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The Chair
Australian Accounting Standards Board
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31 March 2023

Dear Sir

ITC 50 POST-IMPLEMENTATION REVIEW - INCOME OF NOT-FOR-PROFIT ENTITIES

Thank you for the opportunity to comment on the Board's post-implementation review of AASB 1058 Income of Not-for-Profit Entities.

Please refer to Appendix 1 for our detailed comments on your specific matters for comment.

If you have any comments regarding this request, please do not hesitate to contact me.

Yours faithfully

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APPENDIX 1 - Specific matters for comment

Topic 1 - Sufficiently specific criterion and the legal interpretation of agreements

Questions

Regarding the term sufficiently specific in AASB 15 Appendix F, do you have any comments about:

1. the application of the term in practice?

BDO Comment - Question 1

In our experience, both preparers and auditors find the ‘sufficiently specific’ test difficult to apply in practice. The assessment often requires significant judgement, particularly in the ‘grey’ scenarios highlighted in examples (c), (d) and (e) on page 9 of ITC 50.

The assessment is often time-consuming and costly because many not-for-profit entities have a limited number of financial reporting staff, with limited training on the application of AASB 1058. Because of these limited resources, in practice:

- Entities receiving a variety of different grants may apply a ‘broad brush’ approach to assessing ‘sufficiently specific’, for example, by determining that contracts with similar, but not identical, characteristics are accounted for all as income under AASB 1058, or as revenue under AASB 15. In other words, they are not performing a detailed assessment to look for ‘sufficiently specific’ performance obligations for each and every grant contract.
- Entities merely ask the auditor to perform the assessment for them (which is not permitted under the independence rules in APESB 110).

There appear to be two ‘camps’ of entities:

- Those that simply recognise everything as income immediately under AASB 1058 in their statutory financial statements because they don’t want to spend the time performing the ‘sufficiently specific’ assessment. These entities apply ‘matching’ of grant income and expense in their management accounts and are accountable to donors/grantors on this basis (refer comments on Question 9 and 10 below)
- Those that want ‘matching’ in their statutory financial statements. If the terms of a grant are not ‘sufficiently specific’, they will use ‘termination for convenience clauses’ (where present) to achieve this outcome.

Our overall observations are therefore that ‘sufficiently specific’ is difficult to apply in practice and requirements and guidance that are simpler to understand, and therefore easier and less time-consuming to apply in practice, would be preferable.

2. the extent of specificity needed to meet the sufficiently specific criterion for a contract (or part of a contract) to be within the scope of AASB 15?



BDO Comment - Question 2

We have identified a number of different challenges applying the ‘sufficiently specific’ criterion in practice, and these are discussed below.

How specifically must the service or good be described in the grant agreement?

In our view, the guidance contained in AASB 15, Appendix F20-F27 is vague. We acknowledge that the ‘sufficiently specific’ assessment is based upon applying principles and requires judgement. However, paragraphs F20(a) to (d), when read together with the comment in F22 (“*No specific number or combination of the conditions noted in paragraph F20 need to be specified in an agreement for the promise to be sufficiently specific.*”) provide limited and potentially contradictory guidance to preparers and auditors.

On the one hand F20 is saying one must consider the nature or type of goods or services, their cost of value, their quantity and the period over which they must be transferred, yet F22 leaves the door open to not-for-profit entities concluding that **two, one or possibly none** of these criteria need to be present. This contradiction may be the reason ITC 50, examples (c), (d) and (e) are highlighted as not having a definitive conclusion, with the time period being specified, but the type of services specified in varying degrees, and no quantities specified.

The core principle of AASB 15 (outlined in paragraph 2) is that an entity shall recognise revenue to **depict the transfer of promised goods or services to customers** in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Moreover, AASB 15 assumes that, provided one or more distinct performance obligations can be identified, the entity would be able to determine whether each performance obligation is being satisfied at a point in time or over time, and consequently identify an appropriate basis to recognise revenue when (or as) the entity satisfies the performance obligation.

In contrast, the core principle of AASB 15 as it applies to not-for-profit entities would appear to be articulated in paragraph F20 of Appendix F to AASB 15, which states (emphasis added): “*A necessary condition for identifying a performance obligation of a not-for-profit entity is that the promise is sufficiently specific to be able to determine when the obligation is satisfied. Judgement is necessary to assess whether a promise is sufficiently specific*”. Accordingly, to account for a contract with a customer under AASB 15, a not-for-profit entity must be able to:

- Identify the promised good(s) or service(s), **and**
- Establish that the performance obligation is sufficiently specific to enable the entity to identify an appropriate basis to recognise revenue when (or as) the entity satisfies the performance obligation.

Consequently, from a not-for-profit entity’s perspective, the overriding factor that determines the applicability of AASB 15 is whether it is possible to reliably measure when the promised good(s) or services(s) have been transferred (i.e. performance obligation has been satisfied). On this basis, we consider the answer for examples (a) and (b) to be clearly ‘No’, and example (h) to be clearly ‘Yes’.

Furthermore, we do not think that articulating the ‘to whom’ and/or ‘where’ more precisely (i.e. narrowing down the target recipients and/or location of the recipients of the promised goods or services as shown in examples (d), (e) and (f)) necessarily assists preparers and auditors in determining



whether the entity can more or less reliably measure when the promised good(s) or services(s) have been transferred.

Regardless of whether the grant agreement requires generic counselling services, counselling services in Melbourne, or counselling sessions in relation to mental health in Melbourne - the recipient of the grant is likely to have difficulty determining when the additional services were provided as there is no minimum number of sessions specified, nor is it clear from the fact pattern whether the recipient must be available (stand-ready or merely turn up) to provide counselling sessions, regardless of whether anyone presents for counselling.

In our view, absent some minimum quantification of sessions, or a clear 'stand-ready/show-up' requirement to provide counselling services (irrespective of whether any clients present to the entity), examples (c), (d), (e) and (f) would not meet the 'sufficiently specific' requirements because the entity is unable to demonstrate it could reliably measure when the promised good(s) or services(s) have been transferred. Similarly, for example (g), adding in a 'monthly' requirement does not assist in determining when the services are required (24 months being the overall period). Only example (h), in our view is 'sufficiently specific', and any of examples (c), (d), (e), (f) and (g) if there is a 'stand-ready/show-up' obligation.

Internal activities, outcomes and outputs

Paragraph F21 notes:

"...However, performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to a customer. For example, research activities undertaken to develop intellectual property that the entity will license to a customer are not themselves a transfer of goods or services to the customer."

In practice, grant agreements contain a long list of activities that a not-for-profit entity must perform, many of which are of an administrative nature, and do not directly result in a good or service being transferred to a customer (**internal activities**). Entities therefore often confuse these 'internal activities', or milestones, with sufficiently specific performance obligations, and want to recognise revenue on the basis of expenditure patterns.

Amongst the long list of activities in grant agreements, there may appear:

- A description of required outcomes
- A description of specific outputs.

We think of 'outcomes' as being high level objectives of the grant, which is not specific enough to enable an entity to determine when it has satisfied its performance obligation. We think of 'outputs' as goods or services where an entity is able to measure **WHEN** it has transferred that good or service. There is only a sufficiently specific performance obligation if a specific output can be identified.

We think it could be helpful for preparers and auditors to include additional discussion in Appendix F framed around the difference between internal activities, outcomes and outputs.



3. whether differences in application exist?

If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

BDO Comment - Question 3

Please refer to our comments for Question 2 above.

4. In addition to the existing guidance in AASB 15 Appendix F, is there any other guidance that would help you determine whether a contract (or part of a contract) is sufficiently specific? If so, please provide details of the guidance and explain why you think it would be useful.

BDO Comment - Question 4

While Example 7A to AASB 15 provides a good example on how to account for internal activities noted in our comments to Question 2 above, Examples 2 to 5 only relate to research activities. Given the diversity in practice in other types of grant arrangements (e.g. counselling services noted in examples (a) to (h) in ITC 50), it would be useful to include an example for a non-research type service, illustrating clearly why examples (c) to (f) - and possibly (h) in ITC 50 are contentious (refer to our comments for Question 2 above).

Topic 2 - Capital grants

Questions

Regarding the term identified specifications in AASB 1058 paragraph 15(a), do you have any comments about:

5. the application of the term in practice?

BDO Comment - Question 5

In our experience, not-for-profit entities apply the term broadly and consistent with the overall objective of paragraph 15 of AASB 1058, which is to facilitate consistent accounting between entities that receive a financial asset in exchange for an obligation to acquire or construct a recognisable non-financial asset that is to be controlled by the entity. Accordingly, provided that the agreement under which the financial asset is received specifies that the asset is only to be used to acquire or construct a recognisable non-financial asset (eg, doesn't provide the entity with a choice between, for instance, acquiring an item of property or using the funds to further the entity's not-for-profit objectives), we are not aware of any examples of not-for-profit entities failing to account for a funding arrangement that would otherwise meet the criteria in paragraph 15 because, for instance, the agreement doesn't specify the design features of the non-financial asset.

6. the extent of specificity needed for a contract to meet the requirements of AASB 1058 paragraph 15(a)?



BDO Comment - Question 6

In our experience, provided the non-financial asset is being constructed on the entity's land (whether owned or leased), preparers and auditors have not required 'identified specifications' in great detail. Usually, such grants are made for a specified purpose and provided that purpose is noted in the agreement, this would be considered sufficient to meet the requirements for 'identified specifications'. In other words, detailed plans would not be required.

If specific government regulations must be adhered to (e.g. building regulations), this would not, by itself, be sufficient. The type of building would need to be described (e.g. early learning centre, school hall, etc.).

7. whether differences in application exist because of the use of the term identified specifications?

If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

BDO Comment - Question 7

Refer to our response to Questions 5 and 6 above.

8. In addition to the existing illustrative examples in AASB 1058, is there any other guidance that would help you determine when to recognise revenue following the transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity? If so, please provide details of the guidance and explain why you think it would be useful.

BDO Comment - Question 8

Examples 9 and 10 adequately illustrate the principles for recognising income over time or at a point in time when an entity receives a capital grant to construct (Example 9) or acquire (Example 10) a recognisable non-financial asset (paragraphs 15-17). However, other than referring to AASB 1058.16, the answers to Examples 9 and 10 do not fully explain why each one is recognised over time or at a point in time.

It may be useful to elevate the comments in AASB 1058.BC98 to the current guidance contained in AASB 1058.B16 so that preparers understand that the approach for over time vs. point in time from AASB 15 should be followed. That is, AASB1058.BC98 notes (emphasis added).

"For avoidance of doubt, the Board decided to identify the accounting that applies to such transfers. In its redeliberations, the Board observed that in such arrangements, in substance, the transferor had intended to transfer a recognisable non-financial asset to the not-for-profit entity. The Board considered that an insubstance transfer of a good for use by the entity itself should not result in income until the recipient has satisfied its obligation to construct or acquire the asset. That is, the timing of income recognition should reflect the entity receiving the asset directly, rather than the cash to construct or acquire the asset. Accordingly, the Board decided that the accounting for such transactions should reflect that of the approach in AASB 15. However, given the diverse views as to



whether AASB 15 applies, the Board decided to specify instead requirements in AASB 1058 to mirror, to the extent appropriate, the accounting that would be achieved had the transaction been accounted for had it been incontestably a contract with a customer within the scope of AASB 15.”

Topic 3 - Differences between management accounts and statutory accounts and alternative revenue recognition models

Questions

9. Do you have any comments regarding the timing of revenue recognition required by AASB 15 and AASB 1058 of NFP entities? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also helpful.

BDO Comment - Question 9

In our experience, many entities run two sets of books - one for statutory accounting purposes and one for management accounting purposes, or for acquittal purposes when reporting to donors. This is more prevalent where the types of grants received are not sufficiently specific (i.e. revenue recognised upon receipt under AASB 1058, paragraph 10) but the entity is nevertheless required to spend the money in future, or else return unspent funds. We understand that this occurs because boards, management, and other users of not-for-profit entity financial information don't find the 'mismatch' between receipt of revenue and recognition of expenses useful.

We have also noted that some entities, rather than keeping a separate set of books for management accounting purposes, do 'reserve accounting' to account for any mismatches between the timing of revenue recognition and expenses. For example, if an entity recognises grant income received prior to 30 June 2023 of \$100,000, which is all to be spent during FY2024, in its Statement of Changes in equity, the entity might process the following entry:

| | | | |
|----|-------------------|-----------|-----------|
| Dr | Retained earnings | \$100,000 | |
| Cr | Reserve | | \$100,000 |

Being amount of revenue that would have been deferred had matching been permitted under AASB 1058

While the profit or loss statement will still reflect a surplus in the FY23 year and a deficit in FY24 year (assuming no other funding), we understand that this approach is followed where statutory financial statements are used to attract funding. That is, they are concerned that a surplus could be understood that the entity does not require funding. Conversely, a deficit could be understood as being that the entity is not properly managing its projects.

10. Do you have any views on alternative approaches to recognising revenue in the NFP sector? For example, should an NFP entity initially recognise a liability and recognise revenue:
- based on a common understanding between the entity and the transfer provider of the manner in which the entity is expected to use the inflows of resources;



- b. where there are terms in law or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity;
- c. on a systematic basis over the periods in which the entity recognises as expenses the related costs for which a grant is intended to compensate;
- d. where the outflows of resources are incurred in accordance with the requirements set out in a binding agreement.

If so, please provide your views on your preferred alternative(s) above or another alternative approach.

BDO Comment - Question 10

Our preferred approach is based on approach (c). While we agreed with the proposal in Question 42 of our comment letter regarding the Board's proposal for the 'common understanding' approach for Tier 3 not-for-profit private sector entities, this is to allow smaller not-for-profit entities more flexibility in the way they recognise grant revenue. We do not believe that such a liberal approach is suitable for Tier 1 and Tier 2 not-for-profit entities as it will reduce comparability.

Having an approach along the lines of (c) will simplify the accounting for grant income because:

- No assessment will be required as to whether the entity has provided 'sufficiently specific' goods and services. That is, applying AASB 1058, paragraph 9, the entity will not need to determine whether a related credit is accounted for under AASB 15, and
- Entities will not have to measure progress towards satisfying specific performance obligations (over time or at a point in time). This can be difficult for entities whose total expenditure will exceed grant funding received. For example, if a NFP will spend \$120,000 on a project, but only receive grant income of \$100,000, it is not clear whether measuring progress is based upon the \$100,000 to be received, or the total project cost of \$120,000. That is, should a portion of the additional costs of \$20,000 be expensed over the period that the \$100,000 income is recognised, or only when incurred near the end of the project?

As grant income is generally provided to a not-for-profit entity **to cover expenses** (non-financial assets are dealt with separately under paragraphs 15-17), requiring grant income to be recognised using approach (c) will:

- Facilitate matching and be simpler for accounting staff of not-for-profit entities to apply in practice
- Provide more relevant and reliable information to donors and other users about progress on a project/activity
- Enhance comparability between entities (i.e. reduce application difficulties with sufficiently specific)
- Remove the need for entities to identify one or more sufficiently specific performance obligations, as well as progress towards satisfying those obligations
- Be consistent with the requirements in AASB 1058, paragraphs 15-17 for the acquisition or construction of a non-financial asset.

We note though, that ordinary donations, which are not linked to specific expenditure, should still be recognised immediately under AASB 1058, paragraph 10.



Applying approach (c) to the Topic 1 PIR examples in ITC 50 (counselling services), all the ‘problem’ examples (c), (d), (e), (f) and (g) would be resolved. That is, if say \$100,000 was received on 30 June to be spent on future counselling services over the next 24 months, the \$100,000 income would be deferred and recognised as income when the costs of providing the counselling services was incurred.

Under AASB 15, the sufficiently specific performance obligations would likely require specification of a minimum number of counselling hours, or a ‘stand-ready/show up’ requirement as noted in our comments to Question 2 above. Applying approach (c), so long as the grant income is spent on counselling expenses (irrespective of number of sessions, hours, or stand-ready/show-up), income is matched to related expenses. It does not matter whether those expenses are incremental, or expanding the service offering of the entity.

Topic 4 - Principal v agent, including the appropriate recognition of financial liabilities

Questions

Regarding the recognition of financial liabilities, if an NFP entity’s only obligation is to transfer funds received to other entities, do you have any comments on:

11. the determination of whether the entity is a principal or an agent?

BDO Comment - Question 11

There is little guidance in AASB 15, Appendix F, or in Examples 3A, 3B and 3C regarding whether the entity is acting as agent or principal. While AASB 15.B34-B38 provides general guidance on agent vs. principal considerations, it would be helpful if tailored guidance or examples are provided for not-for-profit entities.

Facts and circumstances determine whether the entity is acting as agent or principal, and the determination often comes down to the extent of work/input required by the grant recipient, as well as the level of discretion that the entity has in determining who gets what and how much. For example:

- The university scholarship example provided on page 17 of ITC 50 assumes that the university is acting as an agent of the grantor because it has no discretion on how interest income from the grant is used. However, if the university has to spend significant time selecting and interviewing scholarship recipients, it could be considered to be acting as principal.
- The foundation example provided on page 16 of ITC 50 refers to funds being raised by the foundation being passed on to other charities on a ‘best endeavours’ basis. We do not believe that the foundation is acting as an agent in this scenario because it has no obligation to make distributions (i.e. there is no financial liability and the foundation is acting as principal).

If the entity has limited discretion and/or responsibility, it is likely acting as agent.

12. whether differences in application exist in concluding whether an NFP entity is a principal or an agent? If there are differences in application, do they significantly affect the comparability of financial statements?



If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

BDO Comment - Question 12

Refer to our comments for Question 13 below. Many entities do not want to be considered an agent because they are then required to recognise only the fees earning in providing the services, rather than gross funding received and gross funds disbursed. Showing smaller amounts of income could hinder an entity's fundraising abilities. It would therefore be useful for the Board to clarify, via examples, the complete accounting entries where the entity is acting as agent, and where the entity is acting as principal.

- 13. In relation to determining whether an NFP entity is a principal or an agent, do you have examples of specific scenarios where there are practical challenges and application issues?**

If so, please provide details of the complexities associated with this determination, such as the level of discretion the entity has in determining to whom funds will be passed, and illustrate the relevant circumstances, their significance and the prevalence of any differences in application.

BDO Comment - Question 13

We have seen practical challenges where an entity is acting as agent and similar situations are accounted for differently by other entities, which affects comparability. These examples are outlined below.

Where an entity is acting as a 'conduit' to pass-through monies to other organisations (and no other tasks are required), they may consider this a 'trust' arrangement and not recognise the cash (financial asset) or the financial liability on balance sheet. This will affect comparability with other 'agent' entities that recognise a financial asset and a corresponding financial liability under AASB 9.

In other circumstances, an entity is acting as agent and recognises the cash (financial asset) and the corresponding liability. This might be the case when the entity has in the past provided a refund to the grantor for funds lost is misused by the ultimate recipient, notwithstanding that the entity did not have a contractual obligation to do so under the relevant agreement. However, it then also recognises gross grant income and gross expenses because it wants to reflect in its financial statements the source of the donation and services provided. For example, an entity whose only function is to give out scholarships may be heavily involved in selecting the recipient and monitoring that recipient's progress over several years (such as sponsoring a child). The net administration fee received may not reflect the extent of work performed in the arrangement and suggests that the entity is a small operation, which may result in difficulties attracting further funding. A similar situation could occur where research funding is tied to a specific researcher. The funding received is recognised as a financial liability (as agent) but the entity nevertheless recognises gross revenue and expenses.

- 14. Is there any guidance that would help you determine whether an NFP entity is a principal or an agent? If so, please provide details of the guidance and explain why you think it would be useful.**



BDO Comment - Question 14

Refer to comment in Question 11 above.

Topic 5 - Grants received in arrears

Questions

Do you have any comments regarding:

15. the accounting for grants received in arrears, particularly where some of the work to be funded by the grant is performed before the funding is received? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful;

BDO Comment - Question 15

Performing work before funding is received could result in a mismatch between income and expenses during a particular financial year. In our view, a receivable (and income) should only be recognised when the entity has met the specific criteria which entitles them to payment. Otherwise, the 'asset' is more akin to a contract asset under AASB 15, which is still subject to performance risk.

This is similar to accounting for refundable R&D incentives by for-profit entities. If it is probable that the amount will be received (i.e. a professional has reviewed the amount claimed), a receivable is recognised prior to receiving the refund.

16. whether differences in application exist in the accounting for grants received in arrears exists? If so, please provide examples that illustrate the relevant circumstances, their significance and the prevalence of any differences in practice.

BDO Comment - Question 16

While we have not observed differences in application in practice, we anticipate that these exist if amounts are material.

Topic 6 - Termination for convenience clauses

Questions

Regarding accounting for termination for convenience clauses:

17. do you support view (a) or view (b) regarding recognising a liability in relation to unspent funds? Please explain your rationale, including references to Australian Accounting Standards. Examples to illustrate your responses are also most helpful;

BDO Comment - Question 17

We support View (a) that these clauses should be recognised as a financial liability, as would be the case for for-profit entities. We do not consider it appropriate for for-profit entities and not-for-profit entities to treat these clauses differently for accounting purposes.

We also do not agree with View (b)'s justification that the clause should be accounted for in accordance with the substance of the arrangement as outlined in paragraph 15 of AASB 132. This is because paragraph 15 also refers to the instrument being classified in accordance with the definitions of a financial liability, and where there is a termination for convenience clause, the entity cannot avoid paying cash if the grant is terminated by the grantor. We have a number of clients with grantors that have chosen in practice to terminate for convenience.

- 18. do you have any other comments? If so, please provide your views, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.**

BDO Comment - Question 18

We note that not-for-profit entities are looking for termination for convenience clauses in contracts in order to achieve 'matching' or revenue deferral so that they don't have to go through the process of assessing 'sufficiently specific'. If an alternative income recognition model based on approach (c) in Question 10 is adopted, entities may default to a revenue deferral model. This may not provide the correct answer though as the existence of a termination for convenience clause will still require recognition of a financial liability until funds are spent.

Topic 7 - Accounting for research grants

Questions

- 19. Do you have any comments regarding the accounting for research grants (other than termination for convenience clauses, which are covered in Topic 6?)**
- If so, please provide your views on the requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful**

BDO Comment - Question 19

We do not have any comments.

Topic 8 - Statutory receivables

Questions

Do you have any comments regarding:

- 20. the subsequent accounting treatment of statutory receivables? If so, please provide your views, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful;**

BDO Comment - Question 20

We understand that there is diversity in the subsequent accounting for statutory receivables. Some public sector entities may not be applying the AASB 9 subsequent measurement requirements at all, and others may be applying the subsequent measurement requirements, including the expected credit



loss requirements (but not the disclosure requirements). Application of the expected credit loss requirements is complex, regardless of whether applied to statutory or contractual receivables.

- 21. whether the initial measurement of statutory receivables in accordance with AASB 9 added considerably to the workload of preparers and auditors - either on implementation of Appendix C to AASB 9 or subsequently?**

If so, please provide your views on the initial measurement requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

BDO Comment - Question 21

When applying the initial measurement requirements of AASB 9 to statutory receivables, some entities may encounter difficulties with reliable measurement where a taxable event has occurred, but assessment occurs in a later period (for example income taxes). However, this is already dealt with in AASB 9, paragraph C7.

Usually, statutory receivables are short-term in nature, so we do not anticipate great difficulties applying the initial fair value measurement requirements in AASB 9.