Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Private Sector Financial Reporting Framework**	**Meeting:**	M196
Topic:	**Tier 3 – Application of the drafting approach to selected topics**	**Agenda Item:**	10.2
		Date:	6 June 2023
Contact(s):	Jim Paul jpaul@aasb.gov.au Maggie Man mman@aasb.gov.au Fridrich Housa fhousa@aasb.gov.au	**Project Priority:** **Decision-Making:** **Project Status:**	High Low Drafting Exposure Draft

The objective of this paper

1 The objective of this paper is for the Board to **consider** the application of the approach to drafting the Tier 3 Exposure Draft on selected Tier 3 topics of Property, Plant and Equipment; Fair Value Measurement and Borrowing Costs.

2 No decisions are required from the Board, as staff seek preliminary feedback only from Board members on:

(a) how staff have applied to three selected topics the approach the Board decided at its May 2023 meeting to use for drafting Tier 3 proposed requirements; and

(b) the factors staff are considering in drafting simplified requirements for Tier 3 not-for-profit (NFP) entities.

Background and reasons for bringing this paper to the Board

3 The Board decided at its May 2023 meeting to proceed with the development of an Exposure Draft on a Tier 3 Accounting Standard with simplified recognition, measurement and disclosure requirements for smaller NFP private sector entities.

4 The Board also decided the approach to drafting the Tier 3 Exposure Draft, as presented in Appendix B in Agenda Paper 10.1 for this meeting, noting that it would consider, at a future meeting, illustrations drafted by staff of how the approach may be applied to selected Tier 3 topics. The Board decided to apply the approach to the extent it is consistent with the project objective to develop simplified and proportionate requirements for smaller NFP private sector entities and in line with the principles the Board applies in this regard.

5 Staff currently plans to employ the approach to drafting of the Tier 3 Exposure Draft, incorporating any feedback from the Board at this meeting, to other Tier 3 topics for consideration by the Board at future meetings.

6 Whilst the selected topics received strong support from stakeholders for the Board's proposals and did not attract significant disagreement,[1] staff are in the process of analysing the stakeholder feedback received on the selected topics that might be the subject of further Board consideration. Therefore, the staff suggestions reflected in the drafting of the three selected topics are subject to the Board's future deliberations regarding the feedback on the Board's Tier 3 Discussion Paper (DP).

7 The primary objective of this paper is to provide Board members with an early indication of the possible breadth and structure of the draft Tier 3 ED requirements for individual topics and seek preliminary feedback from Board members on those aspects.

Structure of the paper

8 This paper is structured as follows:

(a) Considerations in drafting the illustrative examples of selected topics; and questions for Board members (para. 11 – 23)

(b) Tier 3 Property, Plant and Equipment: Application of drafting approach to AASB Tier 3 ED (para. 24 – 25):

(i) Comparison of the scope of Tier 3 requirements

(ii) Draft section for AASB Tier 3 ED

(c) Tier 3 Fair Value Measurement: Application of drafting approach to AASB Tier 3 ED (para. 26 – 27):

(i) Comparison of the scope of Tier 3 requirements

(ii) Draft section for AASB Tier 3 ED

(d) Tier 3 Borrowing Costs: Application of drafting approach to AASB Tier 3 ED (para. 28 – 29):

(i) Comparison of the scope of Tier 3 requirements

(ii) Draft section for AASB Tier 3 ED

9 **Agenda Paper 10.2.1: Tier 3 – staff analysis and application of the drafting approach to selected topics** shows application of the drafting approach for Property, Plant and Equipment; Fair Value Measurement and Borrowing Costs.

10 For each selected topic, this paper presents a table that compares the scope of the International Financial Reporting Standard for Small and Medium-Sized Entities Exposure Draft (IFRS for SMEs) ,[2] the New Zealand Tier 3 Standard[3] and the staff's suggested coverage (initial draft only) for the corresponding section of the Board's Tier 3 ED. Explanations of differences between the scope of staff's suggested coverage and that of the above-mentioned source documents are provided in the 'comments' column in Agenda Paper 10.2.1.

Considerations in drafting the illustrative examples of selected topics, and questions for Board members

11 The Board's proposals for Property, Plant and Equipment; and Fair Value Measurement in its Tier 3 DP, and the IASB's proposals for an amended IFRS for SMEs Standard, conform to Tier 2. This Tier 3 proposal is stated in paragraphs 5.116 – 5.117 (in relation to fair value

1 The selected topics were classified as Category A in Agenda Paper 3.1 for the May 2023 Meeting, for which staff recommended drafting based on the proposed Tier 3 accounting requirements with minor issues to be resolved through discussion with the Board.

2 Exposure Draft of the Third Edition of the IFRS for SMEs Accounting Standard, September 2022

3 *Tier 3 (NFP) Standard, Reporting Requirements for Tier 3 Not-for-Profit Entities*, issued May 2023

measurement) and 5.136 (in relation to property, plant and equipment) of the Board's Tier 3 DP. During the process of developing AASB 1060, the following comparison was prepared between the recognition and measurement requirements in full IFRS and the IFRS for SMEs: https://www.aasb.gov.au/admin/file/content142/c2/ACCED295_08-19_Staff_Analysis_SME_RM.pdf

12 Therefore, consistent with the Board's approach to Tier 3 requirements, the IFRS for SMEs ED was used as the starting point for drafting Tier 3 wording, but exploring further simplification based on the New Zealand Tier 3 Standard. In addition, the text of the IFRS for SMEs ED, where used as a starting point, was modified where necessary for NFP entity specific issues, having regard to 'Aus' paragraphs in Australian Accounting Standards and other Australian-specific guidance and modifications (and in future will have regard to corresponding text developed by the International Non-Profit Accounting Guidance (INPAG)).

13 In relation to draft wording for Borrowing Costs, the Board's proposal (to expense all borrowing costs immediately) differs from the Tier 2 requirement. This Tier 3 proposal is stated in paragraph 5.155 of the Board's Tier 3 DP. However, the Board's proposal is consistent with the IFRS for SMEs ED. Accordingly, consistent with the Board's drafting approach, the IFRS for SMEs ED is used the starting point for drafting the recognition requirement, and a fit-for-purpose disclosure section is included (which aligns with the IFRS for SMEs ED).

14 In considering how to draft the Tier 3 ED wording to, overall, achieve simplification of the reference source wording (specifically, identifying which wording should be retained, omitted, added or retained but further simplified), the following factors were taken into account to the extent they achieve consistency with the Board's proposals set out in its Tier 3 DP:

(a) prima facie reasons for retaining particular wording of the IFRS for SMEs Standard, which include either of the following:

(i) it is also included in the New Zealand Tier 3 Standard; and

(ii) it addresses a transaction, other event or condition likely to affect many Tier 3 NFP entities;

(b) prima facie reasons for omitting text of the IFRS for SMEs Standard, which include any of the following:

(i) it is not included in the New Zealand Tier 3 Standard;

(ii) it addresses a transaction, other event or condition unlikely to affect many Tier 3 NFP entities (in forming such a view, consideration would be given to any findings of AASB Research Report 19[4] on the item in question); and

(iii) it is likely to be unduly complex or difficult to understand for typical preparers of Tier 3 NFP entity financial statements (taking into account cost/benefit considerations);

(c) prima facie reasons for adding text not included in the IFRS for SMEs Standard, which include any of the following:

(i) it is also included in the New Zealand Tier 3 Standard;

(ii) it addresses an NFP-specific issue likely to affect many Tier 3 NFP entities (having regard to any Aus paragraphs or other items of NFP-specific guidance in Australian Accounting Standards, INPAG or UK FRS 102/Charities SORP); and

4 AASB Research Report 19, *Common Financial Statement Items: Charities with $0.5–$3 million in revenue*, April 2023.

(iii) it reduces the need to apply judgement regarding the appropriate treatment of a transaction, other event or condition likely to affect many Tier 3 NFP entities. This reflects a view that simplicity in application does not always involve greater brevity of wording. However, staff expect that such additions would be limited; and

(d) further simplification, based on:

(i) removing any repetition or overlaps;

(ii) using simpler terminology or expression; and

(iii) considering other ways in which the New Zealand Tier 3 Standard achieves greater brevity (including the use of tables rather than narrative: such presentation aspects will be considered in future drafting).

15 In relation to paragraph 14(b), staff suggest omitting various paragraphs of the IFRS for SMEs ED because they seem unlikely to affect many Tier 3 private sector NFP entities (and in a number of those cases, those paragraphs are not included in the New Zealand Tier 3 Standard). Where the findings set out in AASB Research Report 19 provide evidence of the financial statement item being reported by only a small percentage of charities of the size researched, that evidence is noted. However, for numerous paragraphs in the IFRS for SMEs ED, the findings in AASB Research Report 19 are at a less granular level and evidence from that Report is unavailable. In such cases, the assessment of infrequent likely application is based on staff's general knowledge as informed through previous outreach activities, and involves the exercise of judgement. Staff plan to test the validity of those assessments about frequency/ pervasiveness through the public exposure process and other outreach activities, including consultation with the NFP Project Advisory Panel.

16 In relation to paragraph 14(c)(ii), staff note that INPAG is likely to issue proposed guidance on some issues, such as exchanges of non-monetary assets,[5] for which staff do not suggest including wording in the Tier 3 ED. Although the draft INPAG guidance is being developed using the IFRS for SMEs as a starting point, because the draft INPAG guidance will not be targeted to Tier 3-sized NFP entities, staff consider that differences between the scope of INPAG guidance and the Board's Tier 3 guidance will sometimes be warranted.

17 In relation to paragraph 14(c)(iii), an example of guidance additional to that in the IFRS for SMEs ED suggested to be included to reduce the need to apply judgement regarding application of a requirement is adding a clarification that if the revaluation model is adopted for a class of property, plant and equipment, it would be necessary to continue applying that model (aligning with paragraph A135 of the New Zealand Tier 3 Standard: see draft paragraph 17.9 below). It seems likely to be less burdensome to stipulate this than to leave it to Tier 3 NFP entities to assess whether reverting to the cost model would result in reporting information that (in terms of the criteria for a voluntary change in accounting policy set out in paragraph 10.8(b) of the IFRS for SMEs) "results in … reliable and more relevant information".

Avoiding unintended consequences of drafting amendments

18 As noted in paragraphs 11 and 13, based on the Board's recognition, measurement and disclosure proposals in its Tier 3 DP, the starting point for drafting the Tier 3 ED wording for the three trial sections is the IFRS for SMEs ED (which is consistent with the Board's proposals). The draft simplification of wording for the selected Tier 3 topics creates a risk of inadvertently changing the substance of the Board's proposal in its Tier 3 DP to conform to the relevant Tier 2 requirement (without a Board decision to change having been made); the greater the simplification, the greater the risk.

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5 These are the subject of IFRS for SMEs ED paragraph 17.14 in Agenda Paper 10.2.1.

19 A key issue is whether the suggested amendments to the IFRS for SMEs ED marked up in Agenda Paper 10.2.1 are confined to matters of drafting, i.e. do not cross the line into amendments that change the meaning or substance of the Board's proposals in its Tier 3 DP, as these would be beyond the scope of drafting and would require a decision by the Board supported by staff analysis of the issue, including where appropriate further analysis of related feedback on the Tier 3 DP.

20 An example of where this issue arises is the suggested clarification and simplification of guidance on an asset's 'financially feasible use' for the purposes of identifying its highest and best use, starting with paragraph 12.11(c) of the IFRS for SMEs ED. Staff propose significant editing of that IFRS for SMEs ED paragraph but consider that doing so should not change the substance of the Board's proposal in its Tier 3 DP to conform to the relevant Tier 2 requirement. Other options are to leave the paragraph unchanged or simply to omit the guidance on 'financially feasible use'.

21 The issue arises whether the simplified guidance drafted about an asset's 'financially feasible use' changes the meaning of 'fair value' in the Tier 3 ED. This may be a matter of degree because, in a sense, any editing of a source document changes its meaning to some extent. The concern would be if two meanings of 'fair value' across the suite of Australian Accounting Standards arise from simplification of measurement requirements for Tier 3 entities. In this regard, the Board proposed in its Tier 3 DP (paragraphs 5.116 – 5.118) that reporting requirements for Tier 3 NFP entities should:

(a) adopt the same meaning of 'fair value' as that in AASB 13 (i.e. Tiers 1 and 2); and

(b) express the AASB 13 framework in a manner that is easier for preparers who are not accounting experts to follow (but retaining reference to a non-financial asset's highest and best use).[6]

22 The draft guidance on an asset's 'financially feasible use' developed by marking up paragraph 12.11(c) of the IFRS for SMEs ED is a useful test case of how staff exercised judgement in making drafting suggestions for the selected Tier 3 topics.

23 In respect of that issue, and the five other issues identified in Table 1 below, feedback is sought from Board members on whether they agree with staff's assessment of whether there is a significant risk that the suggested amendment would constitute inconsistency with the Board's proposals in its Tier 3 DP, and therefore warrant being considered at a future Board meeting supported by a staff analysis (see Question 4 for Board members). Each of those issues is the subject of a Note to Board members above the source wording in Agenda Paper 10.2.1.

Table 1: Issues for which suggested 'drafting' amendments might inadvertently change the substance of the Board's proposal to conform to the relevant Tier 2 requirement

Paragraph no.in Agenda Paper 10.2.1	Issue	Staff view about whether a significant risk that draft amendment might depart from the Board's proposal
PP&E: 17.15.1	Adding guidance about the need to continue to revalue a class of property, plant and equipment once the revaluation model is adopted for subsequent measurement	No

6 In comparison, 'current value', rather than fair value, was adopted as the revaluation basis in the New Zealand Tier 3 Standard. Therefore, the same risk did not arise from the New Zealand Tier 3 Standard.

Paragraph no.in Agenda Paper 10.2.1	Issue	Staff view about whether a significant risk that draft amendment might depart from the Board's proposal
PP&E: 17.19	Adding guidance restricting the potential trigger events requiring reassessment of the residual value or useful life of an asset	No
PP&E: 17.27A	Adding guidance providing a practical expedient limiting the range of factors that might need to be considered in identifying whether an asset is expected to generate no future economic benefits from its use or disposal and therefore cease to be recognised ('recorded')	No
FVM: 12.11(c)	NFP clarification and simplification of guidance regarding an asset's 'financially feasible use' in identifying its highest and best use	No
FVM: 12.12	Adding guidance providing a practical expedient limiting the circumstances in which a Tier 3 NFP entity would need to consider whether an asset's highest and best use might differ from its existing use	Yes
FVM: 12.22	Excluding the fair value hierarchy set out in AASB 13 and the IFRS for SMEs ED.	Yes

Questions for Board members

Q1. Do Board members have any preliminary feedback on how staff have applied to the three selected topics the drafting approach decided by the Board? For example, is the illustrative drafting presented as clean text beneath paragraphs 25, 27 and 29 striking more or less the right balance between sufficient coverage of important guidance and simplicity?

Q2. Do Board members have any preliminary feedback on the factors in paragraph 14 that staff are taking into account to draft simplified requirements for Tier 3 NFP entities?

Q3. Do Board members find useful the structure of Agenda Paper 10.2.1 – specifically, the tables comparing the IFRS for SMEs ED (as suggested to be modified in the Tier 3 ED) with the New Zealand Tier 3 Standard, including the column commenting on the differences between those sources and the initial draft wording of the sections for the Tier 3 ED? In which ways might future comparisons prepared for draft sections of the Tier 3 ED be improved?

Q4. Do Board members have any preliminary feedback on whether they agree with the staff's assessment in Table 1 beneath paragraph 23 regarding whether there is a significant risk that each suggested drafting amendment identified in that table might inadvertently change the substance of the Board's proposal to conform to the relevant Tier 2 requirement?

Q5. Do Board members have any suggestions regarding how to simplify further the draft wording for the selected Tier 3 topics while remaining consistent with the Board's proposals in its Tier 3 DP?

Tier 3 Property, Plant and Equipment:

Comparison of scope of recognition, measurement and disclosure principles across IFRS for SMEs ED and NZ Tier 3 Standard

24 Reasons for including/excluding text in the initial draft of the Tier 3 ED section are provided in the 'Comments' column of the 'Tier 3 draft marked up for changes to IFRS for SMEs ED' (Agenda Paper 10.2.1).

Principle/sub-part	IFRS for SMEs ED (paragraphs)	NZ Tier 3 Standard	Application of drafting approach: AASB Tier 3 ED
Scope of section	Included (17.1 – 17.3)	Only a description of PP&E is included	Included
Recognition	Included (17.4 – 17.8)	Includes rule on timing of recognition, but not recognition criteria	Includes rule on timing of recognition, but not recognition criteria
Measurement at recognition	Included (17.9 – 17.9)	Included	Included, but renamed "Initial measurement"
Elements of cost	Included (17.10 – 17.12)	Excluded	Included
Measurement of cost	Included (17.13)	Excluded	Included, but folded within "Measurement at recognition" sub-part
Exchanges of assets	Included (17.14)	Excluded	Excluded
Measurement after initial recognition	Included (17.15)	Included	Included
Cost model	Included (17.15A)	Included	Included
Revaluation model	Included (17.15B – 17.15D)	Included	Included
Reliable measure of fair value	Excluded (included in FVM section instead: para. 12.18 – 12.21)	Excluded	Included (transferred from FVM section of IFRS for SMEs ED)
Depreciation (general)	Included (17.16 – 17.17)	Excluded	Included
Depreciable amount and depreciation period	Included (17.18 – 17.21)	Included	Included
Depreciation method	Included (17.22 – 17.23)	Excluded	Included
Impairment (only a signpost to other section)	Included (17.24)	Excluded	Excluded
Recognition/measurement of impairment	Included (17.24)	Excluded	Excluded
Compensation for impairment	Included (17.25)	Excluded	Excluded

Principle/sub-part	IFRS for SMEs ED (paragraphs)	NZ Tier 3 Standard	Application of drafting approach: AASB Tier 3 ED
PP&E held for sale	Included (17.26)	Excluded	Excluded
Derecognition	Included (17.27 – 17.30)	Included	Included, but renamed "Ceasing recording"
Disclosures	Included (17.31 – 17.33)	Included	Included

Initial draft text for Tier 3 ED

25 The paragraph numbers in the draft text below differ from the corresponding paragraphs of the IFRS for SMEs ED used as a starting point for drafting, since the scope of the draft text below differs from that in the IFRS for SMEs ED. In addition, the section numbers are expected to change during the development of the Tier 3 ED.

Section 17: Property, Plant and Equipment

Scope of this section

17.1 This section applies to accounting for:

(a) property, plant and equipment; and

(b) investment property whose fair value cannot be measured reliably on a continuing basis (to which Section XX *Investment Property* applies).

17.2 Property, plant and equipment are tangible assets that are:

(a) held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(a) expected to be used during more than one period.

Recording an item

17.3 An entity shall record an item of property, plant and equipment as an asset from when it is purchased by, or donated to, the entity.

Initial measurement

17.4 Subject to paragraph 17.5, an item of property, plant and equipment shall initially be measured at its cost.

17.5 If an item of property, plant and equipment was donated to the entity, that entity may elect to initially measure the item either at:

(a) its cost; or

(b) its fair value as at the date of donation, measured in accordance with Section XX.

Elements of cost

17.6 The cost of an item of property, plant and equipment comprises all of the following:

(a) its purchase price, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management (e.g. legal fees and installation costs).

(c) the initial estimate of any related restoration, rehabilitation or other "make good" obligation.

17.7 The following costs are not costs of an item of property, plant and equipment and shall be recorded as an expense when they are incurred:

(a) costs of opening a new facility;

(b) costs of introducing a new good or service (including costs of advertising and promotional activities); costs of operating in a new location or with a new class of beneficiaries (including costs of staff training); and

(c) administration and other general overhead costs.

Measurement after initial recording

17.8 An entity shall choose either the cost model in paragraph 17.11 or the revaluation model in paragraph 17.12 as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. An entity shall apply the cost model to investment property whose fair value cannot be measured reliably on a continuing basis. An entity shall record the costs of day-to-day servicing of an item of property, plant and equipment in profit or loss in the period in which the costs are incurred.

17.9 Electing to revalue a class of property, plant and equipment after initially recording an item is an accounting policy choice. Therefore, once a class of property, plant and equipment is revalued it shall continue to be measured on the revaluation model thereafter (rather than reverting to being measured under the cost model).

17.10 For the purposes of paragraphs 17.8 and 17.9, a class of property, plant and equipment is a grouping of assets of a similar nature or function. Possible classes of property, plant and equipment are:

(a) Land;

(b) Buildings;

(c) Motor vehicles;

(d) Furniture and fixtures;

(e) Office equipment;

(f) Computers (including software); and

(g) Machinery.

Cost model

17.11 An entity shall measure an item of property, plant and equipment after initial recording at cost less any accumulated depreciation and any accumulated impairment losses (which are recorded and measured in accordance with Section XX *Impairment of Assets*).

Revaluation model

17.12 An entity shall measure an item of property, plant and equipment whose fair value can be measured reliably at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses (which are recorded and measured in accordance with Section XX). Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Section XX *Fair Value Measurement* provides guidance on determining fair value.

Reliable measure of fair value

17.13 The fair value of an asset is reliably measurable if:

(a) a market price of an identical or similar asset is observable close to the measurement date; or

(b) either:

(i) the variability in the range of reasonable fair value measures is insignificant for that asset; or

(ii) the probabilities of the various measures within the range can be reasonably assessed and used in estimating fair value.

17.14 For assets for which a market price of an identical or similar asset is not observable, there are many situations in which the variability in the range of reasonable fair value measures is likely to be insignificant. Normally it is possible to estimate the fair value of an asset that an entity has acquired from an outside party. However, if the range of reasonable fair value measures is significant and the probabilities of the various measures cannot be reasonably assessed, the entity is precluded from measuring the asset at fair value.

17.15 If a reliable measure of fair value is no longer available for an asset measured at fair value (or is not available without undue cost or effort when such an exemption is provided (for example, see paragraphs 11.14(c) and 11.56(b)), its carrying amount at the last date the asset was reliably measurable becomes its new cost. An entity shall measure the asset at this cost amount less any accumulated depreciation and any accumulated impairment losses until a reliable measure of fair value becomes available (or becomes available without undue cost or effort when such an exemption is provided).

Recording revaluation increases and decreases

17.16 If the carrying amount of a class of assets is increased as a result of a revaluation, the net revaluation increase shall be recorded in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the net revaluation increase shall be recorded in profit or loss to the extent that it reverses a net revaluation decrease of the same class of assets previously recorded in profit or loss.

17.17 If the carrying amount of a class of assets is decreased as a result of a revaluation, the net revaluation decrease shall be recorded in profit or loss. However, the net revaluation decrease shall be recorded in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that same class of assets. The net revaluation decrease recorded in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

Depreciation

17.18 An entity shall allocate the depreciable amount of an asset on a systematic basis over its useful life. The resulting depreciation charge for each period shall be recorded in profit or loss unless another section of this Standard requires the cost to be recorded as part of the cost of an asset. For example, the depreciation of manufacturing property, plant and equipment is included in the costs of inventories (see Section XX *Inventories*). Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

17.19 If the major components of an item of property, plant and equipment have significantly different useful lives or patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. Other assets shall be depreciated over their useful lives as a single asset. Land has an unlimited useful life and therefore is not depreciated.

Depreciable amount and depreciation period

17.20 An entity shall consider all the following factors in determining the useful life of an asset:

(a) the expected usage of the asset, assessed by reference to the asset’s expected capacity or physical output.

(b) expected physical wear and tear.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the external demand for the output (goods or services) of the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

17.21 If an asset has been damaged physically or its capacity to provide services has been affected adversely as a result of either:

(a) the entity having changed its strategy; or

(b) being affected by a reduction in external demand for its services,

this may indicate that the residual value or useful life of an asset has changed since the most recent annual reporting date. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life. The entity shall account for the change in residual value, depreciation method or useful life as a change in an accounting estimate in accordance with Section XX *Accounting Policies, Estimates and Errors.*

17.22 Depreciation of an asset ceases when the asset ceases to be recorded. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

Depreciation method

17.23 An entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset’s future economic benefits. The possible depreciation methods include the straight-line method, the diminishing balance method and a method based on usage such as the units of production method.

17.24 If there is an indication that there has been a significant change since the last annual reporting date in the pattern by which an entity expects to consume an asset’s future economic benefits, the entity shall review its present depreciation method and, if current expectations differ, change the depreciation method to reflect the new pattern. The entity shall account for the change as a change in an accounting estimate in accordance with Section XX.

Ceasing recording an item

17.25 An entity shall cease recording an item of property, plant and equipment when:

(a) it is sold or otherwise disposed of; or

(b) no future economic benefits are expected from its use or disposal.

17.26 For the purposes of paragraph 17.25(b), an entity needs to consider the possibility that no future economic benefits are expected from the use or disposal of an asset only when:

(a) the asset has been damaged physically; or

(b) the entity has changed its strategy or been affected by a reduction in external demand for its services and in either case the asset's capacity to provide services might have been affected adversely as a result.

17.27 An entity shall record the gain or loss upon ceasing to record an item of property, plant and equipment immediately in profit or loss (unless Section XX *Leases* requires otherwise on a sale and leaseback). The entity shall not classify such gains as revenue. Section XX applies to disposal by a sale and leaseback.

17.28 An entity shall determine the gain or loss arising from ceasing to record an item of property, plant and equipment as the difference between the net sale proceeds, if any, and the carrying amount of the item.

Disclosures

17.29 An entity shall disclose the following for each class of property, plant and equipment determined in accordance with paragraph 17.10 and separately for investment property carried at cost less accumulated depreciation and impairment:

(a) a description of the asset class (for example, equipment or furniture);

(b) the measurement bases used;

(c) the carrying amount at the beginning and end of the reporting period;

(d) increases or decreases resulting from revaluations under paragraphs 17.16 and 17.17 and from impairment losses recorded or reversed in other comprehensive income in accordance with Section XX;

(e) impairment losses recorded or reversed in profit or loss in accordance with Section XX; and

(f) depreciation.

17.30 An entity shall also disclose the following:

(a) the existence and carrying amounts of property, plant and equipment to which the entity has restricted title or that is pledged as security for loans (including the nature and amount of loans that are secured);

(b) the amount of contractual commitments for the acquisition of property, plant and equipment; and

(c) if the entity has investment property whose fair value cannot be measured reliably, it shall disclose that fact and the reasons why fair value cannot be measured reliably for those items of investment property.

17.31 If items of property, plant and equipment are stated at revalued amounts, an entity shall disclose the following:

(a) the effective date of the revaluation; and

(b) whether an independent valuer was involved.

17.32 Where, in accordance with paragraph 17.5(a), an entity elects to initially measure at cost a donated item of property, plant and equipment, it shall disclose information that helps users of financial statements to assess:

(a) the entity's dependence on donations of assets; and

(b) the nature and terms of the donation arrangement, including:

(i) a description of the donated asset and the class of assets to which it relates;

(ii) any amounts owing to the donor at the reporting date; and

(iii) restrictions on the use of the donated asset imposed by the donor.

17.33 The disclosures in paragraph 17.32 shall be provided for each donated asset that is individually material to assessing the aspects in part (a) or (b) of paragraph 17.32. However, such disclosures shall be aggregated for donated assets of a similar nature. The entity shall consider the level of detail necessary to enable those assessments by users of financial statements. The disclosures shall be aggregated or disaggregated so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items with substantially different characteristics.

Tier 3 Fair Value Measurement:

Comparison of scope of measurement and disclosure principles across IFRS for SMEs ED and NZ Tier 3 Standard

26 Reasons for including/excluding text in the initial draft of the Tier 3 ED section are provided in the 'Comments' column of 'Tier 3 draft marked up for changes to IFRS for SMEs ED' (Agenda Paper 10.2.1).

Principle/sub-part	IFRS for SMEs ED (paragraphs)	NZ Tier 3 Standard	Application of drafting approach: AASB Tier 3 ED
Objective of FVM/ other current value ("Measurement")	Objective of FVM included (12.3 – 12.9)	No objective stated	Objective of FVM included
Highest and best use	Included (12.10 – 12.13)	Excluded	Included
Market, cost and income approaches ("Valuation techniques")	Included (12.14 – 12.17)	Excluded	Included
Reliable measure of fair value	Included (12.18 – 12.21)	Silent (beyond reference to a suitably qualified independent valuer)	Included in PP&E section rather than separate FVM section
Fair value hierarchy	Included (12.22 – 12.27)	Excluded	Excluded
Disclosures	Included (12.28 – 12.32)	Optional disclosure (A138)	Excluded
Examples	Four included (12A.1 – 12A.8)	None included	None included

Initial draft text for Tier 3 ED

27 The paragraph numbers in the draft text below differ from the corresponding paragraphs of the IFRS for SMEs ED used as a starting point for drafting, since the scope of the draft text below differs from that in the IFRS for SMEs ED.

Section 12: Fair Value Measurement

Scope of this section

12.1 This section applies when another section requires or permits fair value measurements or disclosures about fair value measurements.

Measurement

12.2 The objective of a fair value measurement is to estimate the price at which an orderly transaction (not a forced transaction) to sell an asset or to transfer a liability would take place between market participants at the measurement date under current market conditions (that is, an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

12.3 Fair value is a market-based measurement, not an entity-specific measurement. Therefore, it is measured using the assumptions that market participants would use when pricing the asset or liability at the measurement date, taking into account the characteristics of the asset or liability that market participants would take into account. Such characteristics include, for example:

(a) the condition and existing location of the asset; and

(b) legal restrictions, if any, on the sale or use of the asset (see paragraph 12.6(b)).

12.4 The market price used to measure the fair value of the asset or liability shall not be adjusted for transaction costs (ie, costs directly attributable to selling an asset or transferring a liability, such as costs of marketing an asset for sale). Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to a transaction.

12.5 If location is a characteristic of the asset, the asset's market price shall be adjusted for transport costs.

Highest and best use for non-financial assets

12.6 A fair value measurement of a non-financial asset (such as an item of property, plant and equipment) assumes a market participant would use the asset for its highest and best use, which takes into account:

(a) the asset's physical characteristics (for example, the location or size of a property);

(b) any legal restrictions affecting the market participant's use of the asset (for example, the zoning regulations applicable to a property); and

(c) whether the use makes financial sense, i.e. it would generate at least a market rate of return on investing in the asset or sufficient goods/services to beneficiaries to justify buying the asset.

12.7 An entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that it is highly probable that a different use by market participants would maximise the value of the asset. In general, this exception would occur only when it is highly probable that, within one year of the asset's measurement date, the asset will either be sold to a buyer who would use the asset for a different use or be redeployed by the entity.

Valuation techniques

12.8 When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique. The entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

12.9 Three widely used valuation techniques are the market approach, the cost approach and the income approach. An entity shall use valuation techniques consistent with one or more of these approaches to measure fair value:

(a) the market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. This would often be the case for financial assets and non-financial assets such as land, non-specialised buildings and non-specialised motor vehicles.

(b) the cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost: see paragraph 12.10).

(c) the income approach discounts future cash flows or income and expense items to their present value.

12.10 From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset with the same age, technology, service capacity and condition as that of the asset held. That is because a market participant buyer would not pay more for an asset than the cost of replacing its service capacity. One reason the current replacement cost method may be used is that the asset is specialised and without readily observable market evidence.

Tier 3 Borrowing Costs:

Comparison of scope of recognition, measurement and disclosure principles across IFRS for SMEs ED and NZ Tier 3 Standard

28 Reasons for including/excluding text in the initial draft of the Tier 3 ED section are provided in the 'Comments' column of the 'Tier 3 draft marked up for changes the IFRS for SMEs ED' (Agenda Paper 10.2.1).

Principle/sub-part	IFRS for SMEs ED (paragraphs)	NZ Tier 3 Standard	Application of drafting approach: AASB Tier 3 ED
Description of borrowing costs	Included (25.1)	Included	Included
Recognition of borrowing costs	Included (25.2)	Included	Included
Disclosures	Included (25.3)	Excluded	Excluded

Initial draft text for Tier 3 ED

29 The paragraph number in the draft text below differs from some of the corresponding paragraphs of the IFRS for SMEs ED used as a starting point for drafting, since the scope of the draft text below differs from that in the IFRS for SMEs ED.

Section 25: Borrowing Costs

25.1 Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. An entity shall record all borrowing costs as an expense in profit or loss in the period in which they accrue.