller NFP entities to identify subsidiaries more easily, rather than allowing an accounting policy choice, to encourage consistent and comparable disclosures.

- 13 Findings from AASB Research Report 19 *Common Financial Statement Items: Charities with \$0.5–\$3 million in revenue* (RR 19) showed that only 1% (i.e. 3 of 260) of the sample charities submitted consolidated financial statements. This may indicate that it may not be common for Tier 3-sized NFP entities to be a parent entity, which is also supported by some stakeholders' views that the number of entities impacted by the Board's proposed consolidation requirements is expected to be minimal. However, staff consider that there may be NFP parent entities that have not prepared consolidated financial statements given they can continue to prepare special purpose financial statements. This is consistent with findings from the random sample review of 250 charities' 2021 annual financial reports by the Australian Charities and Not-for-Profits Commission (ACNC) indicating that only 6% of charities provided consolidated annual financial reports while 61% of the financial reports were special purpose financial statements.<sup>4</sup>
- 14 The AASB issued ITC 51 *Post-implementation Review of Not-for-Profit Topics – Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements* in November 2022.<sup>5</sup> Staff have yet to assess in detail the feedback from ITC 51; however, it appears at least some of the comments from stakeholders extracted below are consistent with the feedback identified in ITC 51 around difficulties in assessing control in the NFP private sector, including:
- (a) regulatory financial reporting requirements not aligning with the requirements in AASB 10 where some NFP entities are required to prepare combined financial statements where there is no control between entities;
  - (b) difficulties in determining the linkage between power and variable returns, especially where the power doesn't arise from equity interest or the variable returns are non-financial, that may result in divergence in practice where some entities, such as foundations or trusts, were not consolidated even though these entities were established with a common purpose by the reporting entity;
  - (c) results from consolidated financial statements may not be useful to users regarding membership entities (e.g. sub-branches) where the members have the power to appoint or remove directors of the entity but the reporting entity does not have power over the operations of the sub-branches;
  - (d) practical issues causing difficulties in the preparation of consolidated financial statements due to: (i) lack of financial information about controlled entities; (ii) differences in financial year ends amongst entities in the group; and (iii) different structures with different levels of control, which requires assessment of the constitution and understanding legal documents; and
  - (e) some entities may have elected to continue to prepare special purpose financial statements to avoid application of AASB 10 and therefore the issues in ITC 51 may not yet be fully explored by many NFP private sector entities.
- 15 Further feedback received from PAP members indicated that many of them agreed to allow accounting policy choice to prepare consolidated financial statements because:

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4 Refer to the [ACNC website](#) on "*Reviewing Charities' Financial Information and Annual Financial Reports – 2021*".

5 [ITC 51](#) issued in November 2022 sought feedback on four topics, including control and consolidation for NFP entities. In the ITC, the AASB sought feedback on the NFP sector's application of AASB 10, particularly: (1) the control model, (2) identifying variable returns, (3) customary business practices, and (4) assessing control without an equity interest.

- (a) allowing a choice would be the simplest means for Tier 3 entities to prepare consolidated financial statements to meet regulatory needs or separate financial statements with sufficient disclosures to meet the needs of users that are members rather than for management needs. Separate financial statements with disclosures can provide the visibility over the controlled/other entities that exist without assessment of control and the need for consolidating the information into primary financial statements;
- (b) the risk of incentivising wrong behaviour and restructuring would most likely be attributable to Tier 1/Tier 2 entities, rather than smaller NFP entities. Allowing an accounting policy choice in the Tier 3 framework would ensure users obtain the information they need for this scale of entities, which is better than allowing larger entities to prepare special purpose financial statements (SPFS); and
- (c) exceptions to preparing consolidated financial statements exist in accounting standards and those statements are still referred to as GPFS.
- (d) However, a few members (including a member that supported allowing accounting policy choice in paragraph 15(a)) disagree and consider that the fundamentals of preparing GPFS require consolidated financial statements, especially since the Board considers consolidation to be a recognition and measurement (rather than presentation) issue. Allowing an accounting policy choice would result in many entities preparing separate financial statements even if consolidated financial statements provide users with more useful information about the whole economic group; these PAP members would rather these financial statements were referred to as SPFS.

#### **Staff analysis and recommendation**

16 Considering the approach to simplification applied by the Board in Appendix A of Agenda Paper 5.1 at this meeting, staff incorporated the stakeholder feedback from the DP, findings from RR 19 and further feedback from PAP members in paragraphs 12 – 15 above and consider there are three possible options to address the DP feedback. These options are shown in Table 1 below which consist of:

- (a) **Option 1** is the Board's preliminary proposal in the DP to allow a parent entity an accounting policy choice to prepare separate financial statements that disclose its significant relationships, as an alternative to preparing consolidated financial statements;
- (b) **Option 2** was presented in [Agenda Paper 3.3](#) and considered by the Board at its June 2021 meeting to not allow an accounting policy choice and to align the consolidation requirements to Tier 2 requirements, except for language; and
- (c) **Option 3** is not to allow an accounting policy choice and align the requirements to Tier 2 requirements but simplify the control model by providing a rebuttable presumption that control exists when an entity:
  - (i) owns more than a majority of voting rights of another entity; or
  - (ii) has veto rights; or
  - (iii) can appoint a majority of the Board/those charged with governance or key management personnel; or
  - (iv) has a right to reject a majority of the activities which the entity might choose to undertake; or
  - (v) has a right to reject the use to which a majority of the funds of the entity may be put.

Option 3 has not yet been considered by the Board. It reflects an alternative approach received from DP feedback to provide a rebuttable presumption to enable smaller NFP entities to identify subsidiaries more easily, and the suggestions from NFP panel members on further



characteristics of control in NFP sector. Staff also noted that the arguments for Option 1 would be arguments against Options 2 and 3.

Table 1 Options on providing simplification for Tier 3 consolidation requirements

<b>Option 1 – Proceed with the Board's proposal to allow a parent entity prepare separate financial statements that disclose its significant relationships, as an alternative to preparing consolidated financial statements (similar to Canada ASNFP0)<sup>6</sup></b>	<b>Option 2 – Not allow an accounting policy choice and align the consolidation requirements to Tier 2 requirements, except for language.</b>	<b>Option 3 – Not allowing an accounting policy choice and aligning the requirements to Tier 2 requirements but simplifying the control model by providing a rebuttable presumption (Similar to IFRS for SMEs ED and INPAG ED 1)</b>
<b>Arguments for this approach</b>		
<p><b>1)</b> Addresses the feedback from many stakeholders that supported the Board's proposal in the DP and responds to concerns that the application of control concept is too complex for smaller NFP entities.</p> <p><b>2)</b> Allows entities flexibility aligning with management choice to present either consolidated financial statements (applying the Tier 3 development principle of leveraging existing information management uses) or separate financial statements. It responds to feedback that the preparation of consolidated financial statements is likely to exceed the benefits of that information, especially where entities have mixed or discrete purposes and users may be interested in individual entity level information instead of consolidated information.</p> <p><b>3)</b> Provides the most simplification, compared with Option 2 and Option 3, to not require consolidation.</p> <p><b>4)</b> Ensures consistency with ACNC legislation, which assesses a charity's revenue at an individual entity level. Charities report financial information at the registered charity level, even if there are subsidiaries, although allowed to continue to prepare consolidated financial statements if they are already preparing them.</p>	<p><b>1)</b> Addresses the few stakeholders' feedback that consolidation should be a requirement for general purpose financial reporting and providing a choice to prepare consolidated financial statements would reduce consistency and comparability.</p> <p><b>2)</b> Addressed the views that users need to understand consolidated financial position and performance, in order to ascertain resources available to the group as well as the financial risk associated with the entity as a whole.</p> <p><b>3)</b> RR 19 did not indicate many NFP entities are currently preparing consolidated financial statements. Therefore, it may not warrant simplifications being developed for the few entities that may be a parent entity.</p> <p><b>4)</b> Maintains consistency with Tier 1/Tier 2 requirements.</p> <p><b>5)</b> Harmonises with New Zealand Tier 3 accounting requirements.</p>	<p><b>1)</b> Is an alternative approach suggested by one stakeholder to enable smaller NFP entities to apply the control model that is consistent with Tier 1/Tier 2 requirements but allows for some simplification of consolidation requirements compared with Option 2 by providing a rebuttable presumption to simplify the assessment of control.<sup>7</sup></p> <p><b>2)</b> Facilitates consistency and comparability between NFP financial statements applying the Tier 3 Standard.</p>

6 [Agenda Paper 3.3](#) at the June 2021 Board meeting provides a summary of Canada ASNFP0 requirements, which allow a NFP private sector entity an accounting policy choice to prepare consolidated financial statements or separate financial statements with disclosures of summary financial information about each individually material unconsolidated controlled entity. For immaterial controlled entities, the disclosures include the reason why the controlled entity has not been consolidated.

7 IFRS for SMEs ED proposes amendments to align the requirements for consolidated financial statements with IFRS 10 and introducing the assessment of control as a single basis for consolidation, while retaining a rebuttable presumption where control is presumed to exist when the investor owns, directly or indirectly through subsidiaries, a majority of the voting rights of an investee. The presumption can be overcome if it can be clearly demonstrated that the investor does not have one or more of the elements of control listed in paragraph 9.4B. Paragraph 9.4B states that an investor controls an investee if, and only if, the investor has all of the following: a) power over the investee; b) exposure, or rights, to variable returns from its involvement with the investee; and c) the ability to use its power over the investee to affect the amount of the investor's returns. At the [SME Implementation Group meeting](#) held on 13 July 2023, SMEIG members provided feedback on whether to amend paragraph 9.5 of the ED to specify that the rebuttable presumption is applicable only when voting rights are the main factor in determining control. SMEIG members were generally supportive of the change. [INPAG ED 1](#) section 9 also provides further guidance on when an NFP entity has power over another entity, for instance other than via voting rights.



<b>Option 1 – Proceed with the Board's proposal to allow a parent entity prepare separate financial statements that disclose its significant relationships, as an alternative to preparing consolidated financial statements (similar to Canada ASNFP0)<sup>6</sup></b>	<b>Option 2 – Not allow an accounting policy choice and align the consolidation requirements to Tier 2 requirements, except for language.</b>	<b>Option 3 – Not allowing an accounting policy choice and aligning the requirements to Tier 2 requirements but simplifying the control model by providing a rebuttable presumption (Similar to IFRS for SMEs ED and INPAG ED 1)</b>
<p><b>5)</b> If the disclosures supplement the primary financial statements, this option arguably provides sufficient information to the users who would be interested in the financial position and performance of what would be a consolidated group if consolidated financial statements were produced.</p> <p><b>6)</b> Exceptions to the consolidation requirements already exist, for example, for investment entities. This shows that the information needs of users about investments in subsidiaries can be met in a way other than consolidation, if it is more relevant to users.</p> <p><b>7)</b> Proportionate response to smaller NFP private sector entities, given that the purpose of creating this Tier is to enable information to be prepared for users of this particular scale of entities.</p> <p><b>8)</b> The risk of arbitrage and structuring will continue to exist regardless of Tier 3 requirements because not all NFP entities are required to report in accordance with AAS (e.g. small charities).</p>		
<b>Arguments against this approach</b>		
<p><b>1)</b> Does not align with Tier 1/Tier 2 requirements, which would make transition cost the highest if entities were required to transition to higher tier requirements in the future.</p> <p><b>2)</b> Does not align with NZ Tier 3 Standard, which requires Tier 3 parent entities to comply with PBE IPSAS 35 <i>Consolidated Financial Statements</i>.</p> <p><b>3)</b> Would require the most Board and staff effort to develop a new requirement for disclosures of significant relationships.</p> <p><b>4)</b> A few auditors consider optional consolidation may lead to abuse where a NFP parent entity restructures to transfer assets and liabilities into a subsidiary to achieve desired reporting outcomes. It may risk of loss of oversight and visibility of cash flows to and from the parent entity.</p> <p><b>5)</b> A parent entity would still need to assess its significant relationships with disclosure of financial information, which may not make this option easier to comply with.</p> <p><b>6)</b> There is a view that allowing an accounting policy choice not to present consolidated financial statements would not result in GPFS given the AASB considers that consolidated financial statements relate to a recognition issue rather than a presentation issue.</p>	<p><b>1)</b> Many stakeholders supported the Board's proposal in the DP. Therefore, adopting this approach would seem to go against the feedback from stakeholders.</p> <p><b>2)</b> RR 19 focuses on charities reporting to the ACNC and other regulators, which currently allows parent entities to submit special purpose financial statements. Therefore, there may be more NFP entities that could be parent entities than what is indicated by the research findings.</p> <p><b>3)</b> This option is the most complex to apply.</p>	<p><b>1)</b> Similar to Option 2, many stakeholders supported the Board's proposal in the DP. Therefore, adopting this approach would seem to go against the feedback from stakeholders (albeit to a lesser extent than Option 2, because this approach includes practical relief from strict adherence to AASB 10).</p> <p><b>2)</b> Smaller NFP entities may still consider the application of the rebuttable presumption difficult.</p> <p><b>3)</b> The Board rejected the proposal to depart from the definition of 'control' in Tier 1/Tier 2 requirements, including developing a list of objective criteria to help entities to apply the notion of control, when it formed its preliminary views for the development of the DP.</p> <p><b>4)</b> Some stakeholders did not support partial consolidation or departure from the concept of control as applied in Tier 1/Tier 2 requirements, as this would decrease comparability of financial statements and could be subject to abuse.</p>

<b>Option 1 – Proceed with the Board's proposal to allow a parent entity prepare separate financial statements that disclose its significant relationships, as an alternative to preparing consolidated financial statements (similar to Canada ASNFPO)<sup>6</sup></b>	<b>Option 2 – Not allow an accounting policy choice and align the consolidation requirements to Tier 2 requirements, except for language.</b>	<b>Option 3 – Not allowing an accounting policy choice and aligning the requirements to Tier 2 requirements but simplifying the control model by providing a rebuttable presumption (Similar to IFRS for SMEs ED and INPAG ED 1)</b>
<p>7) Information necessary to prepare consolidated financial statements might also be necessary for management oversight purposes. Therefore, directors might not have effective oversight of controlled entities if consolidated financial statements are not required, which may lead to going concern risk or ineffective oversight of potential liabilities when directors discharge their obligations.</p>		

### Staff recommendation

- 17 Staff recommend Option 1, the Board's proposal in the DP, based on the arguments presented in Table 1 and after considering the assessment against the Tier 3 development principles in Appendix A of Agenda Paper 5.1. Staff continue to think Option 1 will keep the Tier 3 Standard simple and that the cost of preparing consolidated financial statements for Tier 3 preparers may outweigh the benefits to users of Tier 3-sized entities.
- 18 Staff noted one stakeholder considers the Option 1 requirement for a parent entity to disclose information about its significant relationships may contradict the accounting policy choice of whether to present consolidated financial statements, because the entity may need to assess application of control criteria in order to determine whether significant relationships exist. However, staff disagree because:
- (a) the notion of a significant relationship would not be the same as the notion of control under AASB 10. The definition of significant relationships, if the Board agrees with Option 1, is discussed in the section starting from paragraph 20 below; and
  - (b) as mentioned in Agenda Paper 3.1.1 at the May 2023 meeting, the Board's proposal to provide accounting policy options for measuring investments in subsidiaries, associates and joint ventures ensures that the accounting requirement caters for the Board's decision to allow Tier 3 entities to present consolidated financial statements.
- 19 Staff identified other possible approaches, including those noted below, but did not consider them further:
- (a) under Option 1, limiting the circumstances in which an entity can apply the accounting policy choice of whether to prepare consolidated financial statements. This would be similar to how an entity determines whether it is an investment entity when applying AASB 10. In addition, International Non-Profit Accounting Guidance Exposure Draft 1 (INPAG ED 1) in paragraph G9.8 acknowledges that, in exceptional circumstances, consolidation of an entity may not result in faithful and relevant presentation; however, it notes this would not be due to dissimilar business activities. Staff have not suggested this alternative approach to Option 1 because staff cannot determine clear criteria or any differentiating factors for specifying the circumstances in which to apply the accounting policy generally across the NFP entities expected to be within the scope of Tier 3 requirements. For example, feedback from a user in paragraph 12(a) suggested specifying a material parameter based on revenue/expense/asset when consolidation should be mandatory. However, staff think any parameter will be arbitrary in nature and should not be determined by standard setters, similar to the Board's decision not to specify financial reporting thresholds in Australian Accounting Standards; and

- (b) providing practical expedients or some form of guidance that can be developed in the Tier 3 Standard instead of allowing an accounting policy choice. However, as noted by members, there is already guidance in AASB 10 and this approach would not address the feedback that consolidation is complex for the reasons highlighted in paragraph 14.

**Question 1: Do Board members agree with the staff recommendation in paragraph 17, for the purpose of drafting the Tier 3 ED, to proceed with Option 1? That is, allow an accounting policy choice for a Tier 3 parent entity to present either:**

- (a) separate financial statements as its only financial statements, even if it has subsidiaries, however, require disclosure of information about the parent's significant relationships; or
- (b) consolidated financial statements consolidating all its controlled entities.

**If not, what does the Board suggest?**

## **Issue 2: The Tier 3 requirements for a parent entity preparing separate financial statements**

- 20 Only if the Board agrees with the staff recommendation to proceed with Option 1 (i.e. for a parent entity preparing separate financial statements either in addition to consolidated financial statements or its separate financial statements as its only financial statements,<sup>8</sup> with disclosure requirements regarding significant relationships), the Board will need to consider the requirements of separate financial statements including:
- (a) the definition of significant relationships, discussed in **Matter 1** in paragraphs 23 – 34;
- (b) the disclosure requirements about the parent entity's significant relationships, discussed in **Matter 2** in paragraphs 35 – 43; and
- (c) measurement of the parent entity's investment in entities representing significant relationships (or subsidiaries if the parent prepares consolidated financial statements) in its separate financial statements in **Matter 3** in paragraphs 44 – 53.
- 21 Staff note the term 'parent' entity would normally be used in the context that an entity has control of a subsidiary and may not be appropriate for a Tier 3 entity that assesses its significant relationships which may not necessarily be based on control (see further discussion in Matter 1 below). As such, staff are considering different terminologies such as a 'reporting entity' or 'holding entity' in place of a 'parent entity'. The remainder of the paper will continue to use the term 'parent entity' when discussing significant relationships; however, staff will consider the terminology further when drafting the Tier 3 ED.
- 22 This paper also uses both 'interest(s)' and 'investment(s)' in other entity/entities in different places. Staff noted that both terms are used in various Australian Accounting Standards.<sup>9</sup> While staff

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8 Staff think Tier 3 entities that elect to prepare separate financial statements as their only financial statements would be unlikely to choose to apply AASB 127 – and should not be required to apply that Standard – in preparing those separate financial statements. This is because applying AASB 127 would require the entity to identify its subsidiaries in accordance with AASB 10, which has been argued to be a significant practical challenge for NFP entities in the private sector (see paragraph 14).

9 'Interest' or 'investment' in other entity/entities are used in various Australian Accounting Standards including:

(a) AASB 12 *Disclosure of Interests in Other Entities* mainly refers to "interests" rather than "investments";

(b) AASB 11 *Joint Arrangements* uses both terms jointly for example "A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method ..."

(c) AASB 9 *Financial Instruments* refers to "investment in an equity instrument;

consider the Australian Accounting Standard refer to ‘investment(s)’ more often than to ‘interest, however staff also noted that an ‘interest’ is a broader notion than an ‘investment’ and captures scenarios where an entity may not have a financial investment in another entity. The remainder of the paper will continue to use the terms ‘interest(s)’ and ‘investment(s)’ in other entity/entities, however, staff will consider the consistency of expression when drafting the Tier 3 ED.

### **Matter 1: The definition of ‘significant relationships’**

- 23 As outlined in the DP, the Board did not develop a proposed definition of ‘significant relationships’ or proposed disclosure requirements for separate financial statements prior to receiving feedback on whether stakeholders supported the choice to prepare consolidated financial statements.
- 24 At a high level, AASB 10 states that, for an investor to control an investee, the following three control criteria must be satisfied: power over the investee, variable returns to the investor, and a link between power and returns. As per the feedback that the Board received when developing the DP and also highlighted in ITC 51 and summarised in paragraph 14, previous outreach with stakeholders has identified challenges in determining control within the NFP sector, including difficulties in identifying controlled entities because:<sup>10</sup>
- (a) information is not available to them;
  - (b) it is challenging to identify variable returns; and
  - (c) assessing control without an equity interest is challenging.

25 Staff consider that stakeholders' concerns stem from:

- (a) a misinterpretation of the control concept, which is based on the three criteria and which may be considered complex to assess; and
- (b) terminology such as 'parent', 'subsidiary', 'control' and 'joint venture', which might not capture relevant relationships within the NFP sector.<sup>11</sup>

Therefore, staff think an avenue of simplification is not to require the assessment of control in order to develop a definition of ‘significant relationships’.

- 26 To support consideration of the approach to simplification applied by the Board in Appendix A of Agenda Paper 5.1 for this meeting, Table 2 (following paragraph 32) incorporates stakeholder feedback (including from the PAP) and staff analysis thereof regarding the following four options for developing the definition of ‘significant relationships’:
- (a) **Option 1:** define significant relationships to exist when a parent entity has significant influence over another entity that is not an associate as defined in AASB 128 *Investments in Associates and Joint Ventures*;
  - (b) **Option 2:** define significant relationships consistent with the definition of ‘related parties’ in AASB 124 *Related Party Disclosures*. This option would interact closely with the related party disclosure requirements, where the parent entity would apply the same criteria to identify its related parties when determining its significant relationships;

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(d) AASB 10 *Consolidated Financial Statements* uses a mixture of terminology, including: “parent’s ownership **interest**” and “parent’s **investment** in each subsidiary”;

(e) AASB 127 *Separate Financial Statements* generally uses ‘investment(s)’ rather than ‘interest(s)’; and

(f) AASB 128 *Investments in Associates and Joint Ventures* uses a mixture of terminology, although it mentions ‘investment(s)’ considerably more often than ‘interest(s)’.

10 Refer to ITC 51 *Post-implementation Review of Not-for-Profit Topics – Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements*.

11 Langford, R.T., 2021, *Charitable companies and related party transactions*

- (c) **Option 3:** not to proceed with the DP proposal to develop a definition of significant relationships. Instead, require parent entities to identify all subsidiaries in accordance with AASB 10 *Consolidated Financial Statements*; these would be subject to the choice between consolidation and the alternative disclosure requirements; and
- (d) **Option 4:** define significant relationships to exist when the parent entity has an economic interest in another entity.

#### Further explanation of each option above

27 **Option 1** proposes to define a significant relationship entity to exist when the parent entity has significant influence over another entity that is not an associate.<sup>12</sup> This means entities that would not meet the definition of controlled entity under AASB 10 such as joint ventures<sup>13</sup>, and subsidiaries of the parent entity would be captured as significant relationship entities. The proposed definition of a significant relationship leverages off the AASB 128 definition of an ‘associate’ and is described as:

- (a) a parent that has significant influence to participate in the financial and operating policy decisions of another entity that is not an associate of the parent entity. A parent entity that holds, directly or indirectly, more than 20% of voting power of another entity that is not an associate is presumed to have a significant relationship with that other entity unless that can clearly be disproved. The existence of a significant relationship can be evidenced in at least one or more ways that is not an associate including:
  - (i) representation on the board of directors or equivalent governing body of the other entity;
  - (ii) participation in the other entity’s policy-making processes, including participation in decisions about dividends or other distributions;
  - (iii) material transactions between the parent entity and the other entity;
  - (iv) interchange of managerial personnel; or
  - (v) provision of essential technical information.
- (b) Option 1 was developed based on staff’s thinking that previous outreach from stakeholders did not indicate any concerns with present accounting requirements for an entity’s interest in its associates as per paragraph 5.130 of the DP whereas the difficulties for NFP entities is around determining control. As such, Option 1 assumes that it may not be difficult for NFP entities to determine whether an entity has significant influence over another entity based on the current definition under AASB 128.
- (c) Staff note that the interplay between significant relationships and significant influence may be confusing to stakeholders. But staff consider significant influence is already a defined term in

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12 Paragraph 5 of AASB 128 states that if an entity holds, directly or indirectly (e.g. through subsidiaries), 20% or more of voting power of the investee, it is presumed that the entity has significant influence unless it can be clearly demonstrated that this is not the case. Paragraph 6 of AASB 128 also outlines that the existence of significant influence by an entity can be evidenced in one or more ways including:

- (a) representation on the board of directors or equivalent governing body of the investee;
- (b) participation in the policy-making processes, including participation in decisions about dividends or other distributions;
- (c) material transactions between the entity and its investee;
- (d) interchange of managerial personnel; or
- (e) provision of essential technical information.

13 The IFRS for SMEs ED proposes to align the definition of ‘joint control’ with IFRS 11 *Joint Arrangements* while retaining the three classifications of joint arrangements in Section 15 *Investments in Joint Ventures* (i.e. jointly controlled operations, jointly controlled assets and jointly controlled entities) including renaming the section from *Investments in Joint Ventures* to *Joint Arrangements*. Staff will consider whether to continue to use the term joint venture or align with the IFRS for SMEs ED when drafting the Tier 3 ED.

AASB 128 and, as noted in paragraph 27 above, the term significant relationships will be a defined term in the Tier 3 Standard to alleviate the potential for confusion.

- (d) Staff also note that whilst 'significant' is not a defined term, it is used extensively in varying contexts in the Australian Accounting Standards.<sup>14</sup> The New Zealand Tier 3 Standard contains the following definition: *“An item is significant if recording and/or disclosure of the particular item, whether financial or non-financial, could influence a user’s understanding of the entity’s overall performance. For the purposes of this Standard, it has the same meaning as material”*. Staff do not suggest aligning the definition of ‘significant’ with the definition in the New Zealand Tier 3 Standard because staff consider an entity can meet the definition of a significant relationship without it being material to the financial statements. That is, a Tier 3 preparer is expected to consider whether a significant relationship is material for the preparation of Tier 3 general purpose financial statements.

28 **Option 2** proposes to develop a definition for significant relationships broadly consistent with the definition of a related party in AASB 124. This means associates, joint ventures or subsidiaries of the parent entity and other related entities that meet the categories in paragraph 9(b) of AASB 124 would be captured as significant relationship entities.<sup>15</sup> A significant relationship entity would be defined as any entity that meets any of the following conditions:

- (a) The entity over which the parent entity has significant influence, joint control or control, including an associate, joint venture or subsidiary or fellow subsidiary of the parent entity.
- (b) The entity and the parent are joint ventures of the same third party.
- (c) One entity is a joint venture of a third party and the other entity is an associate of the third party.
- (d) The entity is controlled or jointly controlled by a director of the parent entity.
- (e) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the parent entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the parent entity.
- (f) The parent entity provides key management personnel to the entity or another member of a group of which it is a part.

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14 In 2021, the IASB amended IAS 1 to require entities to disclose their material accounting policies instead of significant accounting policies because ‘significant’ is not a defined term. ‘Material’ is defined as “Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity”.

15 Part (b) of the definition of ‘related party’ in paragraph 9 of AASB 124 states:

*“An entity is related to a reporting entity if any of the following conditions applies:*

- (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).*
- (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).*
- (iii) Both entities are joint ventures of the same third party.*
- (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.*
- (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.*
- (vi) The entity is controlled or jointly controlled by a person identified in (a).*
- (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).*
- (viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.”*

- 29 **Option 3** proposes not to proceed with the DP preliminary view to develop a new definition of a parent entity's 'significant relationships'. Instead, Tier 3 parent entities would need to assess whether they control subsidiaries in accordance with AASB 10, for the purpose of identifying the subsidiaries that will be subject to disclosure requirements in separate financial statements proposed in Matter 2 in paragraph 35 below.
- 30 **Option 4** proposes to define 'significant relationships' to exist when the parent entity has an economic interest in another entity when:
- (a) the other entity holds resources for the benefit of the parent entity; or
  - (b) the parent entity provides financial support to the related entity or the related entity is economically dependent on the parent entity; or
  - (c) when the parent entity or the related entity is responsible for or provides guarantees for the parent or the other entity's liabilities or for each other related entity.<sup>16</sup>

This option would capture the narrowest range of related entities as having a significant relationship with the parent entity.

#### **Other possible approaches considered**

- 31 Staff observed that there are other possible alternatives (listed below) but, for the following reasons, does not recommend that the Board considers them:
- (a) developing the definition of significant relationships based on the definition of joint ventures as defined in AASB 128, that is, a significant relationship exists when a parent entity has at least joint control of another entity. Staff consider this approach would duplicate Option 1 since Option 1 already captures joint ventures and subsidiaries as being the parent's significant relationships. Staff also think that to assess whether an entity is a joint venture, an entity would need to determine whether there is joint control, which denotes that the concept of control would still need to be considered. As highlighted in paragraph 14, stakeholder feedback indicated the concept of control is complex to determine for NFP entities; therefore, staff do not recommend this approach; and
  - (b) allow entities to consolidate some, but not all, subsidiaries (that is, where a parent entity can identify control of a subsidiary, to allow these subsidiaries to be consolidated and supplemented by financial information of other subsidiaries not consolidated). Staff did not analyse this approach further as the Board rejected (subject to considering stakeholder feedback) this alternative when developing the proposals for its DP on the basis that it does not improve comparability between entities and because of the potential for abuse of the requirements through selective consolidation. Also, the feedback on the DP noted that even those stakeholders supporting optional consolidation would not support partial consolidation

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16 This option captures the Canada ASNFPO definition of economic interest in paragraph 4450.10 which states: *"The reporting organisation has economic interest in another not-for-profit organisation when the other organisation holds resources for the benefit of the reporting organisation. An economic interest also exists when the reporting organisation is responsible for the other organisation's liabilities. The following are possible indicators of economic interest:*

- (a) *The other organisation solicits funds in the name of and with the expression or implied approval of the reporting organisation, and substantially all the funds solicited are intended by the contributor or are otherwise required to be transferred to the reporting organisation or used at its discretion or direction;*
- (b) *The reporting organization transfers significant resources to the other organisation, whose resources are held for the benefit of the reporting organisation;*
- (c) *The other organization is required to perform significant functions on behalf of the reporting organisation that are integral to the reporting organisation's achieving its objectives; or*
- (d) *The reporting organisation guarantees significant liabilities of the other organisation."*



or departure from the concept of control as applied in Tier 1/Tier 2 requirements as this would decrease comparability of financial statements.

### **Summary of further stakeholder outreach**

- 32 Panel members have mixed views, where a few members supported Option 3 not to create a new definition of significant relationships and preferred requiring entities to identify the entities that are subsidiaries using control principles. However, a few members supported Option 2 to use existing principles in AASB 124 to develop a definition of 'significant relationship' because some NFP private sector entities already are required to comply with AASB 124. These members opposed Option 3 due to the complexity of assessing control under AASB 10. No significant support was expressed for Option 1; one panel member noted that in some cases assessment of significant influence may be as complex as applying the control criteria. Option 4 was developed based on an alternative approach suggested by a few panel members.

Table 2 Options for developing definition of the term “significant relationship entity” including stakeholders views and staff analysis

<p><b>Option 1 – ‘significant relationship entity’ being any entity over which a parent entity has significant influence and that is not an associate</b></p>	<p><b>Option 2 – significant relationship based on the definition of related party in AASB 124</b></p>	<p><b>Option 3 – not to develop a definition of significant relationships. Instead, parent entities assess its subsidiaries in accordance with AASB 10 (consistent with Canada ASNFPO)</b></p>	<p><b>Option 4: significant relationships exist when the parent has an economic interest in another entity (definition of economic interest taken from Canada ASNFPO)</b></p>
<p><b>Support for this approach</b></p>			
<p><b>1)</b> This option is based on a criterion that may be considered easier to interpret than the control concept in AASB 10, given stakeholders have not previously indicated difficulties in assessing whether an entity is an associate.</p> <p><b>2)</b> Determining whether an entity is an associate is already an existing requirement that preparers may be familiar with, rather than developing something new.</p> <p><b>3)</b> It mitigates the stakeholder concern that some 'controlled' entities are not, in practice, controlled by the reporting entity and therefore prevents the 'misidentification' of an entity as a subsidiary under current requirements.</p> <p><b>4)</b> Arguably, this option may increase comparability between entities given the assessment of whether an entity has significant influence over another entity may be easier than assessing whether an entity has control (which is based on assessing three criteria).</p> <p><b>5)</b> Determining significant influence may arguably be easier for certain NFP entities than determining whether an entity control exist, e.g. a church may have significant influence over the religious school based on the indicators in paragraph 27(a).</p>	<p><b>1)</b> Similar to Option 1, Option 2 may be considered easier to interpret than control, given stakeholders have not previously indicated difficulties in assessing whether an entity is a related party. Additionally, charities that are currently registered with the ACNC would be familiar with the definition as they are required to comply with AASB 124.</p> <p><b>2)</b> Similar to Option 1, it mitigates stakeholder concerns about the misidentification of an entity as a subsidiary under current requirements.</p> <p><b>3)</b> Similar to Option 1, Option 2 may arguably increase comparability for those entities that have misinterpreted the assessment of control under AASB 10.</p>	<p><b>1)</b> The least amount of Board and staff time would be required because this option avoids needing to develop a new definition.</p> <p><b>2)</b> It does not deviate from the control concept applied by Tier 1/Tier 2 entities by still requiring entities to assess whether they control a subsidiary.</p> <p><b>3)</b> Less preparer costs would be necessary to transition to a higher tier.</p> <p><b>4)</b> Fewer entities would be subject to disclosure requirements compared to Option 1 and Option 2, given assessing whether an entity controls another entity is a 'higher bar' compared with the approach proposed in Option 1 or 2.</p>	<p><b>1)</b> Identifies the narrowest range of entities as having a significant relationship with the reporting entity, and thus the fewest entities would be subject to disclosure requirements.</p> <p><b>2)</b> Similar to Option 1 and Option 2, it mitigates the stakeholder concern about the misidentification of an entity as a subsidiary under current requirements.</p> <p><b>3)</b> Similar to Option 1 and Option 2, arguably, it may increase comparability for entities with concerns about assessing control under AASB 10.</p> <p><b>4)</b> Arguably, this option may address stakeholder concerns identified in ITC 51 noted in paragraph 25 where the parent would be expected to have information on a related entity if the parent guarantees debts or the related entity is financially reliant on the parent entity without assessing variable returns or equity interest.</p>

Option 1 – ‘significant relationship entity’ being any entity over which a parent entity has significant influence and that is not an associate	Option 2 – significant relationship based on the definition of related party in AASB 124	Option 3 – not to develop a definition of significant relationships. Instead, parent entities assess its subsidiaries in accordance with AASB 10 (consistent with Canada ASNFPO)	Option 4: significant relationships exist when the parent has an economic interest in another entity (definition of economic interest taken from Canada ASNFPO)
<b>Arguments against this approach</b>			
<p><b>1)</b> Basing this definition on significant influence, rather than the narrower concept of control in AASB 10, would lead to a wider group of entities being subject to disclosure requirements, potentially leading to an increase in cost. For example, staff consider entities that will be captured under this option would include joint ventures in addition to subsidiaries.</p> <p><b>2)</b> Result in transition costs if preparers transition to Tier 1/Tier 2 requirements.</p> <p><b>3)</b> This option may not be simple because significant influence would still require judgement to be exercised.</p>	<p><b>1)</b> Is similar to Option 1, and its disclosure requirements would apply to the broadest range of entities of any option, since this definition is based on the related party definition (which captures associates, joint ventures and subsidiaries).</p> <p><b>2)</b> Similar to Option 1, Option 2 results in transition cost if preparers transition to Tier 1/Tier 2 requirements</p>	<p><b>1)</b> Stakeholder feedback collected through this project and ITC 51 indicated that it is often difficult for NFP entities to identify controlled entities based on AASB 10 requirements.</p> <p><b>2)</b> This option was presented as a possible approach when the Board was determining its DP proposals at its June 2021 Board meeting in <a href="#">Agenda Paper 3.3</a>, where it was not considered further because it would not address the concern that entities will still need to assess whether they control a subsidiary for disclosure purposes.</p> <p><b>3)</b> Many stakeholders supported the DP proposals not to require identification of subsidiaries under AASB 10; hence, adopting this option may be considered to disregard the feedback received on the DP.</p>	<p><b>1)</b> This option may risk a parent entity not identifying an entity that would otherwise be a subsidiary under AASB 10 even if it exposes the parent entity to the financial risk associated with that entity as a whole.</p> <p><b>2)</b> Similar to Option 1 and 2, Option 3 results in transition costs if preparers transition to Tier 1/Tier 2 requirements.</p> <p><b>3)</b> The Option requires application of judgement regarding identification of related entities and interpretation of definitions of the terms “financial support” and “financial dependency” and may introduce criteria currently not assessed by Tier 3 entities.<sup>17</sup></p>

17 The terms “financial support” and “financial dependency” are not defined in Australian Accounting Standards. If the Board supports Option 4, staff will consider the need to include guidance on these terms when drafting the Tier 3 ED.

## Staff recommendation

- 33 Staff have mixed views. Some staff prefer Option 1 because it:
- (a) provides a simplification in the definition of significant relationships based on an existing known concept with which preparers may already be familiar;
  - (b) does not overly broaden the scope of entities that may be captured (compared with Option 2);
  - (c) concurs with many stakeholder views that supported the development of a definition of significant relationships, rather than aligning with the current requirement to assess control under AASB 10; and
  - (d) is not expected that many Tier 3-sized entities would be a parent entity.

In contrast, some staff consider Option 4 would address most of the stakeholder concerns and provide a proportionate response to the size of Tier 3 entities, by avoiding broadening the range of entities that may be captured as significant relationship entities as defined in Option 1 and subject to proposed disclosures in Matter 2 below. Option 4 would keep with the objective of developing simplified reporting requirements.

- 34 On balance, the staff recommend Option 1, based on the arguments presented in Table 2 and after considering the assessment against the Tier 3 development principles in Appendix B of Agenda Paper 5.1. This is because Option 1 is: (a) likely to use established concepts; (b) should avoid capturing an unnecessarily wide range of entities; and (c) may be less subject to interpretation than Option 4.

**Question 2a: Do Board members support, for the purpose of drafting the Tier 3 ED, defining 'significant relationships' to exist when the parent entity has a significant influence over another entity that is not an associate as described in paragraph 27?**

**If not, what does the Board suggest?**

## Matter 2: The disclosure requirements for the parent entity's significant relationships

- 35 Consistent with the Board's disclosure approach (refer to in Appendix B of Agenda Paper 5.1 at this meeting), the starting point for drafting the disclosure requirements is any other comparable recognition and measurement requirements in other jurisdictions/frameworks. When developing the proposal for the DP, staff presented the accounting approaches of other jurisdictions with respect to controlled entities and consolidated financial statements.
- 36 Both Canada – Part 111 of the *Handbook Accounting Standards for Not-for-Profit Organisations* (Canada ASNFPPO) and Hong Kong – *Small and Medium-sized Entity Financial Reporting Standards* (HK SME-FRF & SME-FRS) allow at least some parent entities to present consolidated or separate financial statements with disclosures. However, only Canada ASNFPPO allows each parent entity an accounting policy choice to present separate financial statements. HK SME-FRF & SME-FRS only allows a parent entity to exclude one or more subsidiaries from consolidation when their exclusion measured on an aggregate basis is not material to the group as a whole or their inclusion would involve expenses and delay out of proportion to the value to members of the company.<sup>18</sup>
- 37 Staff also noted that a similar requirement to disclose information about unconsolidated subsidiaries, joint ventures and associates is required for investment entities under AASB 12 *Disclosure of Interests*

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18 Refer to Agenda Paper [3.3](#) at the June 2021 Board meeting

*in Other Entities*.<sup>19</sup> Staff did not include a comparison with AASB 12 when analysing the proposed Tier 3 disclosures for significant relationships because the disclosures required by Hong Kong and Canada contain broadly similar disclosure requirements to those required by AASB 12. In addition, AASB 1060 (being the starting point for developing Tier 3 disclosures) does not require the equivalent disclosures about investment entities to those required by AASB 12.<sup>20</sup>

- 38 Despite AASB 1060 not requiring the disclosures about investment entities in AASB 12, in the context of Tier 3 NFP entity disclosures about significant relationships, staff observe that an alternative option is applying an approach similar to AASB 12, to include general guidance requiring disclosures of “summarised financial information about the assets, liabilities, profit or loss and cash flows of the subsidiary that enables users to understand the interests that non-controlling interests have in the group’s activities and cash flows. That information might include but is not limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss and total comprehensive income.” However, staff did not recommend this approach because providing just examples and linking to user needs would not be helpful as it would lead to judgement and interpretation, possibly resulting in inconsistent disclosures and unnecessarily increased cost to preparers.
- 39 The staff analysis and reason for including/excluding a disclosure requirement is provided in the third column in Table 3 below and is based on the consideration of whether:
- (a) the disclosure is required by both Canada ASNFPO and HK SME-FRF & SME-FRS (noting the different scope of the disclosures in these jurisdictions compared to the scope of staff recommendation for Tier 3 requirements);
  - (b) an existing disclosure is required by AASB 1060 (noting the limited disclosures in this regard due to the reasons noted in paragraph 37 and footnote 19); or
  - (c) information would be considered useful to users in revealing the extent of the operations of entities with which the parent has significant relationships.

The staff analysis is consistent with the disclosure approach presented in Appendix B in Agenda Paper 5.1 at this meeting, that is, where there is a difference in recognition and measurement with Tier 2 requirements. The Tier 3 disclosures will be based on a comparable recognition and measurement requirements in other jurisdictions/frameworks. This approach is consistent with the principle of developing Tier 3 requirements where consistency with Tier 2 requirements is desirable but might not always be warranted.

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19 AASB 12 requires an investment entity that has applied the exception to consolidation and accounted for its investment in a subsidiary at fair value through profit or loss to disclose that fact. Paragraphs 19B-19E and 21-22 require that, for each unconsolidated subsidiary, joint venture or associate, an investment entity shall disclose: (a) the subsidiary's name, (b) the principal place of business; (c) the proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held. In addition, an investment entity shall disclose the nature and extent of any significant restrictions on the ability of an unconsolidated subsidiary to transfer funds to the investment entity; any current commitments or intentions to provide or assist in obtaining financial or other support, including amount and reasons for providing support, to an unconsolidated subsidiary. Paragraphs B10-B12 include requirements to disclose summarised financial information including dividends paid to non-controlling interests and other information including, but not limited to, information about assets, liabilities, revenue, profit or loss, other comprehensive income and total comprehensive income.

20 As presented in the [staff analysis](#) of comparison in IFRS for SMEs Standard and full IFRS disclosures for ED 295, staff considered not to add disclosure regarding unconsolidated entities on the basis that the measurement of these investments at fair value through profit or loss will provide better information about liquidity and hence alleviate the need for additional disclosures. Staff also noted the IASB's assessment that the investment entity exemption would be expected to have a limited practical impact on the majority of non-publicly accountable entities.

Table 3 - comparison of disclosure requirements between HK SME-FRF & SME-FRS and Canada ASNFPO

#	HK SME-FRF & SME-FRS (Paragraph 19.16)	Canada ASNFPO (Section 4450)	Staff analysis and comments to include/exclude the disclosure requirements
1	(a) the fact that the exemption from consolidation has been used if an entity elects not to present consolidated financial statements	.15 For a controlled not-for-profit organisation, regardless of whether or not it is consolidated, the following should be disclosed:  (a) the policy followed in reporting the controlled organisation...	<b>INCLUDE</b>  Staff think this disclosure should be included in Tier 3 to provide users with the information that the parent entity has elected not to present consolidated financial statements.
2	(b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;	No equivalent disclosure	<b>EXCLUDE</b>  Staff think this disclosure should not be required in Tier 3 given there is no equivalent requirement in Canada ASNFPO and staff recommended definition of significant relationships proposed in Option 1 paragraph 33, which is not based on the concept of control. However, staff recommend a similar disclosure to that required by Canada ASNFPO, to provide a description of the relationships with controlled organisations as required in row 7.
3	(c) the basis for concluding that control does not exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an investee, if applicable;		
4	(d) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of consolidated financial statements		
5	(e) The nature and extent of any restrictions (e.g. resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans	.22 (c) details of any restrictions, by major category, on the resources of the controlled entity	<b>INCLUDE</b>  Staff think this disclosure should be included given both jurisdictions require it. Staff consider the information is useful to users to understand whether there exist any significant restrictions on the ability of entities with significant relationships to transfer funds to the parent entity and any information about external restrictions that preclude the transfer of resources to the parent entity. This disclosure also is currently required by AASB 1060. <sup>21</sup>
6	(f) a list of significant investments in subsidiaries (other than any subsidiaries excluded in accordance with paragraph 19.2(b)), including the name, the principal place of operation and place of incorporation, an indication of the nature of business, the	No equivalent disclosure	<b>EXCLUDE</b>  Staff think the disclosures should not be required in Tier 3 as the requirements are duplicated for entities that have not been consolidated (i.e. an entity's significant relationships) and are considered directly in row 7.

21 Paragraph 104(d) of AASB 1060 requires disclosures in consolidated financial statements about the nature and extent of any significant restrictions (for example resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans.

#	HK SME-FRF & SME-FRS (Paragraph 19.16)	Canada ASNFPO (Section 4450)	Staff analysis and comments to include/exclude the disclosure requirements
	proportion of ownership interest and, if different, proportion of voting power held; and		
7	(g) particulars of each subsidiary that has been excluded from consolidation including:  (i) the name of the subsidiary;	.15 (b) a description of the relationship with the controlled organisation	<b>INCLUDE</b>  Staff think an equivalent disclosure should be required to provide users with information about which entities are considered to have a parent's entity's significant relationship.
8	No equivalent disclosure required for description of the relationships		<b>INCLUDE</b>  Staff think an equivalent disclosure should be required as the disclosure provides users with information about which entity is considered to have a parent entity's significant relationship, and why, (based on the indicators as presented in paragraph 27). This disclosure is also similar to that required by paragraph 104(b) of AASB 1060 for a parent entity preparing consolidated financial statements to disclose the basis for concluding that control exists when the parent does not own, directly through subsidiaries, more than half of the voting power.
9	(ii) the principal place of operation and place of incorporation and	No equivalent disclosure	<b>EXCLUDE</b>  Staff do not think this information is necessary given only HK FRS-SME requires the information and AASB 1060 does not require disclosure of similar information
10	an indication of the nature of business	.15 (c) a clear and concise description of the controlled organisations' purpose	<b>INCLUDE</b>  Staff think an equivalent disclosure should be required to provide users with information to ascertain the nature of the operations of the significant relationship entities and the business risks of those entities. PAP members also consider that descriptive or narrative disclosures are sometimes more useful than financial information.
11	No equivalent disclosure	its intended community of service, its status under income tax legislation and its legal form	<b>EXCLUDE</b>  Staff think this disclosure should not be required as this information is more related to service performance reporting information. As proposed in the DP, and supported by the majority of stakeholders, service performance reporting will be considered in a separate project. <sup>22</sup>
12	the proportion of ownership interest and if different proportion of voting power held;	.15 (d) the nature and extent of any economic interest that the reporting organisation has in the controlled entity	<b>EXCLUDE</b>  Staff think this disclosure should not be required as this disclosure is not required by AASB 1060 for both a parent entity or its subsidiaries.
13	(iii) any amount recognised in the entity's income statement in respect of:	No equivalent disclosure	<b>EXCLUDE</b>  Staff think this disclosure should not be required given it is not required by Canada ASNFPO and it



#	HK SME-FRF & SME-FRS (Paragraph 19.16)	Canada ASNFPO (Section 4450)	Staff analysis and comments to include/exclude the disclosure requirements
14	(a) dividends received or receivable from the excluded subsidiary;		is likely that information, except for impairment losses relating to the investment in the excluded subsidiary, would generally already be captured in related party disclosure requirements (discussed in Issue 4)
15	(b) impairment losses relating to the investment in the excluded subsidiary		
16	(c) other transactions with the excluded subsidiary;		
17	(iv) amounts recognised in the entity's statement of financial position in respect of:		
18	(d) investment in the excluded subsidiary;		
19	(e) any balances due to or from the excluded subsidiary;		
20	(v) whether the excluded subsidiary prepares audited financial statements;		<b>INCLUDE</b> Staff think this disclosure should be required based on feedback from PAP members of possible assurance concerns with including financial information that may be unaudited. Hence, disclosure of whether a significant relationship entity's financial information is sourced from audited financial statements would be useful to users.
21	(vi) summarised financial information in respect of the excluded subsidiary, including the excluded subsidiary's: (a) revenue;	.22 For each controlled NFP organisation or group of similar controlled organisations not consolidated in the reporting entity's financial statements, to disclose: (a) revenues (including gains)	<b>INCLUDE</b> Staff think this disclosure should be included as summarised financial information is required by both HK and Canada. When a parent entity assesses that it has significant relationships with other entities, it would be useful for users to understand the resources of those entities and whether there is any poor financial performance amongst the entities. <sup>23</sup>
22	N/A	(b) expenses (including losses)	As indicated by feedback on Question 17 of the DP (refer to Appendix A), users may be interested in the information at the individual entity's level, especially where there are mixed purposes between the parent entity and its controlled entities. Sufficient disclosure should accompany separate financial statements to ensure

23 AASB Research Report 13 noted that financial statements of, or other financial information about, subsidiaries might be useful (in addition to, or even instead of, consolidated financial statements) because:

- (a) **Poor performance of subsidiaries:** If a subsidiary lost a substantial amount of money in the year as a result of poor sales, financial statements readers may not see that information if the loss is combined with profits of the parent company, and financial ratios based on consolidated numbers might not be representative of each entity's ratios; and
- (b) **Establishment of legal rights:** financial information about subsidiaries provides insights into the amounts that can be legally claimed by banks/creditors in case of default by a particular entity.

Whilst its research and findings relate to private sector for-profit entities, the research report is considered equally relevant to private sector NFP entities that can enter into borrowing arrangements.

#	HK SME-FRF & SME-FRS (Paragraph 19.16)	Canada ASNFPO (Section 4450)	Staff analysis and comments to include/exclude the disclosure requirements
			<p>information about controlled entities is not hidden and that users are provided information about the total exposure of the whole set of operations for which the board of the entity is responsible.</p> <p>Staff also think the disclosure is justifiable. Providing summarised financial information would also allow interested users to derive the consolidated result and financial position of the whole set of operations.</p>
	No equivalent disclosure	cash flows from operating, financing and investing activities reported in the period	<p><b>EXCLUDE</b></p> <p>Staff do not think this disclosure should be required as HK FRF-SME do not have equivalent/similar requirements. In addition, this disclosure would appear to be overly onerous for smaller NFP entities.</p>
24	(b) profit before tax;	No equivalent disclosure	<p><b>EXCLUDE</b></p> <p>Staff do not think this disclosure should be required as users should be able to determine the profit or loss based on the disclosure of income and expense in rows 21 – 22, and staff recommend including total profit or loss after tax in row 26.</p>
25	(c) income tax expenses;		<p><b>EXCLUDE</b></p> <p>Staff do not think this disclosure should be required as many smaller entities and their subsidiaries, associates and joint ventures would be similar NFP entities that would not be subject to tax.</p>
26	(d) profit after tax;		<p><b>INCLUDE</b></p> <p>Staff think this disclosure should be required to ensure no items of income and expenses are omitted from aggregate financial information. In addition, “after tax” would be omitted from this line item, for the reasons noted in row 25.</p>
27	(e) total assets; and	total assets,	<p><b>INCLUDE</b></p>
28	(f) total liabilities;	total liabilities and	<p>Staff think this disclosure should be required because, similar to reasons for including information about an entity's income, staff think it would be useful for users to understand the resources of the entities over which the parent entity has significant relationships and the total exposure of the parent entity to the liabilities of those other entities.</p> <p>For the same reason noted by staff for requiring disclosure of income and expenses, staff think requiring the disclosure of total assets and liabilities is appropriate (i.e. it would allow interested users to derive the consolidated result and financial position of the economic entity).</p>

#	HK SME-FRF & SME-FRS (Paragraph 19.16)	Canada ASNFPO (Section 4450)	Staff analysis and comments to include/exclude the disclosure requirements
29	No equivalent disclosure	net assets	<b>EXCLUDE</b> Staff think this disclosure should not be required, given users should be able to determine the total equity based on proposed required disclosure of total assets less total liabilities.
30	(vii) the basis of preparation of the summarised financial information disclosures in respect of the excluded subsidiary, including:	No equivalent disclosure	<b>EXCLUDE</b> Staff do not think this disclosure should be included because there is no equivalent disclosure required by Canada ASNFPO.
31	(f) the period covered by the information;		
32	(g) the accounting framework adopted in its preparation; and		
33	(h) whether the information has been extracted from audited financial statements and if not, why not.		
34	No equivalent disclosure	.22 (d) significant differences in accounting policies from those followed by the reporting organisation	<b>INCLUDE</b> Staff think this disclosure should be included. While HK FRF-SME do not have an equivalent disclosure, staff consider the information is useful to users to understand whether there are differences in the accounting policies between the parent entity and the other entity, and it may be especially relevant in cases where the parent entity and the other entity have different purposes. Staff note that disclosure of significant accounting policy differences is not a Tier 2 requirement, but staff think the disclosure is justifiable to allow users to assess whether there are significant differences in the accounting policies used to present the summary financial information.

### Staff recommendation

- 40 Staff noted the feedback from PAP members in paragraph 8(c) and the difficulties in obtaining information as noted in feedback from ITC 51 resulting in some members not supporting requiring financial information as part of the disclosure requirements. PAP members also considered there were possible assurance issues if such financial information were sourced from unaudited financial statements. Instead, they considered requiring narrative information about the name, type of entity (i.e. whether ASIC- or ACNC-regulated), relationship with the parent entity and restrictions or commitments to fund (or similar) to be disclosed.
- 41 Staff acknowledge that some assurance implications of requiring disclosure of financial information may also include:

- (a) auditors having difficulties accessing information and audit evidence that may be sourced from a third party, including entities that may not be required to prepare financial statements, or because some entities may be reporting under cash accounting or prepare another type of financial information, for example Annual Information Statements in accordance with ACNC requirements;
- (b) a possible increase in audit cost to provide assurance over the disclosures, including from assessing the:
  - (i) materiality of the financial information about significant relationships; and
  - (ii) completeness and accuracy of, and valuations reported in, the proposed disclosures; and
- (c) if an auditor is unable to provide assurance on the proposed disclosures, the auditor may be required to provide an emphasis of matter or, depending on the materiality and/or the pervasiveness of the financial information about significant relationships, a qualified opinion or disclaimer of opinion.

42 However, there are counterarguments to the PAP members' views because requiring financial information instead of presenting consolidated financial statements:

- (a) aims to provide users with sufficient information about the cash flows, resources and the possible risk of exposure to liabilities of that entity; without such disclosures, the risk of not meeting the needs of users in the absence of consolidated financial statements would be significantly higher (staff noted that some PAP members considered that the financial statements without consolidated subsidiaries should not be referred to as general purpose financial statements);
- (b) may enable the view, for users that are interested in such information, of overall financial position and performance of the reporting entity and entities with which it has significant relationships, similar to the information that consolidated financial statements would provide;
- (c) if supported by required disclosures about whether the financial information is derived from audited financial statements and any significant differences between accounting policies, would enable users to make judgements about the financial information disclosed;
- (d) would include disclosures about an entity's commitments already required under the proposed related party disclosures considered in Issue 4 below; and
- (e) would not be dissimilar to what may currently occur, where a parent entity would be required to source the financial information for consolidation purposes, or account for its associates or joint ventures where some of these entities may not be required to prepare financial statements or the financial information is prepared on a different basis.

Nevertheless, staff suggest that if an entity is unable to obtain the financial information of another entity with which it has a significant relationship, it should disclose that fact, and explain the circumstances underlying that assertion to allow users to make their own informed assessments.

43 On balance, staff recommend that a parent entity preparing separate financial statements instead of consolidated financial statements should be required to disclose the information about its significant relationships identified in Table 3 above. That is, Tier 3 parent entities that elect to prepare separate financial statements should be required to disclose for each entity with which the parent entity has a significant relationship:

- (a) the name of the entity;
- (b) a description of the nature and operations of the entity;
- (c) the relationship with the parent entity;
- (d) whether the significant relationship entity prepares audited or reviewed financial statements;

- (e) total income;
- (f) total expenses;
- (g) profit or loss;
- (h) total assets;
- (i) total liabilities;
- (j) details of any restrictions, by major category, on the resources of the entity (including restrictions on its ability to transfer funds to the parent); and
- (k) significant differences in accounting policies from those followed by the parent entity.

For the purposes of disclosures required in (e) to (k) above, if an entity is unable to obtain the financial information of an entity with which it has a significant relationship, it should disclose that fact and explain the circumstances underlying that assertion.

Staff also recommend allowing further breakdowns or disaggregations of the categories in paragraph 43, for example, a breakdown of total assets and total liabilities into their current and non-current portions. The objective would be to provide a breakdown that gives the most useful information to users of the financial statements.

**Question 2b: Do Board members agree with the staff recommendation in paragraph 43, for the purpose of drafting the Tier 3 ED, to require the parent entity that elects to prepare separate financial statements instead of consolidated financial statements to disclose the information about the parent entity's significant relationships proposed in paragraph 43?**

**If not, what does the Board suggest?**

**Matter 3: measurement of the parent entity's investments in entities representing significant relationships (or subsidiaries if the parent prepares consolidated financial statements) in its separate financial statements**

**Background**

- 44 As detailed in paragraph 5.48 of the DP, the decided to gather feedback on it's preliminary view on the accounting requirements for a parent that presents separate financial statements to measure its investments in subsidiaries in Question 18 of the DP below:

**Question 18**

***Paragraph 5.48 to 5.54 discusses the Board's preliminary view on the accounting requirements for a parent that presents separate financial statements to measure its interest in subsidiaries either:***

- (a) at cost;***
- (b) at fair value through other comprehensive income; or***
- (b) using the equity method of accounting.***

***Do you agree? Why or why not? If you disagree with the Board's view, which of the requirement(s) in (a) – (c) concerns you the most? Please specify and explain why.***

- 45 The DP proposes that the changes in fair value for investments in subsidiaries, associates, or joint ventures to be captured in other comprehensive income. However, the Board will be considering the geography of whether fair value should be captured in profit or loss or other comprehensive income for financial assets held for capital return and income in Agenda Paper 5.3 at this meeting.

### Summary of feedback from DP and further stakeholder outreach

- 46 As presented in Agenda Paper 3.1.1 at the May 2023 Board meeting, most stakeholders (74%), including half of those making written submissions, supported the Board's proposed Tier 3 requirements on the accounting for the parent entity's investments in its subsidiaries to allow an entity to elect an appropriate method supported by disclosures.
- 47 Some stakeholders (12%), including half of those making written submissions, do not support allowing an accounting policy choice and expressed mixed views, including:
- (a) a few stakeholders consider that including an accounting policy choice for the measurement basis being either fair value or the equity method of accounting to measure investments in subsidiaries is not simpler to apply than the Tier 2 requirements<sup>24</sup> and arguably consolidation would be more appropriate;
  - (b) the equity method is not consistent with the consolidation proposal and it will be necessary to disclose information about the nature of the significant relationships, whether control exists, and why consolidation is not considered appropriate. However, if the Board was to allow a parent entity the option to prepare separate financial statements that disclose its significant relationships, as an alternative to preparing consolidated financial statements, measuring investments in subsidiaries that are held as financial investment vehicles at fair value through other comprehensive income may appear appropriate; and
  - (c) one stakeholder considers too many choices are provided, which may affect the consistency of application and simplicity for preparers. They encouraged the Board to investigate the most commonly applied approach to inform it whether to mandate that approach or to permit a choice.
- 48 Findings from RR 19 did not indicate any charities disclosing investments in subsidiaries. However, as stated in paragraph 5.52 of the DP, the Board observed that, especially in the NFP sector, control might be obtained by contract or other relationship, rather than by a shareholding giving voting power in the subsidiary entity. Consequently, the cost or carrying amount of equity-accounted investment in a subsidiary may be nil or a nominal amount and may not appear on the balance sheet.
- 49 Further feedback was sought from the NFP PAP members, who did not disagree with allowing an accounting policy choice to measure investments in subsidiaries/other significant relationship entities at cost or fair value through comprehensive income or by applying the equity method. Those members who commented supported the choice because:
- (a) while members noted most entities would likely elect to apply the cost method, they were not concerned if an accounting policy choice allowed other measurement bases; and
  - (b) one member noted all three measurement bases should provide sufficient information to users of Tier 3 financial statements but asked whether there can be situations in which it may be difficult to derive an amount under any measurement basis. This member questioned whether a narrative description proposed for Matter 2 (see paragraph 43) would be sufficient.

### Staff analysis and recommendation

- 50 If the Board agrees with staff's recommendation in paragraph 34 that a parent entity's significant relationships should be defined to exist when a parent has significant influence over another entity that is not an associate (i.e. significant relationship entities would be any entities ordinarily considered a joint venture or subsidiary under current Australian Accounting Standards), the parent entity will need to measure its investments in its significant relationship entities as outlined in paragraph 51 below.

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24 AASB 127 allows an accounting policy choice for an entity to measure its interest in subsidiaries, joint ventures and associates at either cost, in accordance with IFRS 9 or using the equity method of accounting.

51 Staff noted the Board's proposal to allow an accounting policy choice for a parent entity preparing separate financial statements whether in addition to consolidated financial statements or otherwise, to measure investment in subsidiaries or its other significant relationship entities at:

- (a) cost; or
- (b) fair value through other comprehensive income; or
- (c) by applying the equity method continues to be appropriate;

because, as detailed in paragraphs 5.49 to 5.51 of the DP, the Board considered that:

- (i) cost may be an appropriate proportionate measure because the entity's investments in a subsidiary or its other significant relationship entities will, in many instances, be an avenue for furthering the entity's NFP objectives, rather than as a financial investment vehicle. Feedback on the DP also noted that the election of this measurement basis would likely be the option preferred by preparers;
- (ii) as noted by a stakeholder in paragraph 47(b) above, it may also provide users with relevant information where the entity determines the substance of its investments in its subsidiaries is a financial investment vehicle. The Board will consider the geography for changes at fair value through either profit or loss or other comprehensive income for financial instruments held to generate both an income and capital return for the entity. in Agenda Paper 5.3 at this meeting ; and
- (iii) the equity method allows treating investments in subsidiaries in the same manner as investments in associates, and this measurement basis could provide relevant information to users of the parent entity's financial statements where the parent determines that the substance is more akin to that of an investment in an associate.

52 Other alternative approaches are:

- (a) to limit the accounting policy choice to allow a parent entity to measure its investments in subsidiaries or other significant relationship entities. There are variations the Board could consider on which measurement basis to limit the accounting policy choice such as, at cost or fair value through other comprehensive income, or at fair value or equity method, or only at cost. As explained in Agenda Paper 3.3 presented at the June 2021 Board meeting, limiting accounting policy choices would be consistent with the Board's principles for developing Tier 3 requirements and arguably might provide better clarity and direction to Tier 3 preparers. Staff do not agree with limiting the accounting policy choice to either fair value or applying the equity method because such measurement bases are more costly to apply than cost. Staff expect that investments would generally be in unlisted controlled entities and it would be expected to be difficult to establish a fair value in accordance with AASB 13 *Fair Value Measurement*; and
- (b) as suggested by some PAP members, the Board could require measurement at fair value or by applying the equity method where doing so does not impose undue cost or effort; otherwise, a parent entity could apply the cost basis. However, this approach might increase costs for preparers compared to allowing an unconditional choice of measurement bases. As noted in paragraph 5.144 of the DP, the Board also rejected introducing an "undue cost or effort" criterion because it is likely to be interpreted differently by different entities.

53 Staff recommend the Board confirms its proposal to allow an entity the accounting policy choice to measure its investments in a subsidiary or other significant relationship entity in separate financial statements (whether in addition to the consolidated financial statements or otherwise) at cost or fair value through other comprehensive income or by applying the equity method, for the reasons outlined in paragraphs 5.49 to 5.51 of the DP (and repeated in paragraph 51). Staff also think allowing an accounting policy choice:



- (a) would enable management to elect a measurement basis that best meets their users' needs;
- (b) would be consistent with current Tier 1/Tier 2 requirements; and
- (c) where the parent elects either the equity method or cost with disclosure proposed by staff in paragraph 51, would provide sufficient information to users about the parent's investments in those subsidiaries/other significant relationship entities, addressing concerns the Board noted in paragraph 5.53 of the DP.

**Question 2c: Do Board members agree with the staff recommendation in paragraph 53, for the purpose of drafting the Tier 3 ED, to allow a parent entity that presents separate financial statements to measure its investments in subsidiaries (in addition to a parent presenting consolidated financial statements in accordance with AASB 10) or in its other significant relationship entities either:**

- (a) at cost;
- (b) at fair value, subject to Board's decision in Agenda Paper 5.3 at this meeting, through either profit or loss or other comprehensive income; or
- (c) by applying the equity method of accounting?

**If not, what does the Board suggest?**

**Issue 3: Tier 3 requirements for investment in associates and joint ventures for:**

- (a) a parent that does not consolidate and prepares separate financial statements (associates only);
- (b) an investor that is not a parent (associates and joint ventures); and
- (c) a parent that prepares consolidated financial statements (associates and joint ventures).

#### **Background**

- 54 As detailed in paragraphs 5.129 to 5.132 of the DP, under AASB 128, investments in associates and joint ventures are measured using the equity method of accounting in an investor's financial statements, unless the investor presents separate financial statements as the only set of financial statements.<sup>25</sup>
- 55 When developing the DP, the Board had not heard any stakeholder concerns with present accounting requirements for an entity's investments in its associates and joint ventures. Consequently, the Board considered it may be an appropriate response for the Board to continue to require the equity method in most instances.
- 56 However, the Board observed that it may be inconsistent to develop a requirement for a smaller NFP private sector entity to measure its investments in its associates and joint ventures using the equity method of accounting in instances in which the entity's subsidiaries are not consolidated. Therefore, the Board formed a preliminary view to develop the following requirements for investments in associates and joint ventures:
- (a) If the NFP private sector entity is a parent that presents consolidated financial statements – consistent with Tier 1/Tier 2 requirements, that entity applies the equity method of accounting to its investments in associates and joint ventures.

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25 An entity is exempt from applying the equity method to its investments in an associate or a joint venture if the entity is a parent that is exempt from preparing consolidated financial statements because the entity is controlled by another Australian entity (conditions apply), or the investment in an associate or joint venture is held by, or is held indirectly through, a venture capital organisation, or a mutual fund, unit trust and similar entities.

- (b) If the NFP private sector entity is not a parent – consistent with Tier 1/Tier 2 requirements, that entity applies the equity method of accounting to its investments in associates and joint ventures.
- (c) If the NFP private sector entity is a parent that presents separate financial statements as its only financial statements (i.e. does not consolidate its subsidiaries) –that entity does not apply the equity method of accounting to measure its investments in associates and joint ventures, and instead applies either cost or fair value through other comprehensive income.

57 The Board also proposed that, for an investor that presents separate financial statements, whether:

- (a) in addition to consolidated financial statements; or
- (b) in addition to equity-accounted financial statements; or
- (c) as its only set of financial statements;

to measure its investments in associates and joint ventures at either cost or at fair value through other comprehensive income. Allowing these investments to be measured at fair value through other comprehensive income would be consistent with the Board's proposals for other financial instruments held to generate income and capital returns to also be measured at fair value through other comprehensive income.

58 As such, the following questions were included in the DP to seek feedback on the Board's preliminary proposals as follows:

**Question 32**

**Paragraphs 5.129 to 5.132 discuss the Board's preliminary view to develop a requirement for interests in associates and joint ventures to be measured:**

**For a Tier 3 not-for-profit private sector entity that is:**

- (a) a parent entity that presents consolidated financial statements or it is not a parent entity, the entity applies the equity method of accounting consistent with the requirements in AASB 128 Investments in Associates and Joint Ventures to its interests in associates and joint ventures; and**
- (b) a parent entity that presents separate financial statements as its only financial statements, the entity does not apply the equity method of accounting to measure its interests in associates and joint ventures.**

**The Board has not yet discussed other exemptions and exceptions to applying the equity method as it is only consulting on its general approach to accounting for interests in associates and joint ventures at this stage of its project.**

**Do you agree? Why or why not? If you disagree with the Board's view, do you prefer other alternatives? Please specify and explain why.**

**Question 33**

**Paragraphs 5.133 to 5.134 discuss the Board's preliminary view to allow an accounting policy choice to require an investor that presents separate financial statements, whether in addition to consolidated financial statements or equity-accounted financial statements, to measure its interests in associates and joint ventures either:**

- (a) at cost; or**
- (b) at fair value through other comprehensive income.**

**Do you agree? Why or why not? If you disagree with the Board's view, do you prefer other alternatives? Please specify and explain why.**

## Summary of feedback on the DP

- 59 As presented in Agenda Paper 3.1.1 at the May 2023 Board meeting, most stakeholders (71%) agree with the proposals in the DP and consider entities with investment in associates and joint ventures may be complex, therefore supporting consistency with the existing Tier 1/Tier 2 requirements. A few stakeholders that supported the Board's proposal also provided other suggestions including:
- (a) that a parent should be allowed to measure investments in associates and joint ventures at fair value through profit or loss, rather than through other comprehensive income; and
  - (b) whether a disclosure note (similar to the disclosures that will be proposed for significant relationships) would be adequate for transparency purposes.
- 60 Only a few stakeholders (5%) disagree with the Board's proposals on the accounting for investments in associates and joint ventures, expressing various views including:
- (a) for a parent entity that has elected to prepare separate financial statements only:
    - (i) to allow the equity method for a parent entity in its separate financial statements; and
    - (ii) the proposal to allow a parent entity to assess its significant relationships with subsidiaries, associates or joint ventures appears contradictory as the entity would need to undertake an evaluation of whether it is a parent entity in order to determine the appropriate measurement basis for these investments. In addition, the accounting requirements proposed for investments in associates and joint ventures should be consistent with investments in subsidiaries, that is, to allow an accounting policy choice of measuring at cost or fair value through other comprehensive income or by applying the equity method.
  - (b) for an investor that is not a parent (i.e. has no subsidiaries), the accounting for investment in associates and joint ventures should be at cost or at fair value through other comprehensive income. And if research indicates that investments in associates and joint ventures are uncommon amongst smaller NFP private sector entities, the accounting policy should be limited to only allow measurement at cost; and
  - (c) an investor should be allowed to present separate financial statements only, rather than presenting them in addition to equity-accounted financial statements. It is unclear why an investor would prepare both equity-accounted financial statements and separate financial statements. If an investor that prepares separate financial statements as its only financial statements and has equity-accounted subsidiaries, it would seem reasonable to capture associates and joint ventures similarly (i.e. applying the equity method).
- 61 Findings from RR 19 showed that no charities in the sample of reviewed financial statements held any investments in associates or joint ventures, which is consistent with feedback from PAP members<sup>26</sup> that few smaller NFP private sector entities hold investments in associates and joint ventures.
- 62 Further feedback was sought from the NFP PAP members who did not disagree with allowing an accounting policy choice to measure associates and joint ventures at cost or fair value through other comprehensive income or by applying the equity method because they were not concerned if an accounting policy choice allowed for other measurement bases even though Tier 3 entities are likely to elect measuring associates and joint ventures at cost.

## Staff analysis and recommendation

- 63 Based on the feedback presented in paragraphs 59 –62 above, staff observed feedback from stakeholders that disagree with the Board's preliminary views mainly related to the DP proposals for

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26 Refer to NFP PAP August 2023 meeting minutes presented in Agenda Paper 3.2 at the August 2023 Board meeting.

the accounting for investments in associates and joint ventures required for the following matters discussed in paragraphs 64 – 80 below:

- (a) **Matter 1:** parent entity that does not consolidate and only prepares separate financial statements;
- (b) **Matter 2:** investor entity that does not have any subsidiaries; and
- (c) **Matter 3:** exemptions and exceptions to applying the equity method.

**Matter 1: parent entity that does not consolidate and prepares separate financial statements only**

- 64 When developing its proposals for the DP, the Board had not yet considered a definition of significant relationships and its potential implications for the accounting for investments in associates and joint ventures. If the Board agrees with the staff recommendation in paragraph 34 to define significant relationships to exist when the parent entity has significant influence over another entity that is not an associate, any entities that are joint ventures and subsidiaries would be considered significant relationship entities.
- 65 Staff think the flow-on impact of such a definition of significant relationships on the Board's preliminary views in the DP would be as follows:
- (a) Investment in joint ventures to be accounted for as a significant relationship entity and measured within the parent entity's separate financial statements at cost or fair value, subject to the Board's decision in Agenda Paper 5.3, through either profit or loss or other comprehensive income or by applying the equity method of accounting as per staff recommendation in paragraph 53 above; and
  - (b) Investment in associates would be measured, as per the DP proposals, at cost or fair value through other comprehensive income.
- 66 Staff think the approach above would:
- (a) ensure the accounting for investments in associates and joint ventures complements the proposal to require a parent entity to assess its significant relationships, to address the concern about the contradiction noted by a stakeholder in paragraph 60(c);
  - (b) as noted in paragraph 56 above, not mandating the equity method of accounting to measure investments in associates would be analogical/commensurate to providing an accounting policy choice for consolidation of subsidiaries; and
  - (c) as detailed in paragraphs 5.133 to 5.134 of the DP, not limiting an accounting policy choice to only the cost method and permitting these investments to be measured at fair value would be no different from the measurement requirements proposed for other financial instruments held to generate both income and capital returns for the entity. In addition, feedback from most stakeholders supported allowing the accounting policy choice to measure investments in associates at cost or fair value.
- 67 An alternate approach similar to the proposal for a parent entity's measurement of investments in its subsidiaries/other significant relationship entities within separate financial statements (see paragraph 53), would be to allow a parent entity to measure its investments in associates at cost or fair value through other comprehensive income or by applying the equity method. The advantages of this alternative approach would be similar to the reasons presented to allow an accounting policy choice for measuring investments in subsidiaries in paragraph 50. Staff think this approach to measuring investments in associates would be consistent with Tier 1 and Tier 2 separate financial statements requirements in AASB 127 *Separate Financial Statements*. And, as noted by one stakeholder, if a parent entity elects to measure its investments in subsidiaries/other significant relationship entities by applying the equity method, it would be appropriate to allow the parent entity to measure its associates by applying the equity method.

## Staff recommendation

- 68 Staff recommend a parent entity that prepares separate financial statements as its only financial statements should be allowed the accounting policy option to measure its associates at cost or at fair value through profit or loss or through other comprehensive income (subject to Board's consideration in Agenda Paper 5.3 at this meeting) or by applying the equity method. Staff considered this approach against the assessment with Tier 3 developing principles in Appendix B of Agenda Paper 5.1 for this meeting. While not permitting a parent entity to apply the equity method is supported by most stakeholders, staff think allowing a parent to also apply the equity method of accounting would enable preparers already applying the equity method to continue their current practice.

**Question 3a: Do Board members agree with the staff recommendation in paragraph 68, for the purpose of drafting the Tier 3 ED, to require a parent entity that elects to prepare separate financial statements to measure its investments in associates:**

- (a) at cost;
- (b) at fair value, subject to Board's decision in Agenda Paper 5.3 at this meeting, through either profit or loss or other comprehensive income; or
- (c) by applying the equity method of accounting?

**If not, what does the Board suggest?**

## Matter 2: investor entity with no subsidiaries

- 69 As stated in paragraph 56(b), the accounting for investments in associates and joint ventures for an investor that is not a parent as expressed in the DP would require the equity method of accounting as the Board has not heard any stakeholder concerns with present accounting requirements based on AASB 128.
- 70 Staff noted the Board's proposal in the DP to require an investor that is not a parent (or entities that may not have any significant relationships beyond associates) to account for investments in associates and joint ventures by applying the equity method (i.e. **Option 1**) is appropriate because:
- (a) most stakeholders supported the Board's proposal to require consistency with Tier 1/Tier 2 requirements;
  - (b) requiring an investor with no subsidiaries to measure its investments in associates and joint ventures at cost or at fair value may not provide users with sufficient information about the investor's interest in the net assets and profit or loss of the associates or joint ventures;
  - (c) this reduces the need for judgement because the equity method would be required, rather than providing an accounting policy choice; and
  - (d) this approach is consistent with the New Zealand Tier 3 Standard, which requires Tier 3 entities to refer to Tier 2 PBE Standard IPSAS 36 *Investments in Associates and Joint Ventures*.
- 71 However, Option 1 (requiring application of the equity method) may be considered more difficult to apply compared with cost or fair value because an entity may not have available information about an associate, which may be less than for a joint venture, to prepare equity-accounted financial statements and would need to confirm accounting policies and accounting dates.
- 72 Staff consider an alternative approach is to allow an investor that is not a parent to measure its investments in associates and joint ventures either at cost or fair value or by applying the equity method either in their equity-accounted financial statements and separate financial statements as its only financial statements (i.e. **Option 2**). Staff think this approach would simplify the measurement of investments held by Tier 3 NFP entities because:

- (a) it leverages the information management uses to make decisions about the entity's operations by allowing management to elect a method to measure these investments that meets their users' needs;
- (b) as noted in paragraph 71 above, an entity might not have available information about an associate or joint venture to enable application of the equity method;
- (c) of the argument that equity-accounted financial statements may have limited use in assessing either future cash flows or loan security, whereas fair values are more relevant for those purposes;<sup>27</sup>
- (d) allowing measurement at cost or fair value would be consistent with that proposed for an investor preparing separate financial statements, in view of a stakeholder's concern that an investor might prepare separate financial statements only and not in addition to equity-accounted financial statements. However, as noted in Agenda Paper 3.1.1 at the May 2023 meeting, staff think it may be possible for NFP entities to prepare both consolidated/equity-accounted financial statements and separate financial statements as the ACNC legislation assesses a charity's revenue and reporting financial information at a registered charity level (i.e. separate financial statements) but an entity can elect to prepare consolidated/equity-accounted financial statements when reporting to the ACNC;
- (e) this approach is consistent with the measurement requirements for investments in associates and joint ventures in the IFRS for SMEs; and
- (f) this approach would not require Board and staff time or effort to develop any exceptions or exemptions to the equity method (discussed in Matter 3). Arguably, this approach would be similar to the Board's proposal to allow a parent entity the accounting policy choice to prepare consolidated or separate financial statements and not consolidate its subsidiaries.

73 However, adopting Option 2 may not provide users with information about the investors' net interest in its investments, and most stakeholders supported requiring the equity method to continue to be applied to maintain consistency with Tier 1/Tier 2 requirements, noting that the absence of the equity method may need to be compensated for by disclosures.<sup>28</sup> Staff also do not consider there may be many smaller NFP entities with investments in associates and joint ventures and, therefore, any simplifications might be unwarranted.

#### **Staff recommendation**

74 Staff recommends Option 2, based on the reasons presented in paragraph 72 – 73 and considering the assessment against the Tier 3 development principles in Appendix B of Agenda Paper 5.1 for this meeting. Staff think allowing a choice for Tier 3 NFP entities to use cost or fair value, or apply the equity method, rather than requiring application of the equity method only, would be the simplest approach for those entities. If the Board agrees with the staff recommendation, it would be unnecessary to consider Matter 3 below on whether to develop any exemptions to applying the equity method.

**Question 3b: Do Board members agree with the staff recommendation in paragraph 74, for the purpose of drafting the Tier 3 ED, to allow an accounting policy choice for an investor without subsidiaries to measure its investments in associates and joint ventures within its individual (equity-accounted) financial statements or its separate financial statements as its only financial statements:**

<sup>27</sup> Refer to para. BC115 of IFRS for SMEs Standard Basis for Conclusions 2009

<sup>28</sup> Following the approach to developing disclosure approach in Appendix B of Agenda Paper 5.1 at this meeting, the starting point in developing Tier 3 disclosures would be based on the IFRS for SMEs Standard.

- (a) at cost;
  - (b) at fair value, subject to the Board’s decision in Agenda Paper 5.3, through either profit or loss or other comprehensive income; or
  - (c) by applying the equity method of accounting?
- If not, what does the Board suggest?

75 As noted in paragraph 63, most stakeholders were supportive of the Board's proposal and therefore staff recommend that a parent that elects to prepare consolidated financial statements in accordance with AASB 10 should measure its investments in associates and joint ventures:

- (a) using the equity method of accounting within consolidated financial statements in accordance with AASB 128; and
- (b) at cost or fair value (subject to the Board’s decision in Agenda Paper 5.3 at this meeting on whether changes of fair value are recognised in profit or loss or other comprehensive income) or by applying the equity method of accounting in separate financial statements in accordance with AASB 127.

**Question 3c: Do Board members agree with the staff recommendation in paragraph 75, for the purpose of drafting the Tier 3 ED, to continue to require a parent entity to measure its investments in associates and joint ventures:**

- (a) using the equity method of accounting within consolidated financial statements in accordance with AASB 128; and
- (b) at cost or fair value through other profit or loss or comprehensive income (subject to the Board’s decision in Agenda Paper 5.3) or by applying the equity method of accounting in separate financial statements in accordance with AASB 127?

If not, what does the Board suggest?

76 Staff also recommend that an entity shall apply the same accounting policy for all investments in a single class (subsidiaries/significant relationship entities, associates or jointly controlled entities), but may elect different policies for different classes to ensure consistency of accounting is applied for the same class of investments.

**Question 3d: Do Board members agree with the staff recommendation in paragraph 76, for the purpose of drafting the Tier 3 ED, to apply the same accounting policy for all investments in a single class, but it can elect different policies for different classes.**

If not, what does the Board suggest?

77 Table 4 below presents the staff’s recommendations for measuring investments in associates and joint ventures discussed in Issue 2: Matters 1 and 2.

Table 4: accounting for investment in associates and joint ventures

Type of entity	Measuring investments in associates and joint ventures
Parent entity that has prepared consolidated financial statements	<b>Within consolidated financial statements</b>
	Equity method (i.e. consistent with AASB 128)
	<b>Within separate financial statements</b> (i.e. consistent with AASB 127)

	<p>a) at cost; or</p> <p>b) at fair value (through profit or loss or other comprehensive income); or</p> <p>c) by applying the equity method</p>
<b>Investor with no subsidiaries</b>	<p><b>Within individual equity accounted financial statements or its separate financial statements as its only financial statements</b> (i.e. inconsistent with DP proposal to require the equity method)</p> <p>a) at cost; or</p> <p>b) at fair value (through profit or loss or other comprehensive income); or</p> <p>c) by applying the equity method</p>
<b>Parent entity that does not consolidate (i.e. prepares separate financial statements with disclosures of its significant relationships)</b>	<p style="text-align: center;"><b>Measuring investments in associates</b></p> <p><b>Within separate financial statements</b> (i.e. inconsistent with DP proposal to require measurement at cost or fair value through other comprehensive income)</p> <p>a) at cost; or</p> <p>b) at fair value (through profit or loss or other comprehensive income); or</p> <p>c) by applying the equity method</p>

### Matter 3: Exemptions or exceptions to applying the equity method

- 78 If the Board disagrees with the staff recommendation in paragraph 74 above and prefers Option 1 (that is, to adopt the existing requirements in AASB 128 for Tier 3 NFP entities to apply the equity method of accounting to measure their investments in associates and joint ventures), staff think it would be necessary to also consider whether to adopt the exemption in AASB 128 for investment entities not to prepare equity-accounted financial statements. As detailed in the DP, the Board has not yet discussed the exemptions or exceptions to applying the equity method to measure investments in associates and joint ventures.
- 79 Paragraph 18 of AASB 128 exempts an investor's individual financial statements from applying the equity method to its investments in associates and joint ventures where the investor is a venture capitalist or similar entity. Staff recommend developing a similar requirement within the Tier 3 Standard to exempt investors that are venture capitalists or similar entities from measuring their investments in associates and joint ventures by applying the equity method because:
- (a) stakeholders have not previously raised any concerns about the application of AASB 128;
  - (b) feedback from stakeholders supported consistency with Tier 1/Tier 2 requirements, which staff consider extends to the exemptions from applying the equity method in AASB 128; and
  - (c) allowing the exemption that is available within the Tier 1/Tier 2 requirements ensures Tier 3 entities would not be disadvantaged from any exemptions that would apply to an investor preparing financial statements that comply with Tier 1/Tier 2 requirements.
- 80 Staff also noted AASB 10 currently exempts a parent from preparing consolidated financial statements in specified circumstances (paragraphs 4 – AusCFAus4.2), including if the parent is controlled by another Australian entity (conditions apply), and prohibits particular investment entity parents from preparing consolidated financial statements (paragraph 4B). Staff do not propose the Board includes these exemptions and exceptions in the Tier 3 Standard because the Board has



already proposed, subject to its consideration in Issue 1 above, to allow an entity the accounting policy choice to present either consolidated financial statements or separate financial statements.

**Question 3e: Do Board members agree with the staff recommendation in paragraph 79 to include in the draft Tier 3 ED the exemptions in AASB 128 from applying the equity method? If not, what does the Board suggest?**

#### **Issue 4: Tier 3 requirements for related party disclosures**

##### **Background**

- 81 As stated in paragraph 6.6 of the DP, the Board has not yet formed a view on whether simplifications to AASB 1060 disclosure requirements are needed for the Tier 3 reporting requirements on related party disclosures. The Board sought stakeholders' views on which disclosure requirements in AASB 1060 can be further simplified, if any, for Tier 3 reporting requirements.
- 82 As per Appendix B in Agenda Paper 5.1 for this meeting, the disclosure approach agreed by the Board would require using AASB 1060 as the starting point for drafting disclosure requirements where there are no recognition or measurement differences between the proposed Tier 3 requirements and the Tier 1/Tier 2 requirements. The Board decided to consider further simplifications based on stakeholder feedback and benchmarking with selected overseas jurisdictions.

##### **Current requirements under Australian Accounting Standards**

- 83 AASB 124 *Related Party Disclosures* defines a related party and AASB 1060 provides the Tier 2 disclosure requirements for related parties. A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity) including:
- (a) a person or a close family member related to the entity if that person is a member of the entity's key management personnel (KMP), or has control, joint control or significant influence over the reporting entity; and
  - (b) an entity that is a member of the same group including parents, subsidiaries, fellow subsidiaries, other related entities include:
    - (i) an entity that is an associate and joint venture;
    - (ii) both entities are joint ventures of the third entity;
    - (iii) the entity is a joint venture of another entity and the other entity is an associate of a third entity;
    - (iv) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or a related entity;
    - (v) the entity is controlled or jointly controlled by a person in paragraph 83(a);
    - (vi) the entity, or a member of the same group as the entity, provide KMP services to the reporting entity or to the parent of the reporting entity; and
    - (vii) a person that has control or joint control over the reporting entity and the same person is a KMP of the parent of another entity, then the other entity is related to the reporting entity.

- 84 AASB 1060 requires entities to disclose, for separate categories it specifies, information that includes:<sup>29</sup>
- (a) the relationships between a parent and its subsidiaries irrespective of whether there have been related party transactions;
  - (b) KMP compensation in total or amounts incurred by the entity for the provisions of KMP services that are provided by a separate management entity; and
  - (c) related party transactions, regardless of whether a price is charged, including the nature of the related party relationship as well as information about the transactions (including the amount), outstanding balances and commitments, at a minimum, provisions for uncollectable receivables related to outstanding balances; and expenses recognised in respect of bad and doubtful debts from related parties.<sup>30</sup>
- 85 Intragroup related party transactions and outstanding balances are eliminated in the preparation of consolidated financial statements and therefore not required to be disclosed. However, intragroup related party transactions between an investment entity and its subsidiaries measured at fair value through profit or loss are not eliminated and would be required to be disclosed under AASB 124, including within separate financial statements prepared under AASB 127.
- 86 Staff also note that, whilst not directly applicable to NFP private sector entities, government related entities are exempt from general related party disclosures and AASB 124 contains specific Australian implementation guidance that applies to NFP public sector entities only. As detailed in paragraph IG11 of AASB 124, in the NFP public sector, many entities are likely to engage frequently with persons who are a related party of that entity in the course of delivering the entity's public service objectives, including the raising of funds (for example, rates and taxes) to meet those objectives. These related party transactions often occur on terms and conditions no different from those applying to the general public (for example, the Medicare rebate or public school fees). As such, an NFP public sector entity may determine that information about related party transactions occurring during the course of delivering its public service objectives and that occur on no different terms to those with the general public is not material for disclosure in its general purpose financial statements.

#### **Australian legislative requirements**

- 87 All charities registered with the ACNC are required to report related party transactions within their Annual Information Statements from 2023 onwards. Medium and large charities are also required to comply with AASB 124 when preparing their financial statements. However, the ACNC permits those charities to comply with the related party disclosures specified in AASB 1060.
- 88 The ACNC simplified the definition of 'related party' for small charities that are not required to prepare financial reports under the ACNC legislative framework. The definition of 'related party' for medium and large charities is based on AASB 124. The ACNC also developed guidance to assist charities in complying with the requirements, which broadly aligns with Australian Accounting Standards except that the guidance specifies that donations received by the charity from a related

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29 Paragraph 199 of AASB 1060 specifies making the disclosures it requires for each of the following categories:

- (a) Entities with control, joint control or significant influence over the entity;
- (b) Entities over which the entity has control, joint control or significant influence;
- (c) Key management personnel of the entity or its parent (in the aggregate); and
- (d) Other related parties.

30 Paragraph 201 of AASB 1060 provides examples of related party transactions for which disclosures are required, including: purchases or sales of goods, property or other assets; rendering/receiving services; leases; transfers of research and development; transfer under licence agreements or finance arrangements; provision of guarantees or collateral; settlement of liabilities on behalf of the entity or by the entity on behalf of another party; participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities; and commitments to do something if a particular event does/does not occur, including executory contracts.

party are generally considered not material.<sup>31</sup> In contrast, as specified in paragraph 84 above, under AASB 1060 these transactions may still be required to be disclosed.

- 89 The *Taxation Administration (Private Ancillary Fund) Guidelines 2019* and the *Taxation Administration (Public Ancillary Fund) Guidelines 2019* requires financial statements of ancillary funds to be prepared in accordance with Australian Accounting Standards. The Guidelines also specify that all transactions (other than gifts of money) between a public/private ancillary fund and a founder of the fund, a relative of the founder, a donor to the fund, a relative of the donor, the trustee, a director, officer, agent, member or employee of the trustee, or an associate of any of these entities must be disclosed in the financial report.

#### Summary of approaches taken by selected other jurisdictions

- 90 When considering the topic, staff had regard to the requirements of other jurisdictions applying to smaller NFP entities.<sup>32</sup> The IFRS for SMEs Standard defines related parties similarly to AASB 124 and AASB 1060 contains the same disclosure requirements as those required by the IFRS for SMEs Standard.
- 91 Staff consider pronouncements including Singapore CAS, HK SME-FRF & FRS, Canada ASNFPO and the UK Charity SORP to be broadly consistent with the IFRS for SMEs, which is consistent with the requirements of Australian Accounting Standards detailed in paragraphs 83 – 86, except for the following:
- (a) the Singapore CAS specifies certain related parties are deemed not to be a related party (such as providers of finance and trade unions simply by virtue of their normal dealings with a charity) whereas the IFRS for SMEs specifies these entities may not be related parties. The Singapore CAS also states that unless there is evidence to the contrary, donations received by a charity from a related party without attached conditions that would, or might, require the charity to alter significantly the nature of its existing activities are not required to be disclosed, as these transactions are unlikely to influence the pursuit of the separate independent interests of the charity; and
  - (b) the UK Charities SORP specifies transactions involving a trustee or other related party must always be regarded as material regardless of size. However, similar to the Singapore CAS, it does not require disclosure of transactions involving trustees or other related parties (such as donations to the reporting entity without attached conditions) unless there is evidence to indicate they influenced the charity's activities or use of resources.
- 92 The New Zealand Tier 3 Standard provides more succinct requirements and defines related parties as people or other entities that have significant influence over the entity, including close members of their families. Information about related parties required to be disclosed includes: (i) a description of the related party relationships; (ii) a description of, and amount of revenue or expenses arising from, related party transactions; and (iii) any amounts due from or to related parties at the balance date. Disclosure of a related party transaction that occurred during the financial year is required if:
- (a) the transaction is significant to the entity (individually or in aggregate with similar transactions); or

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31 Refer to [ACNC website](#) for guidance on related party transactions.

32 Staff considered the related party disclosures from the following selected jurisdictions: United Kingdom International Accounting Standards Board – IFRS for SMEs, United Kingdom – FRS 102 *The Financial Reporting Standards applicable in the UK and Republic of Ireland (FRS 102)* and Charities SORP (102) *Accounting and Reporting by Charities: Statement of Recommended Practice (Charities SORP)*, New Zealand Tier 3 Standard, Canada ASNFPO, Singapore – *Charities Accounting Standard*, HK SME-FRF & SME-FRS and United States *Accounting Standards Codification Not-for-Profit Topic 958 (US ASC NFP 958)*.

- (b) the transaction (whether significant or insignificant) occurred on terms and conditions likely to differ from the terms and conditions of transactions in similar circumstances between unrelated parties.

93 US ASC NFP 958 has different disclosure requirements to IFRS for SMEs including, but not limited to, not requiring disclosure of KMP compensation, parent and subsidiary relationships, allowance for doubtful debts or commitments to related parties. There is also no exemption from disclosures of transactions with government entities.

#### **Summary of feedback on DP and other stakeholder outreach**

94 While no specific questions were asked in the DP about related party disclosures, some feedback was provided by stakeholders relevant to related party disclosures, including:

- (a) that the AASB should consider requiring disclosure of non-IFRS information such as fundraising and volunteer services, or extend related party disclosures beyond what is currently required in IFRS considering its usefulness to the users of NFP financial statements;<sup>33</sup>
- (b) the importance of related party disclosures and the need to 'cap' the requirements to Tier 2 requirements;<sup>34</sup>
- (c) disclosures about related parties should be reconsidered for transactions like donations where no benefit is received by the related party; and
- (d) the commercially sensitive nature of transactions with related parties is an issue.<sup>35</sup>

95 Although staff have not yet analysed the feedback on ITC 51, which sought comments also on related party disclosures from the perspective of the NFP public sector, some feedback from stakeholders identifies relevant considerations for NFP private sector reporting, including:

- (a) the volume of transactions, data privacy and capturing the information for new and existing related parties/KMP is a practical issue and causing challenges. Therefore, further consideration is required of the extent to which information should be considered useful to users and disclosed in the financial statements;
- (b) for an indigenous entity, there may be a different interpretation of 'close family members', which can result in difficulties in identifying related parties subject to AASB 124 requirements unless it is culturally insensitive to disclose the information; and
- (c) where donations are received from related parties, there may be a desire for those to be anonymous or not reported back to the specific donor. Some donors would rather cease providing donations than have their donation amount reported. This feedback was consistent with the feedback observed by staff when ACNC's requirements for medium and large charities to present related party disclosures were being introduced.

96 Further feedback was sought from the NFP PAP members who did not disagree with requiring related party disclosures consistent with current Tier 2 requirements and aligning with the ACNC requirements. They supported the exception to requiring disclosure of donations received by an NFP entity from a related party without attached conditions. A member noted that sometimes a director/board member of an NFP entity may employ their immediate family members and/or may have become a member of key management personnel (KMP) since commencing employment and would be subject to disclosure requirements. They consider disclosing whether compensation was paid to those KMP in accordance with the relevant award/salary band may be more useful to users than disclosing the amount of benefits paid to those KMP.

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33 Refer to Question 36 in Agenda Paper 3.1.1 at the May 2023 Board meeting.

34 Refer to Questions 46-49 in Agenda Paper 3.1.1 at the May 2023 Board meeting.

35 Refer to Question 8 in Agenda Paper 3.1.1 at the May 2023 Board meeting.

## Staff analysis and recommendations

- 97 Considering the approach to simplification applied by the Board in Appendix A and the disclosure approach in Appendix B of Agenda Paper 5.1 for this meeting, stakeholder feedback and related party disclosure requirements applied by other jurisdictions, staff recommend that the current disclosure requirements specified in AASB 1060 should apply to Tier 3 NFP entities. For parent entities that elect to prepare separate financial statements rather than consolidated financial statements, intragroup related party transactions between the parent entity and its significant relationship entities would not be eliminated and would be required to be disclosed. Staff consider this approach is appropriate because:
- (a) most jurisdictions require similar related party disclosures to the IFRS for SMEs, from which staff infer that the current requirements are adequate;
  - (b) related party disclosures are important information for users, especially because related parties may enter into transactions that unrelated parties would not;<sup>36</sup>
  - (c) charities reporting to the ACNC, and public and private ancillary funds, are already required to make related party disclosures regardless of size; and medium and large charities are required to comply with AASB 1060 or AASB 124 in their financial statements,<sup>37</sup> and
  - (d) it would align with Tier 2 requirements (where practitioners would be familiar with the existing requirements) and minimise transition costs.
- 98 However, staff also noted the concerns in paragraph 96 about requiring disclosures of donations received from a related party where no benefit is received by the related party may be less useful to users, and the potential commercially sensitive nature of transactions, having regard to the ACNC's and Australian Taxation Office's view that these donations may not be material for disclosure purposes. To address these concerns, staff recommend not to require disclosure of donations received by a NFP entity from a related party without attached conditions, regardless of their monetary amount, unless:
- (a) there is evidence indicating the donations influenced the NFP entity's activities or use of resources. This is because these transactions are unlikely to influence the pursuit of the separate independent interests of the NFP entity. This exemption is similar to that provided by the Singapore CAS and the UK Charities SORP mentioned in paragraph 91(a); or
  - (b) information about those donations would be required to be disclosed under the general requirement to disclose material information i.e. information that is omitted, misstated or obscured could reasonably be expected to influence decisions of the primary users of financial statements.

**Question 4: Do Board members agree with the staff recommendations in paragraphs 97 – 98, for the purpose of drafting the Tier 3 ED, to adopt the same related party disclosure requirements as those in AASB 1060, except that disclosure should not be required of donations received by a NFP entity from a related party without attached conditions unless there is evidence indicating the donations influenced the NFP entity's activities or use of resources?**

**If not, what does the Board suggest?**

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36 Langford, R.T., 2021, *Charitable companies and related party transactions* highlighted the importance of disclosing related party transactions.

37 Langford, R.T., 2021, *op. cit.*, noted that related party transactions arguably should be disclosed, highlighting that in ACNC Compliance Reports 2012 and 2018, one of the most common concerns raised by the public and investigated by the ACNC was charities providing individuals with private benefits.

**Appendix A – Extract from the summary of detailed feedback presented in Agenda Paper 3.1.1 at the May 2023 Board meeting**

**Q17) Consolidated financial statements\***

**Total response = 367**

Yes = 257 (70%) consisting of:

- 40 preparers (11%)
- 104 auditors (28%)
- 1 regulator (0%)
- 2 users (1%)
- 6 others (2%)
- 1 blank (0%)
- 93 virtual sessions (25%)
- 10 written responses (3%) (PP, MA, CPA/CA ANZ, SD, IPA, KPMG, UWA, DH, ACNC, Deloitte)

Not applicable = 71 (19%) consisting of

- 35 preparers (10%)
- 14 auditors (4%)
- 2 users (1%)
- 20 virtual sessions (5%)

Many stakeholders agree and a few of these stakeholders noted:

- the information provided in consolidated financial statements where entities have mixed or discrete purposes may not be useful especially where users may be interested in the information at the individual entity's level. An example of mixed charity group is where a church with a subsidiary being a school or a charity that 'controls' a trust where the trust cannot transfer funds back to the 'parent'. The cost of consolidation significantly outweighs the benefits for smaller organisations (SD);
- consolidation is recognised as challenging within the NFP space such as when there is a common trustee, e.g. endowment or buildings funds;
- for many smaller NFP entities, the application of AASB 10 *Consolidated Financial Statements* is confusing and separate financial statements for each entity would be much more useful and valuable;
- while it may lead to lack of comparability and potential abuse (e.g. arbitrarily undertaking activities and executing transactions in unconsolidated subsidiaries), the number of entities impacted is expected to be minimal given the application to smaller NFPs (PP);
- the accounting policy choice will cater for circumstances when it is more meaningful and useful for users to use consolidated financial statements;
- they would not support partial consolidation or departure from the concept of control as applied in Tier 1/Tier 2 requirements as this would decrease comparability of financial statements and could be subject to abuse (IPA);
- allowing the choice for smaller NFP entities currently preparing SPFS and not presenting consolidated financial statements is important given cost-benefit considerations (Deloitte); and
- the approach is consistent with ACNC legislation, which assesses a charity's revenue and requires charities to report financial information at the registered charity level, even if there are subsidiaries. It is also important to retain the option to prepare consolidated financial statements, especially if the charity is already preparing them (ACNC).

One stakeholder noted that the AASB proposals to exempt the parent entity from presenting consolidated financial statements and provide information about its significant relationships are contradictory since an entity must evaluate whether it has investments in a subsidiary, associate or joint venture. They also consider that a parent entity will need to assess whether the investment is a subsidiary, associate or joint venture and their nature to determine whether it is required to measure the investment at fair value or cost (DH).

	<p><u>Other comments</u></p> <ul style="list-style-type: none"> <li>• Sufficient disclosures should accompany separate financial statements to ensure information about controlled entities is not hidden and that users are provided information on the total exposure of the whole entity and what the entity's board is responsible for. The disclosures should not be too onerous for preparers (Deloitte).</li> <li>• Significant relationships will need to be clearly defined (KPMG).</li> <li>• The interactions of significant relationship disclosures with related party disclosures will need to be clarified.</li> <li>• The feedback from AASB 10 PIR will need to be considered and the NZASB guidance on identifying significant relationships for financial reporting purpose (XRB EG A9) may be of assistance (CPA/CA ANZ).</li> <li>• Consider further simplification of consolidation requirements or guidance within Tier 3 standard for NFP entities that choose to prepare consolidated financial statements (MA, CPA/CA ANZ, UWA).</li> <li>• Guidance and examples will be needed to support those charged with governance in making decisions around accounting policy to present consolidated financial statements or separate financial statements (UWA).</li> <li>• Preparation basis needs to be clear and upfront to enable users to identify the type of financial statements prepared (DH).</li> </ul>
<p>No = 39 (11%) consisting of:</p> <ul style="list-style-type: none"> <li>• 4 preparers (1%)</li> <li>• 21 auditors (6%)</li> <li>• 4 users (1%)</li> <li>• 1 other (0%)</li> <li>• 8 virtual sessions (2%)</li> <li>• 1 written response (0%) (BDO)</li> </ul>	<p>Some stakeholders that disagree noted that the accounting policy choice can reduce comparability of the financial statements, and there should be no choice in consolidation. Of those that disagree:</p> <ul style="list-style-type: none"> <li>• Users think: <ul style="list-style-type: none"> <li>○ that consolidated financial statements are important in providing transparency about the resources available to the entity as well as the financial risk associated with the entity as a whole;</li> <li>○ some organisations have separate entities which perform specific functions for their organisation (e.g. a separate entity may be formed to pay administration costs or run the social enterprise part arm of the business). If consolidation was not required, it is difficult for users to assess the true size and financial KPIs of the organisation; and</li> <li>○ a material parameter could be provided to mandate consolidation (e.g. an entity should prepare consolidated financial statements if revenue, expenses or assets are greater than 10% of the aggregate of the business).</li> </ul> </li> <li>• Auditors think: <ul style="list-style-type: none"> <li>○ consolidation is important if an entity is a common trustee of endowment or building funds and the entity should prepare consolidated financial statements;</li> <li>○ those charged with governance need to see what entities they control. As such, allowing an accounting policy choice would be seen to carry on special purpose reporting and detracts from the overall purpose of the reporting framework;</li> <li>○ allowing parent entities a choice to prepare separate financial statements with some disclosures will undermine the usefulness and comparability between similar NFP groups, as well as create a lack of transparency for funding providers.</li> </ul> </li> </ul>

- That is, this may cause a funder potentially providing excess funding to individual entities in a group because they are unable to see the complete picture as to how much funding the group receives from all sources on a consolidated basis;
- this choice could lead to abuse by, for example, an NFP parent restructuring to transfer assets and liabilities into a subsidiary to achieve reporting outcomes otherwise unachievable under a general purpose financial reporting framework;
  - additional disclosure about the parent entity's significant relationships assumes that the parent entity has already gone through a process of identifying subsidiaries. Identifying subsidiaries is not a problem that is unique to small NFP entities. If the entity is unable to identify subsidiaries, any additional disclosures would be ineffective; and
  - if the main problem is identifying subsidiaries (rather than the mechanics of consolidation), then an alternative approach should be establishing simpler principles to enable smaller NFP private sector entities to identify subsidiaries more easily. That way, consolidation would not be such a major burden for these entities, while at the same time encouraging consistent and comparable disclosures (BDO).
- Some preparers and an auditor think all NFP should be required to prepare separate financial statements and the statement be made available for public scrutiny.

**Staff analysis:** While many stakeholders support the proposals for the accounting requirements for consolidation, some stakeholders do not support allowing an accounting policy choice to prepare consolidated financial statements even if supplemented by disclosures. In addition, staff noted that the majority of users that completed the survey did not support the proposals and considered the presentation of consolidated financial statements is necessary to provide transparency to users of the resources controlled by the economic entity.

Staff also noted the feedback concerning possible inconsistencies of the AASB proposals for consolidating and evaluating whether an entity has a significant relationship with a subsidiary may contradict the requirement for an entity to determine whether the entity has interest in subsidiaries, associates and joint ventures (JV). However, the Board provided the accounting policy options for measuring interests in subsidiaries (and associations and JVs) to ensure the appropriate accounting requirement caters for the Board decision to allow Tier 3 entities to present consolidated or separate financial statements with significant relationship disclosures only.

Additionally, based on RR19, around 1% (or 3 of 260) of the sample charities submitted consolidated financial statements.<sup>38</sup> This can indicate that, while feedback generally supports the simplification proposed to be introduced for Tier 3 entities, it may not be common for Tier-3-sized NFP entities to be a parent entity based on the findings from the research. This is also supported by stakeholder feedback that the impact of allowing an accounting policy choice for consolidation would be minimal.

Given the findings from RR19 and the feedback, staff will further analyse whether an accounting choice to present consolidated financial statements is needed. On one hand, given that many stakeholders supported the simplification of consolidation, staff think the Tier 3 requirements should therefore allow an accounting policy choice of presenting consolidated financial statements. On the other hand, it may not be common for NFP private sector entities of the size the Board had in mind when developing the Tier 3 requirements to be a parent entity. Therefore, it is questionable whether such a simplification is needed and justifiable in light of the comments from the stakeholders who disagreed with the preliminary view.

<sup>38</sup> Based on RR19, charities are required to self-declare whether they submitted a consolidated financial statements in the ACNC Annual Information Statements. The research found that while 18 of the sample of 260 charities self-declared they submitted consolidated financial statements, only three charities had in fact submitted consolidated financial statements.



Staff will conduct further analysis and bring recommendations at a future meeting on:

- a) whether to allow an accounting policy choice for presenting consolidated financial statements or to consider consolidation as an omitted topic;
- b) subject to the Board decision to allow an accounting policy choice to present consolidated financial statements, the requirements for disclosing information on the parent entity's significant relationships if a Tier 3 entity presents only separate financial statements; and
- c) subject to Board decision not to allow an accounting policy choice to consolidation, whether any further simplification could be developed instead.

**Staff suggested action for next steps :** Staff will bring **further analysis** on the consolidation per a), b) and c) above for the Board to consider at a future meeting.

**Q18) Separate financial statements of the parent**  
**Total response = 204**

<p>Yes = 150 (74%) consisting of:</p> <ul style="list-style-type: none"> <li>• 33 preparers (16%)</li> <li>• 101 auditors (50%)</li> <li>• 4 users (3%)</li> <li>• 1 regulator (0%)</li> <li>• 6 others (2%)</li> <li>• 5 written responses (2%) (PP, UWA, BDO, ACNC, Deloitte)</li> </ul> <p>Not applicable = 30 (15%) consisting of:</p> <ul style="list-style-type: none"> <li>• 22 preparers (11%)</li> <li>• 6 auditors (3%)</li> <li>• 1 user (0%)</li> <li>• 1 other (0%)</li> </ul>	<p>Most stakeholders agree with the proposals. One stakeholder that provided comments through online survey agree with the election of an appropriate method supported by disclosures. Another stakeholder noted that the election of the cost method would likely to be the preferred option by the preparers (PP).</p>
<p>No = 24 (12%) consisting of:</p> <ul style="list-style-type: none"> <li>• 5 preparers (2%)</li> <li>• 14 auditors (7%)</li> <li>• 5 written responses (2%) (IPA, MA, SD, CPA/CA ANZ, DH)</li> </ul>	<p>Some stakeholders that completed the online survey and the significant proportion of those that provided written submissions disagree and provided the following comments:</p> <ul style="list-style-type: none"> <li>• if an NFP entity have subsidiaries, it would appear to be a more complex entity and be required to comply with the current requirements,</li> </ul>

- too many choices are provided which may affect the consistency of application and simplicity for preparers. The Board should research the commonly applied approaches by smaller NFP entities and analyse the cost and benefits of each approach. The research would inform the decision of whether to mandate an approach or to permit choice (IPA);
- the value of requiring parent entity to measure their investments in subsidiaries at fair value or using the equity method in place of consolidation is not clear. While supportive not requiring consolidation, however, the introduction of fair value or using the equity method of accounting to measure subsidiaries is not simpler to apply (and arguably consolidation would be more appropriate) and may introduced other complexities (MA, SD);
- the equity method of accounting is not consistent with consolidation proposals and the information about the nature of the significant relationships, whether a control exist and why consolidation is not considered appropriate will be necessary. While not supportive of the option to measure the interest at FVTOCI, if the Board decides to proceed with the consolidation accounting policy choice, and evidence of significant relationships is required, then allowing an accounting policy choice to measure investments in subsidiaries that are held as financial investment vehicles at FVOCI may appear appropriate (CPA/CA ANZ); and
- while accounting policy choice may be appropriate it contradicts the proposal to exempt entities from evaluating whether an entity for which it has significant relationship is a subsidiary, associate or joint venture. For an entity to be eligible to use cost, or use equity method, it must evaluate whether the investment is a subsidiary.

**Staff analysis:** Staff noted that most stakeholders agree with the proposals. When first discussed with the Board,<sup>39</sup> staff had not identified at the time that accounting requirements for this topic are an area of significant interest beyond terminology and language. As such, the Board's preliminary views closely aligned with the Tier 1/Tier 2 requirement other than require fair value gains/losses through other comprehensive income to align with the Board's preliminary proposal for the subsequent measurement of financial assets held to generate both income and capital return.

In response to the feedback from stakeholders above, the equity method would appear inappropriate if a Tier 3 entity have elected not to prepare consolidated financial statements due to the complexities in determining control. Staff noted that the Board considered its preliminary view on the separate financial statements of a parent regardless of the parent choosing to consolidate or not and decided to develop additional disclosure requirements to provide additional information in the absence of consolidated financial statements. The Board also noted that the equity method would allow treating the investments in subsidiaries in the same manner as the investments in associates.

In response to the feedback on the number of accounting policies to choose from hindering comparability and simplicity of the requirements, staff noted the Board had made several decisions to continue to allow accounting policy choice. Staff noted the Board for example:

- continued to allow property, plant and equipment to be measured at cost or at fair value even though cost would likely be the simplest and likely measurement method elected;

<sup>39</sup> See [minutes](#) of August 2022 Board meeting

- decided on several topics to allow accounting policy choices (e.g. consolidation, initial measurement of non-financial assets measured at significantly less than fair value) which the Board had considered within the principles of developing Tier 3 requirements.

Staff had also previously considered possible Tier 3 simplifications for separate financial statements to limit available accounting policy options. That is, to require investments in subsidiaries to be recognised at cost less impairment, unless investment entity or venture capitalist exceptions apply.<sup>40</sup> However, the Board noted that its decision to permit an entity the choice of whether or not to prepare consolidated financial statements would mean that such interest would generally be recognised at FVTOCI in the entity's separate financial statements. This may impose greater costs on the entity than the accounting permitted by AASB 127 *Separate Financial Statements*. As such, the Board decided to allow the accounting policy choice to measure interests in subsidiaries consistent with current Tier 2 requirements.<sup>41</sup>

On the other hand, limiting the accounting policies to a single option is not inconsistent with the Board's principles for developing Tier 3 reporting requirements. As confirmed by feedback, it is reasonably expected that cost would be the most common accounting policy adopted. It would address the need for a consistent approach and could further reduce preparer cost by limiting accounting judgement. Further, as noted in the discussion of Q17) above, the findings in RR19 indicated that it is not common for smaller NFP private sector entities to be a parent entity. This would suggest that limiting the Tier 3 requirements to a single accounting policy is not expected to impact entities applying other measurement methods significantly.

Staff will need to conduct further analysis, including the most common method used by smaller NFP entities under current requirements and possible options to address the feedback. The analysis would include whether the Tier 3 Standard should require a parent entity preparing separate financial statement to measure its investment in subsidiaries at cost less impairment, except for an investment entity or venture capitalist or similar entity,<sup>42</sup> to limit the accounting policy choices available and address the stakeholders' concerns regarding the complexity such choice may represent.

**Staff suggested action for next steps:** Staff will bring **further analysis** of the possible options for requirements of measuring investments in subsidiaries in separate financial statements for the Board to consider at a future Board meeting

### Q32–33) Investment in associates and joint ventures

**Total response = 192**

Yes = 137 (71%) consisting of:

- 25 preparers (13%)
- 98 auditors (51%)
- 4 users (2%)
- 4 others (2%)
- 1 regulator (1%)

Most stakeholders agree with the proposals in the DP. A few of these stakeholders commented:

- entities with investment in associates and joint ventures (JVs) may be considered complex, and therefore it should be considered whether the existing requirements in higher tiers are more appropriate to apply to maintain consistency with other entities;
- it would be highly unlikely for smaller NFP entities to have investments in associates and joint ventures;
- investors should be required to measure investments in associates and joint ventures at FVTPL, rather than FVTOCI (SD);

<sup>40</sup> See [Agenda Paper 3.3](#) at the June 2022 Board meeting

<sup>41</sup> Refer to [Agenda Paper 3.2.2](#) at the August 2022 Board meeting

<sup>42</sup> Paragraph 11 of AAB 127 specifies if an entity or parent elects to measure its investments in associates or joint ventures a fair value through profit or loss, then it shall also account for its investment in a subsidiary the same way in its separate financial statements.

<ul style="list-style-type: none"> <li>• 5 written responses (3%) (PP, SD, IPA, UWA, ACNC)</li> </ul> <p>Not applicable = 47 (24%) consisting of</p> <ul style="list-style-type: none"> <li>• 34 preparers (18%)</li> <li>• 12 auditors (6%)</li> <li>• 1 other (1%)</li> </ul>	<ul style="list-style-type: none"> <li>• definition of parent and subsidiary in the context of NFP sector needs clarification to ensure the application of the requirements is appropriate (UWA); and</li> <li>• on the need for further engagement with sector practitioners on the most cost-efficient way of measuring NFP interest in associates and JVs, either cost or equity method and consideration whether a disclosure note [similar to disclosure of significant relationships] would be adequate for transparency purpose (ACNC).</li> </ul>
<p>No = 8 (5%) consisting of:</p> <ul style="list-style-type: none"> <li>• 5 auditors (3%)</li> <li>• 3 written responses (2%) (MA, CPA/CA ANZ, DH)</li> </ul>	<p>Only a few stakeholders disagree and consider:</p> <ul style="list-style-type: none"> <li>• interests in associates and joint ventures should be measured at cost rather than allowing for accounting policy choice;</li> <li>• a parent entity preparing separate financial statements should measure interest in associates and joint ventures using the equity method;</li> <li>• it is unclear why an investor would be preparing both equity-accounted and other separate financial statements. This stakeholder also disagrees with prohibiting an investor from using the equity method of accounting if the investor only presents separate financial statements when the DP proposes a parent entity with subsidiaries to equity account its investment in subsidiaries. If the investor also has equity-accounted subsidiaries in those separate financial statements, it would seem reasonable that it should still be able to capture associates and joint ventures similarly. Otherwise, it would be appropriate to require for both an investor or parent entity with investment in subsidiaries that does not prepare consolidated or equity-accounted financial statements to measure its investment in associates and joint ventures at cost or at fair value (MA);</li> <li>• while a parent preparing consolidated financial statements should measure investment in associates and joint ventures using the equity method, if the entity is not a parent entity, such investments should be accounted either at cost or FVTOCI. Further research should be conducted to identify whether NFP entities invest commonly in associates and joint ventures and if these transactions are not common, then accounting policy choice should be limited to only cost as measurement basis. (CPA/CA ANZ); and</li> <li>• the proposal to exempt entities from evaluating whether an entity has significant relationship with a subsidiary, associate or JV is contradictory as the entity will need to have undertaken an evaluation of whether it is a parent. The accounting requirements for investment in associates and joint ventures should be consistent with accounting for investment in a subsidiary, i.e. allowing choice of cost, equity method or FVOCI (DH).</li> </ul>
<p><b>Staff analysis:</b> Staff note that most stakeholders agree with the Board’s preliminary views in the DP and the Board considered several points raised by stakeholders when arriving at its preliminary views. In particular, staff noted the feedback from non-supportive stakeholders and staff preliminary analysis, including:</p>	

- limiting measurement investments in associates and JVs at cost – as the Board did not hear any stakeholder concerns with present accounting requirements for an entity's interests in its associates and JV, the Board considered it may be an appropriate proportionate response for the Board to continue to require the equity method in most instances;
- a parent entity preparing separate financial statements should apply the equity method only rather than allowing for choice of cost or fair value – the Board observed that it may be inconsistent to develop a requirement for a smaller NFP private sector entity to measure its interests in its associates and JV using the equity method of accounting in instances where the entity's subsidiaries are not consolidated. Therefore, the Board decided not to allow the equity method of accounting for parent entities that do not prepare consolidated financial statements. Staff observed that allowing fair value would also be consistent with the Board's preliminary proposals for financial instruments for these interests to be measured at fair value, and no different from other financial instruments which are held to generate both an income and capital return for the entity. Staff will consider further whether the choice of consolidation and related assessment of controlling interest and significant relationships has implications for the ability of the entity distinguish between requirements to be applied when measuring subsidiaries, associates and JVs in the separate financial statements.
- the proposal to exempt entities from evaluating whether an entity for which it has significant relationship is a subsidiary from associates or joint venture are contradictory given the need to have undertaken an evaluation of whether it is a parent or not – the Board's consolidation requirements to allow a parent entity to present separate financial statements with disclosures of significant relationships means an entity would still be required to assess its significant relationships however removes the need to distinguish between controlling and, for example, other significant interest. Following the preliminary views on consolidation, the accounting requirements in the DP on measurement of an entity's investment in associates and JVs cater for both entities that prepare consolidated financial statements or those that prepare only separate financial statement even though an entity may be a parent entity.
- while staff noted the feedback that it may not be clear whether it is common for an investor being a small NFP entity would prepare separate financial statements when consolidated financial statements or equity accounted financial statements have already been prepared, it is quite possible for various reasons. For example, staff note that the ACNC legislation assesses a charity's revenue and reporting financial information at the registered charity level, however, the entity can elect to prepare consolidated financial statements when reporting to the ACNC. As such, there may be circumstances an entity may prepare both consolidated/equity-accounted financial statements and separate financial statements.

Staff also noted the following suggestions from those supporting the Board's proposals:

- a need for clear guidance on the definition of a parent and subsidiary – the Board's preliminary view on control is to apply consistent requirements as per Tier 2 except for simplification in language and the broader feedback from the sector on the application of AASB 10 will be considered as part of the Board's post-implementation review of that standard; and
- considerations whether disclosures, similar to that proposed for parent entity's significant relationships, could be an alternative approach to account for associates and JVs – this approach could be appropriate for parent entity or investor that may have difficulties in assessing whether they have investments in subsidiaries, associates and JVs due to complexities for these smaller entities in apply AASB 10 in assessing control of these entities. Staff preliminary view is that significant relationships would be broader than subsidiaries.

Staff also noted that some stakeholders have indicated that accounting for investment in associates and joint ventures would not be relevant to their entity or decision making. This is consistent with the findings from RR19 which did not identify any medium-sized charities from the sample with investments in associates and joint ventures.

Given the findings from RR19 and the feedback on the DP preliminary views, staff plans to further analyse whether to include the accounting for investment in associates and joint ventures within the Tier 3 Standard. On one hand, as many stakeholders supported the simplification on consolidation, staff think the Tier 3 requirements should therefore include a consistently simplified accounting for investment in associates and joint ventures. On the other hand, as it may not be common for smaller NFP entities to have investments in associates and joint ventures, consideration should be given whether such simplification is justifiable. Staff also think that the decision on the accounting requirement for investment in associates and joint ventures hinges on the Board's decision on consolidation as discussed above.

Staff think there's merit in conducting further analysis and develop recommendations for the Board to consider at a future meeting on whether:

- a) to consider investment in associates and JVs as a topic to be scoped out from Tier 3 Standard based on the RR19 findings that it may not be common for smaller NFP entities to have investments in associates and JVs, in conjunction with the Board's decision on consolidation discussed in Q17) or
- b) subject to the Board's decision to allow an accounting policy choice to present consolidated financial statements; a similar accounting choice to apply for the accounting of investment in associates and JVs irrespective of the accounting policy choice on consolidation of subsidiaries; and
- c) to revisit the preliminary views in the DP and to either limit or extend the accounting policy choice on the measurement of associates and JVs including:
  - apply equity method of accounting to measure investment in associates and joint venture for a parent or investor with investment in subsidiaries preparing consolidated or equity-accounted financial statements; and
  - for a parent or investor with investment in subsidiaries presenting only separate financial statement (i.e. parent entity does not consolidate its subsidiaries or an investor does not equity-account its investment in subsidiaries) to measure its investment in associates and joint ventures either:
    - at the cost method of accounting; or
    - allow an accounting policy choice at cost or at fair value through OCI or equity method or combination thereof; or
    - clarify or explicitly require disclosure of information of its investment in associates and joint ventures within the disclosure of information of significant relationships.

Staff will bring further analysis for the Board to consider before drafting of the topic as part of the ED.

**Staff suggested action for next steps:** Staff will bring **further analysis** and possible options how to proceed for the Board to consider at a future Board meeting