Agenda Paper 3.2.1
AASB Meeting 3 August 2022 (M189)

Australian Government

Australian Accounting Standards Board

DRAFT

[DRAFT] DISCUSSION PAPER – DEVELOPMENT OF SIMPLIFIED ACCOUNTING REQUIREMENTS FOR NOT-FOR-PROFIT PRIVATE SECTOR ENTITIES

Comments to the AASB by [X Month 202X]

Commented [A1]: **Question 1 to Board members:**
Staff have received feedback that some stakeholders are concerned that describing the additional financial reporting Tier as "Tier 3" may confuse to smaller preparers due to its interaction with 'Tiers' as used by other legislation or regulators to identify an entity's reporting obligations. For example, an entity might not understand that 'Tier' as used by the AASB is not the same as the ACNC tiers for identifying an entity's regulatory reporting obligations, but default to 'matching' ACNC 'medium' charities with Tier 2 GPFS and ACNC 'smaller' charities with Tier 3 GPFS.

Staff note that the 'Tier' descriptor is already used in AASB 1053. Therefore, staff think that the AASB should not avoid use of the descriptor. Staff think that its outreach activity can help educate preparers in this regard. Beyond that, staff think it is the responsibility of the relevant regulator to make it clear whether 'Tier' as used to establish reporting obligations also dictates the form of GPFS prepared by the entity.

However, in recognition of the stakeholder concern, and so as to not inadvertently void 'medium sized' entities from considering the Discussion Paper, staff recommend that the title of the Discussion Paper avoid a reference to 'Tier 3', as reflected in the current August 2022 drafting.

Do Board members agree with the staff recommendations to:
1. continue describing the reporting tier as 'Tier 3'; and
2. name the Discussion Paper as *Development of Simplified Accounting Requirements for Not-For-Profit Private Sector Entities*?

How to Comment on this AASB Discussion Paper

The AASB is seeking comment by [X Month 202X].

Formal Submissions

Submissions should be lodged online via the "Current Projects – Open for Comment" page of the AASB website (www.aasb.gov.au/current-projects/open-for-comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

Survey: [placeholder link]

Commented [A2]: **Note to Board members:**
Staff will be developing a survey based on the questions in the DP. The question will be the same as those included in the DP except for the presentation to allow a more user-friendly experience. Staff are intending to develop the survey and user test the survey before it is made publicly available. Staff have included a mock-up of question one in the DP on page 25.

E-mail: standard@aasb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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Foreword

[To be prepared following the August 2022 AASB meeting]

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Table of contents

Contents

Commented [A3]: Question 2 to Board members
Staff are aware that Sections 1 to 3 of the DP provide the background and reasons for developing Tier 3 reporting requirements that some stakeholders may not be interested in compared to the proposed Tier 3 requirements contained in Sections 4 to 6. As such, staff have now divided Sections 1-3 into Part A and Sections 4-6 into Part B as currently presented and make clear in the Forward highlight the content in those parts to better direct them to read the sections in which they are most interested. To support the DP, staff will develop a 10-15 page snapshot document that would summarise the objective for developing and the Board's preliminary views of the Tier 3 reporting requirements in a more straightforward document. However, staff are seeking Board members' views on whether ordering sections in the DP should:

Options A: to retain the current layout of the DP as currently drafted; or

Option B: Split the DP into two separate documents. Part A containing sections 1 – 3 and Part B containing sections 4 – 6 so stakeholders would only read the Part they are interested. The risk in this approach is that there will be many separate documents to the DP which may introduce more confusion; or

Option C: Reallocate Part B before Part A. This approach directs the sections that may likely interest stakeholders upfront. While this ordering recognises that many stakeholders may only be interested in these sections, however, it may not be a logical flow to propose the Tier 3 reporting requirements without understanding why the Board decided to develop a further differential reporting tier; or

Option D: Reallocate Appendix A to the start of the DP, followed by Part B and Part A. As suggested by a Board member, some stakeholders may appreciate the information in a summarised format upfront. However, staff consider that the snapshot documents would be sufficient in providing the Board's preliminary views in a summarised format rather than reallocating Appendix A.

Staff view is Option A.

Do Board members support the staff view, i.e. Option A? If not, what approach do Board members support?

Commented [A4]: **Question 3 to Board members:**
Key topics in Section 5 are generally based on the ordering of the accounting topics as currently laid out in the *IFRS For SMEs* Standards. The exception is borrowing cost and Impairment of non-financial assets. Staff consider the accounting for borrowing costs and impairment of non-financial assets logically follow from the topic after Property, Plant and Equipment and Investment property given the link between these topics.

Do Board members agree with ordering the key topics currently presented in Section 5?

If not, what order would Board members prefer for the key topics in Section 5?

Summary and invitation to comment

Why is the Board publishing this Discussion Paper?

The Board is publishing this Discussion Paper to seek feedback on its preliminary views about an additional differential reporting tier for use by not-for-profit private sector entities and on the key features of that further reporting tier. General purpose financial statements that comply with Tier 3: Australian Accounting Standards – Simplified Accounting will be based on reporting requirements that are "simpler" to understand and apply compared to existing accounting requirements.

The Board is developing Tier 3 reporting requirements because it intends to remove the capacity for not-for-profit entities to prepare special purpose financial statements under Australian Accounting Standards. Many, but not all, such entities may determine that it is appropriate to prepare Tier 3 compliant general purpose financial statements to satisfy those obligations in the future.

+ More information

The reporting entity concept in SAC 1 *Definition of the Reporting Entity* has, in certain cases, resulted in some less desirable reporting outcomes, including a reduction in comparability between not-for-profit private sector entities with similar economic circumstances. Alongside its other work, the Board is researching the pervasiveness of this concern and considering how to address the reduction in comparability. The International Accounting Standards Board's (IASB) decision to use the term 'reporting entity' in its revised Conceptual Framework for Financial Reporting has provided the Board with renewed impetus to address this concern. The Board considers it necessary, for clarity, to have only one use of the term in Australian Accounting Standards.

In 2018, the Board published Invitation to Comment ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (May 2018). ITC 39 was intended to be a step to improving the quality of financial statements of both for-profit and not-for-profit entities through Board actions to extend the population of entities preparing general purpose financial statements. However, following the feedback received, the Board became aware that it might need to make different decisions for not-for-profit private sector entities, for-profit private sector entities and public sector entities. In particular, the Board was conscious that it might be necessary to develop one or more further differential reporting tiers (sets of accounting requirements) for use by not-for-profit private sector entities. The Board recognises that there is likely to be a larger population of smaller not-for-profit private sector entities that are required to prepare general purpose financial statements, compared to for-profit private sector entities,

This Discussion Paper is the Board's first step in revising its differential reporting framework for use by not-for-profit private sector entities to improve comparability between entities. The primary objective of this Discussion Paper is to set out the Board's preliminary views on key features of the form and content of a proposed third tier of general purpose financial statements, as well as communicate its views on the limits of its project scope.

The Discussion Paper also responds to stakeholder concerns that the existing reporting framework is not a proportionate response for some (smaller) entities should the Board decide to extend the application of accounting standards to certain not-for-profit private sector entities that are not reporting entities as defined by SAC 1. If implemented, the Board expects its preliminary views will improve the quality of reporting by not-for-profit private sector entities through better standardisation of accounting policies and disclosures, thereby improving comparability and reporting transparency by these entities. The financial statements are expected to be more useful to their users.

Commented [A5]: <u>**Question 4 to Board members:**</u>
Do Board members agree with the staff recommendation to describe Tier 3 reporting requirements in the Discussion Paper as Tier 3: Australian Accounting Standards – Simplified Accounting?

<u>**Background, staff analysis and recommendation**</u>
Staff presented several options for identifying the Tier 3 reporting requirements at the February 2022 AASB meeting (refer to M185 Agenda Paper 11.1). The Board did not decide on the name of Tier 3 Standard in that meeting. The options were:

Option A: Tier 3 Australian Accounting Standards – Simplified Accounting. This description is consistent with describing Tier 2 – reporting requirements as 'Simplified Disclosures'.

Option B: Tier 3 Australian Accounting Standards – Simplified Accounting (Not-for-Profit Private Sector Entities). This identifies the entities the Standard is intended for and will help distinguish from any future development of possible Tier 3 reporting requirements for public sector entities. However, such labelling is inconsistent with existing Australian Accounting Standards that do not include their limited application in their titles, such as AASB 8 *Operating Segments* and 1004 *Contributions*.

Option C: Tier 3 Australian Accounting Standards – Less Complex Entities. This corresponds to the description given by the International Auditing and Assurance Standards Board in respect of its proposed auditing standard.

Option D: Tier 3 Australian Accounting Standards – Small and Medium-Sized Entities. This acknowledges the size of the entities for which the reporting Tier is being developed and provides a 'link' to IFRS as the basis for Australian accounting standard-setting.

However, the reference to "small" entities may be confusing for some stakeholders. As such, an alternative is for this descriptor to omit the term 'small' to convey that Tier 1 and Tier 2 general purpose financial statements may be more appropriate for larger NFP private sector entities.

Option E: Tier 3 Australian Accounting Standards – Simplified Accounting for Smaller Not-for-Profit Entities. This maintains consistency with the Tier 2 descriptor as well as identifies the intended user group.

Staff recommended identifying the Tier 3 reporting requirements as Tier 3 Australian Accounting Standards – Simplified Accounting (**Option A**), as reflected in the present DP drafting. At the February 2022 meeting, the Board did not vote on an agreed descriptor, but made the following comments:

<u>1. That the length of the descriptor should be shorter, if possible.</u>
Staff response, August 2022: The proposed title is consistent with the description given to Tier 1: Australian Accounting Standards and Tier 2: Australian Accounting Standards – Simplified Disclosures in AASB 1053. Staff think it is to further shorten the Tier 3 descriptor without changing the naming convention applied to the other reporting tiers. For this reason, staff propose no change to the suggested descriptor in this regard.

<u>2. That the descriptor should, for preference, include a NFP identifier.</u>
Staff response, August 2022: Having regard to the Board comment about minimising the descriptor length, staff propose that the Tier 3 descriptor continue to exclude a reference to the entities it would apply to. This would also retain consistency with the naming convention applied to other AASB pronouncements (e.g. *Conceptual Framework for Financial Reporting*). ... [1]

Who will be affected if the preliminary views in this Discussion Paper are implemented?

The proposals, if developed consistent with the preliminary views, are expected to impact not-for-profit private sector entities that currently:

(a) prepare special purpose financial statements to satisfy a direction to prepare financial statements in accordance with Australian Accounting Standards;

(b) to comply with a regulatory direction, gather financial information or prepare various financial statements in accordance with the recognition and measurement criteria specified by Australian Accounting Standards; or

(c) prepare general purpose financial statements, as the Board proposes to introduce a further form of general purpose financial statements.

+ More information

Subject to any future changes in the regulatory reporting requirements, entities impacted by the Board's proposals, if developed consistent with the Board's preliminary views, include:

(a) 'medium' and some 'large' charities that currently lodge special purpose financial statements with the Australian Charities and Not-for-profits Commission to satisfy their regulatory reporting obligations; and

(b) incorporated associations, co-operatives and not-for-profit companies limited by guarantee that are required to prepare financial statements that comply with Australian Accounting Standards for lodgement with the relevant federal, state or territory authority and which currently prepare special purpose financial statements.

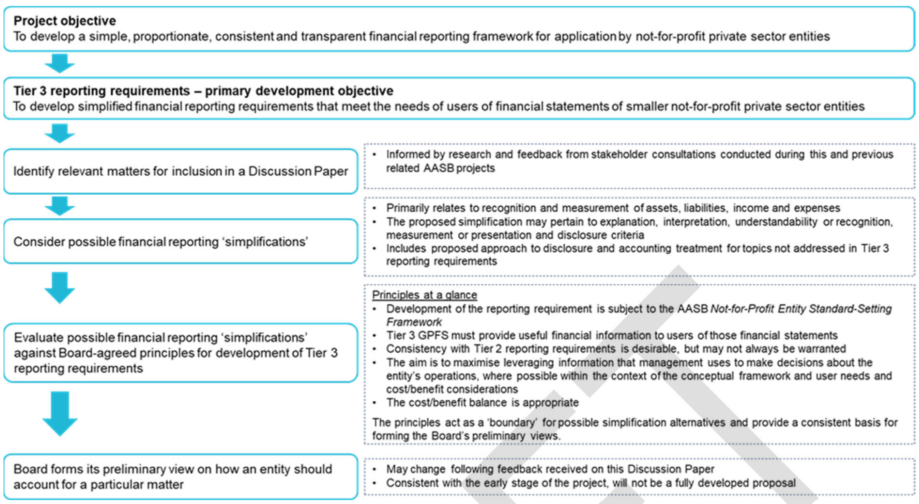
The Board's proposals may also impact some not-for-profit private sector entities preparing general purpose financial statements and those that gather financial information or prepare various financial statements in accordance with the recognition and measurement criteria specified by Australian Accounting Standards. These entities could be impacted because the proposals introduce a further set of accounting requirements that may be accessible by the entity.

The Board's proposals are not expected to impact entities that are not required to prepare financial statements that comply with Australian Accounting Standards. These entities may continue to prepare special purpose financial statements.

How did the Board reach its preliminary views?

The flowchart below outlines the framework through which the Board reached its preliminary views on the form and key accounting aspects of a further differential reporting tier for not-for-profit private sector entities. In forming its preliminary views, the Board considered how it could reduce preparer compliance costs while still providing users of the financial statements with useful information. To do so, the Board considered how it might depart from existing Australian Accounting Standards through different expression (language), recognition and measurement criteria, and approaches to presentation and disclosure.

Illustration of how the Discussion Paper was developed



+ More information

In reaching its preliminary views, the Board considered:

(a) its project objectives to develop a differential reporting framework that is simple, proportionate, transparent and easy to understand and apply;

(b) the views of its Not-for-Profit Project Advisory Panel members and other targeted stakeholders were consulted during the Discussion Paper's development. These stakeholders include regulators of not-for-profit private sector entities, preparers, users, academics and audit firms;

(c) the purpose for which the financial statements are prepared, and the users who might rely on those financial statements;

(d) the extent to which 'like' transactions should be accounted for in the same manner (described as 'transaction neutrality');

(e) whether, for smaller not-for-profit private sector entities, the costs of implementing Tier 1 recognition and measurement requirements outweigh the benefits of that information;

(f) whether its decisions inappropriately disadvantage for-profit private sector entities; and

(g) whether its decisions disadvantage not-for-profit private sector entities compared to their international counterparts.

In reaching its preliminary views, the Board also considered relevant academic and AASB research and feedback from consultations conducted during this and previous related Board projects, including its broader Australian Financial Reporting Framework project. These included:

(a) AASB Research Report No.1 *Application of the Reporting Entity Concept and Lodgement of Special Purpose Financial Statements (June 2014)*

(b) AASB Research Report No.5 *Financial Reporting Requirements Applicable to Charities (October 2017)*;

(c) AASB Discussion Paper *Improving Financial Reporting for Australian Charities (November 2017)*

Commented [A6]: Note for Board members:
Staff will be including in an appendix the academic literature and research that the Board had regard to when considering its preliminary views on the Tier 3 reporting requirements.

(d) AASB Consultation Paper ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems (May 2018)*

(e) AASB Research Report No.11 *Review of Special Purpose Financial Statements: Large and Medium-Sized Australian Charities (September 2019)*; and

(f) AASB Research Report No.16 *Financial Reporting by Non-Corporate or Small Entities (April 2021)*.

When identifying the relevant matters for inclusion in this Discussion Paper, the AASB considered what might be routine transactions, events and balances for a smaller not-for-profit private sector entity. In addition to feedback, it hopes to receive during the public consultation process, the AASB is presently conducting research to determine whether it has adequately identified the common transactions, events and balances of smaller not-for-profit private sector entities for specific simplified accounting requirements that may need to be developed.

What does this Discussion Paper include?

This Discussion Paper discusses:

(a) the Board's preliminary views for the form and accounting requirements of a proposed revised differential reporting framework for not-for-profit private sector entities; and

(b) the Board's proposal to extend the application of Australian accounting standards to not-for-profit private sector entities that are currently not a 'reporting entity' as defined by SAC 1 *Definition of the Reporting Entity*.

Commented [A7]: **Note to Board members:**
In the February 2022 draft Discussion Paper considered by the Board, staff signalled an intention to extend this section to include an image/table to highlight key features of the DP and potentially expanding on the simplification aspects of Explanation, Recognition, Measurement, Disclosure, Interpretation and Understandability.

Staff now consider that the section does not need to be extended in this manner, having regard to the use of summary snapshots/callouts in the document and the proposed inclusion of a Foreword at the start of the discussion paper.

What are the next steps?

The views expressed in this Discussion Paper are preliminary and may change. The Board will consider the comments received in response to this Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.

The Board will also consider the progress of its related projects in making its decisions on its next steps.

We need your feedback

Comments are invited on any of the preliminary views in this Discussion Paper by [X Month 202X]. Feedback plays an important role in the decisions that the AASB will make in regard to a project. The AASB would prefer that respondents express a clear overall opinion on whether the preliminary views, as a whole, are supported and that this opinion be supplemented by detailed comments on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all feedback, whether it addresses some or all questions, additional issues or only one issue (whether an issue is specifically identified below or another issue).

Feedback may be provided to the Board either by:

(a) making a formal submission;

(b) completing a survey, preferably with an explanation of the response;

(c) contacting the AASB to discuss the preliminary views; or

(d) writing to the AASB.

Questions for respondents

The AASB seeks to obtain the views of as many stakeholders as possible to provide a better appreciation of any concerns with the preliminary views presented in this Discussion Paper before developing an Exposure Draft.

For each question below, please indicate the extent to which you agree or otherwise with the preliminary view. The AASB encourages the response to be supplemented by comments that explain why its preliminary views are supported or otherwise.

Key terms

The following terms are used in this Discussion Paper:

Term	Explanation
GPFS	General purpose financial statements. General purpose financial statements are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs. A set of financial statements should not be described general purpose financial statements except where they comply with the recognition, measurement, classification, presentation and disclosure requirements of all of the Australian Accounting Standards applying to the entity. Financial statements that comply with Tier 1: Australian Accounting Standards or Tier 2: Australian Accounting Standards – Simplified Disclosures reporting requirements are general purpose financial statements. If the Board's proposals are finalised, financial statements that comply with Tier 3: Australian Accounting Standards – Simplified Accounting reporting requirements will also be general purpose financial statements.
SPFS	Special purpose financial statements. Special purpose financial statements are those other than general purpose financial statements. These financial statements may not include all the financial statements that form part of a set of general purpose financial statements and/or comply with only some, but not all, of the recognition, measurement, classification, presentation and disclosure requirements of the Australian Accounting Standards applicable to the entity.
Tier 1 Australian Accounting Standards	Refers to Tier 1: Australian Accounting Standards. Tier 1 incorporates International Financial Accounting Standards (IFRS Standards) issued by the International Accounting Standards Board (IASB) and include requirements that are specific to Australian entities. These include recognition, measurement or disclosure modifications specific to not-for-profit entities.
Tier 2 Australian Accounting Standards	Refers to Tier 2: Australian Accounting Standards – Simplified Disclosures. Tier 2 comprises the recognition and measurement requirements of Tier 1 (including consolidation and the equity method of accounting) but substantially reduced disclosure requirements. Except for the presentation of a third statement of financial position under Tier 1 and the option of not presenting a statement of changes in equity, the presentation requirements under Tier 1 and Tier 2 are the same. Tier 2 disclosure requirements are set out in AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*.
Tier 3 reporting requirements	Refers to the proposed suite of accounting requirements, tentatively to be known as Tier 3: Australian Accounting Standards – Simplified Accounting
Tier 3 entity	Refers to an entity preparing financial statements that comply with Tier 3: Australian Accounting Standards – Simplified Accounting

Term	Explanation
Tier 3 general purpose financial statements/ Tier 3 financial statements	Refers to financial statements that comply with Tier 3: Australian Accounting Standards – Simplified Accounting

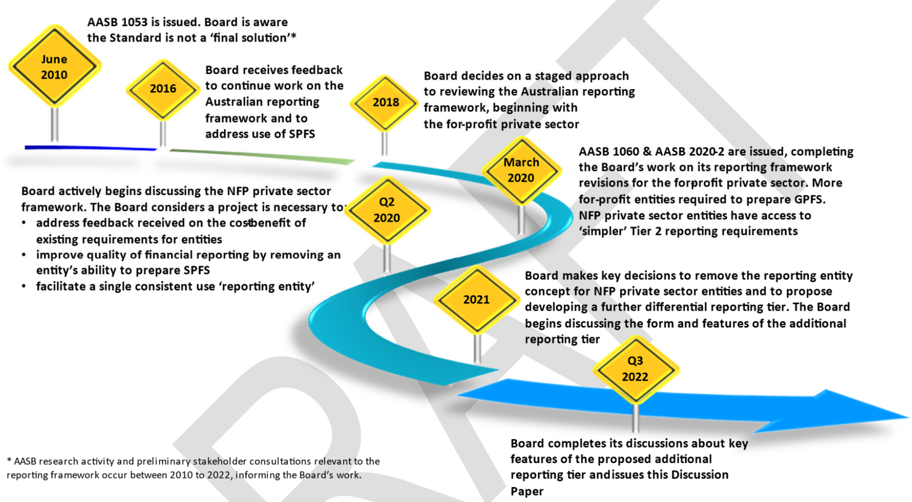
PART A: EXTENDING THE DIFFERENTIAL REPORTING FRAMEWORK

Section 1: Introduction

Background

1.1 Figure 1.1 sets out the timeline of the Board's work to date on the Australian reporting framework.

Figure 1.1: Project origins



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AASB 1053 *Application of Tiers of Australian Accounting Standards* (June 2010) is the Australian Accounting Standard that establishes the differential reporting framework for Australian reporters (described as 'Tiers' of reporting requirements). At the time of its issue in June 2010, the Board regarded it as a pragmatic and substantive response to the need to reduce the financial reporting burden of Australian reporting entities, but acknowledged that it was not a complete or final answer to that need.[1]

Since the issue of AASB 1053, the Board has continued to monitor developments, progress research and engage with constituents concerning various aspects of the reporting framework, either as part of work of its Research Centre or as part of the Board's Australian Financial Reporting Framework standard-setting project. In 2016, the Board observed that many constituents providing feedback on the Board's work program for the period 2017 – 2019 (as part of ITC 34 *AASB Agenda Consultation 2017 – 2019*) recommended that the Board continue its Australian Financial Reporting Framework project as a high priority project and that the project scope should consider also not-for-profit entities and small-to-medium sized private sector entities. This feedback included suggesting the Board consider the possibility of a third differential reporting tier and reconsidering the criteria for classifying entities as subject to Tier 1 or Tier 2 reporting requirements. Stakeholders also encouraged the Board

1 Paragraph BC20 of the Basis for Conclusions to AASB 1053.

to continue its work on reviewing the suitability of the reporting entity concept and the prevalence of special purpose financial statements.

Considering resource limitations and noting that recommendations arising from the 2017-2018 review of Australian Charities and Not-for-profits Commission (ACNC) legislation were likely to inform the Board's work on the not-for-profit private sector, the Board in 2018 elected to progress its project in stages, beginning first with the review and revision of the Australian reporting framework for for-profit private sector entities. That work is now complete with the issue of AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (March 2020) and AASB 2020-2 *Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (March 2020). The outcome of that stage of the Board's project was to require many for-profit entities required by legislation or their constituting document or another document to prepare financial statements that comply with Australian Accounting Standards to prepare general purpose financial statements.

The current stage of the Board's Australian Financial Reporting Framework project explores possible revisions to the Australian differential reporting framework for not-for-profit private sector entities to address a concern that its existing forms of general purpose financial statements[2] might impose, for certain not-for-profit private sector entities, disproportionate costs when regarded against the benefits of that information.[3] The following factors have suggested to the Board that a project is necessary to respond to that concern :

(a) work of the Board's Research Centre over the last decade,

(b) developments in financial reporting, the changing reporting landscape for not-for-profit private sector entities; and

(c) preliminary feedback from targeted consultation with stakeholders over the past several years, including initial feedback received during the Board's public consultation of AASB Invitation to Comment ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (May 2018).

One or more of the above factors may have contributed to the decisions of various entities to, where permitted, prepare special purpose financial statements rather than general purpose financial statements. The Board observed that an outcome of its undertaking a project could be to improve the quality of reporting by such entities through measures to facilitate the adoption of consistent accounting policies supported by the Australian conceptual framework. At the very least, the Board observed that it must consider and address the implications of a proposed decision to have the term 'reporting entity' consistently understood within the body of its pronouncements.[4]

2 Australian Accounting Standards presently consist of two Tiers of reporting requirements for preparing general purpose financial statements: Tier 1: Australian Accounting Standards; and Tier 2: Australian Accounting Standards – Simplified Disclosures.

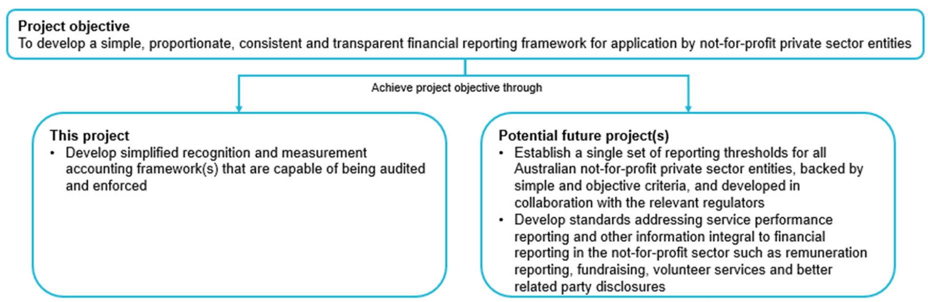
3 Possible revisions to the framework for public sector entities will be considered as part of a parallel stage of the Australian Financial Reporting Framework project.

4 The term 'reporting entity' is used in the *Conceptual Framework for Financial Reporting* in a general manner, to reference the entity that is preparing the (general purpose) financial statements. This differs to the specific manner in which 'reporting entity' is used and understood in Australia, within the context of SAC 1 *Definition of the Reporting Entity* which adopts a concept of the reporting entity that is tied to the information needs of users and the nature of general purpose financial statements. A 'SAC 1 reporting entity' is an entity in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.

Objective and scope of the project

1.2 Figure 1.2 below describes the original project objective and the scope of this project:

Figure 1.2: Original project objective and the scope of this project



+ More information

In preliminary discussions, the Board initially envisaged that this project might be broad-ranging, leading to the development of a simple, proportionate, consistent and transparent reporting framework for all not-for-profit private sector entities in Australia that would include the following features:

(a) a single set of reporting thresholds for all Australian not-for-profit private sector entities, backed by simple and objective criteria and developed in collaboration with the relevant regulators;

(b) simplified recognition and measurement accounting framework(s) that are capable of being audited and enforced;

(c) development of standards addressing service performance and other information integral to financial reporting in the not-for-profit sector such as remuneration reporting, fundraising, volunteer services and related party disclosures, to the extent justified by evidence.

In discussions with stakeholders consulted prior to deciding to progress a project, stakeholders were generally supportive of the Board revisiting its existing reporting framework applying to not-for-profit private sector entities. Stakeholders indicated a desire for there to be more streamlining of financial reporting obligations and for better alignment of accounting standard requirements with existing reporting obligations imposed by Australian regulators, while – particularly in the current economic environment – not resulting in significant incremental costs to entities. Stakeholders were hopeful that the Board's project would result in a reporting framework that was proportionate, simple and easy to understand, and cost effective.

The Board has refined the objective of its project considering regulatory developments since the time of the Board's initial discussions, feedback received from its initial discussions with stakeholders and the Board's consideration of its role and its views on the urgency of developing a revised differential reporting framework. The Board's objective remains the development of a simple, proportionate, consistent and transparent financial reporting framework for not-for-profit private sector entities, but the scope of the project is narrower than initially envisaged.

This project now largely delivers on the Board's objective through proposals to introduce simplified accounting requirements to provide a proportionate reporting response for certain not-for-profit private sector entities. The proposals are expected to improve comparability and the quality of reporting by these entities by requiring consistent recognition and measurement requirements to be applied. However, the Board's current project will not create a single set of reporting thresholds for all Australian not-for-profit private sector entities, and the development of accounting standards

Commented [A8]: **Note for Board members:**
The text in this section has largely been informed by M173 Agenda Paper 5.1 (November 2019), M178 Agenda Paper 3.1 (November 2020), and the Board's decisions at its February 2021 meeting.

Commented [A9]: **Note for Board members:**
This original project objective and scope considered was considered by the Board at its November 2019 meeting, as part of the agreed project plan. The November 2019 project plan can be accessed via this project's Project Summary (M173 Agenda Paper 5.1, AASB Meeting November 2019) at the following link: https://www.aasb.gov.au/media/43xdqylq/ps_afr-nfp_05-26.pdf.

addressing service performance and other information generally considered to provide useful financial reporting in the not-for-profit sector will be considered separately from this Board project.

Establishing reporting thresholds

Commented [A10]: **Note for Board members:** The text in this section has been largely drawn from M179 Agenda Paper 5.3 and the Board's discussion at its February 2021 meeting.

1.3 As depicted in Figure 1.2 above, the Board has decided not to address the subject of reporting thresholds as part of this project. The Board acknowledges that its planned approach may not sufficiently address the stakeholder concern that an entity may not be reporting appropriate or adequate information in its financial statements. For example, under its proposals, an economically significant not-for-profit private sector entity would not be prevented by the Australian Accounting Standards from preparing and lodging Tier 3 general purpose financial statements.

1.4 From its preliminary outreach, the Board appreciates stakeholder feedback supporting a single set of objective reporting thresholds. However, the Board observed that:

(a) it only has the authority to develop thresholds to constrain or require the use of a 'tier' of general purpose financial statements by certain entities by limiting the application of specified Australian Accounting Standards. While it could contribute or lead a project, the Board's authority does not extend to establishing thresholds that dictate whether an entity must prepare financial statements that comply with Australian Accounting Standards. Consequently, any effort by the Board alone (to standardise the use of various accounting requirements) would not achieve the desired outcome; and

(b) while its preliminary outreach suggested some support for entity size represented by revenue/income as a reporting threshold determinant, there was no clear indication that such quantitative threshold would be workable when considering entities across the country. There are also various other challenges in identifying appropriate qualitative or quantitative thresholds, including the appropriateness of using an existing reporting threshold. For example, the Australian Charities and Not-for-Profits Commission (ACNC) specified size criteria may not be an appropriate threshold determinant given the population of not-for-profit private sector entities that are not ACNC-registered charities.

1.5 Ultimately, the Board views the establishment of appropriate reporting thresholds and any dictate of a specific form of general purpose financial statements to be more appropriately within the remit of the relevant legislation or regulatory authority, consistent with the regulatory authority having charge of whether the lodged financial statements must be prepared in accordance with Australian Accounting Standards and whether they are subject to review or audit. Consequently, the Board decided to scope such effort out of this project.

1.6 Nevertheless, the Board notes that consistency in reporting by 'similar' entities is desirable. The Board is also conscious that some users may challenge the 'true and fair view' assertion made by an entity of its results and financial position, where the entity prepares financial statements that comply with a reporting tier that the stakeholder regards as insufficient. Therefore, the Board has not ruled out developing guidance to assist entities in identifying the suitability of preparing financial statements in compliance with the proposed Tier 3 reporting requirements. The Board welcomes suggestions stakeholders may have to help it develop some indicators or "soft" boundaries that could be expected to normally indicate that Tier 3 general purpose financial statements would not meet the needs of the users of those financial statements.

+ More information

In a differential reporting environment, one of the areas creating complexity for not-for-profit entities is understanding their reporting obligations. Understanding their reporting obligations includes identifying an appropriate form of financial statements to prepare. Consequently, the Board's proposal to develop a further form of general purpose financial statements (Tier 3 reporting requirements) but not to develop a set of reporting thresholds for all Australian not-for-profit private sector entities could be expected to further add to this complexity.

The Board acknowledges that some constituents might contend that its planned approach to not-for-profit private sector entities is inconsistent with the approach the Board has taken with respect to for-profit private sector entities (see AASB 1053 *Application of Tiers of Australian Accounting Standards*), and does not reduce 'red tape' complexity for Australian reporters. However, in contrast to for-profit private sector entities, the Board observed that without coordinated timely corresponding amendment to multiple articles of legislation involving different regulatory bodies, the Board introducing thresholds could result in more navigational complexity for the sector. The additional 'navigational complexity' is because an entity may need to consider different criteria to establish its reporting obligations (specified by other legislation/s) and the form of general purpose financial statements it prepares to satisfy those obligations (specified by the Board). The Board is of the view that effort in establishing consistent reporting criteria should be led in the first instance by other bodies, similar to the recent efforts made to align the different state reporting thresholds for incorporated associations.

In forming its view not to develop a set of reporting thresholds for all Australian not-for-profit private sector entities, the Board also observed that identifying appropriate objective criteria, whether quantitative or qualitative, for separating Australian entities into three 'tiers' in a meaningful manner is likely to be challenging considering the broad range of activities undertaken by the sector and the economic disparity in different parts of Australia. As such, extending the project scope would further delay the finalisation of proposals that are expected to improve the quality of reporting by the sector. Regarding feedback received on as part of its 2022 – 2026 agenda consultation, the Board considered that the Board should best be directed to improving accounting in other areas.

1.7 If the Board's views are implemented, a not-for-profit private sector entity would consider relevant legislation, constituting document or another document for the direction of the form of general purpose financial statements it must prepare. Where no such direction exists, the entity can prepare its choice of general purpose financial statements.

1.8 The Board is aware that its planned scope puts the onus on the relevant regulatory body to specify the type of general purpose financial statements to be prepared, where the regulatory body considers such specification necessary. Any change to legislation or regulations to effect such specification – if considered necessary – would take time. The Board intends to work collaboratively with key legislative authorities and regulatory bodies to enable the orderly application of the proposals, where invited to do so, and to the extent it is able. In addition, the Board is aware that some legislation requires compliance with the accounting standards' recognition and measurement requirements. Consequently, introducing a different set of requirements may create complexity for entities and similarly require addressing by the applicable legislation and affected regulatory bodies.

1.9 Before finalising this Discussion Paper, the Board consulted with various regulatory bodies as to whether, according to their expectations, the relevant legislation would be likely to be amended to articulate the type of general purpose financial statements required in response to the Board's intention not to do so. The Board expects that relevant legislative authorities and regulatory bodies will need to consider the AASB's proposals more fully before determining whether future action is necessary.

+ More information

When the Board first started its research into understanding the reporting environment for not-for-profit entities, it identified that one area in which reporting could be made simpler for entities is by providing a clear specification of their reporting requirements. Since then, the Board observed that various actions have been taken, with further efforts underway, to reduce the reporting burden and complexity for various not-for-profit entities, including removing some of the duplication in requirements to prepare financial statements.

Commented [A11]: __Note for Board members:__
Staff have drafted this text inclusion having regard to an early Board direction to engage with regulators on this project.

Commented [A12]: __Note for Board members:__
This text is informed by the staff interactions with regulators as reported in M186 Agenda Paper 4.1 and M188 Agenda Paper 12.1.

Presently, not-for-profit private sector entities have access to two Tiers of reporting requirements for general purpose financial statements. AASB 1053 *Application of Tiers of Australian Accounting Standards* specifies that a not-for-profit private sector entity preparing general purpose financial statements must comply with Tier 2 reporting requirements at a minimum. As part of revising its differential reporting framework, the Board considered whether and how it should amend such requirements. The Board observed that the specification of such requirements would provide entities with better clarity in light of the Board's preliminary view to develop a further differential reporting tier that would specify certain recognition and measurement departures from Tier 1 and Tier 2 reporting requirements.

The Board considered various approaches it could take, including:

(a) being silent as to the reporting Tier an entity preparing general purpose financial statements complies with;

(b) specifying a default reporting Tier for all not-for-profit private sector entities; allowing entities to comply with a different reporting Tier only as permitted or required by a relevant regulatory body or by members; and

(c) specifying the reporting Tier that a not-for-profit private sector entity must, at a minimum, comply with, if the entity is preparing financial statements that are held out to be general purpose financial statements.

The last approach (specification of reporting Tiers) is arguably the most consistent with the Board's past practice, whereby the Board has in effect specified the minimum reporting Tier compliance of each type of entity. This approach is consistent with the view that as the differential information needs of the users of different types of entities is relevant to identifying 'useful information' in each reporting Tier, it appears reasonable for the Board to also then identify which entities it intends the reporting requirements of a particular Tier to, at a minimum, apply to. By so doing, this could be expected to minimise situations where an entity's prepared general purpose financial statements do not meet the needs of users of those financial statements.

Contrastingly, the other identified approaches put the onus on the respective legislation, legislative authority and regulator, or members and those charged with governance, to determine the extent of reporting required, rather than the AASB. These approaches reflect the view that the body requiring the preparation of financial statements should be the body specifying the extent of information required. In its deliberations, the Board observed that to the extent duplicated financial reporting obligations have not yet been reduced where a not-for-profit private sector entity has reporting obligations to more than one regulatory body, taking one of these approaches could arguably add another layer of reporting complexity for the entity. Also, the second approach described above (specifying a default reporting Tier), beyond creating additional 'red tape' for entities, may result in 'similar' entities applying different reporting requirements (either within or across jurisdictions), reducing the comparability of the financial statements those entities prepare.

As described in paragraph 1.3 above, the Board ultimately formed a view that the project scope would not include specifying reporting thresholds for the application of general purpose financial statements by not-for-profit private sector entities (i.e. to adopt the first approach (being silent)).

Service performance information

Commented [A13]: Note for Board members:
The text in this section has largely been informed by or drawn from M177 Agenda Paper 5.1 (September 2020), M178 Agenda Paper 3.1 (November 2020), M179 Agenda Paper 5.4 (February 2021) and the Board's discussion at its February 2021 meeting.

1.10 As part of determining the scope of its current project, the Board observed the significance of information about what a not-for-profit private sector entity has done during the reporting period in working towards its broader aims and objectives to understand how efficiently and effectively management has discharged its responsibilities to use the entity's economic resources. This information is commonly described as 'service performance information'. The Board noted that such information provides context for the entity's financial performance and helps users assess management's stewardship of its economic resources.

1.11 As depicted in Figure 1.2 above, the Board does not intend to develop proposals for reporting service performance information as part of this project (see also paragraph 1.21). The Board considers such information highly relevant to users of a not-for-profit entity's financial statements but was conscious that developing proposals will likely delay the finalisation of any Tier 3 reporting requirements. The Board also observed that reporting service performance information is not a matter specific only to Tier 3 entities. Feedback from targeted stakeholders and from the Board's agenda consultation indicates some support for the planned approach.

1.12 In forming its view, the Board considered matters including:

(a) the complexity of developing proposals on service performance information, noting data collection, interpretation, assurance and other concerns raised by stakeholders in its preliminary consultations on this project;

(b) the urgency for developing proposals, noting that entities may already be required to provide information about their service performance;

(c) whether the sufficiency of Tier 3 general purpose financial statements is intrinsically dependent on whether there is accompanying service performance information; and

(d) its agenda priorities, including this project's focus on smaller not-for-profit private sector entities and the relevance of service performance information to a broader set of entities (see also paragraph 1.21).

+ More information

In preliminary discussions with stakeholders in developing this Discussion Paper, stakeholders were generally receptive to the Board developing a set of accounting requirements similar to those applying to New Zealand Tier 3 not-for-profit entities. The product would be 'simpler' financial statements accompanied by complementary not-for-profit information, including service performance information. However, many stakeholders – including, but not limited to, preparers – signalled concerns about the Board developing requirements about an entity's service performance which might impose reporting obligations that might be subject to assurance on possibly smaller or less well-resourced entities as part of this Board project. These stakeholders questioned whether the user information benefits of service performance information would outweigh the costs of preparing such information, particularly for smaller not-for-profit private sector entities which might be required to provide service performance information that may not be similarly required of other entities.

Some stakeholders were of the view that proposals about service performance information were likely to be complex to develop given diversity in not-for-profit private sector entity objectives, operating models, and considering the financial reporting abilities of not-for-profit private sector entities. These stakeholders were concerned that the Board's differential reporting framework project might be undesirably delayed should requirements about service performance information be developed. These stakeholders would rather see the Board prioritise developing proposals to simplify financial reporting for smaller not-for-profit private sector entities.

In forming a preliminary view of whether the scope of this project should include proposals about service performance information, the Board considered the feedback from its preliminary discussions with stakeholders and:

(a) the urgency of developing requirements on service performance information;

(b) whether service performance information is a fundamental aspect of a differential reporting framework for not-for-profit private sector entities;

(c) the scope of its separate project on reporting service performance information;

(d) the complexity of developing proposals about service performance information;

(e) how important it is that the Australian differential reporting framework for not-for-profit entities aligns with that applying to New Zealand not-for-profit entities;

(f) whether it should be taking the opportunity to obtain feedback on service performance information;

(g) the availability of stakeholders to contribute to the development of, and respond to, proposals on service performance information alongside the other proposals in this Discussion Paper;

(h) local and international developments and other Board projects; and

(i) resourcing limitations.

The Board heard that the Australian Charities and Not-for-profits Commission (ACNC) already requires registered charities to provide some reporting about their performance against not-for-profit programs as part of the entity's publicly available annual information statement. Also, some not-for-profit private sector entities already voluntarily report, apart from the financial statements, on what the entity has done during the reporting period in working towards its broader aims and objectives (the not-for-profit entity sometimes describes these reports as its 'annual report'). Consequently, the Board considers that there may be less need for the Board to develop standardised requirements urgently. However, the Board also notes that there may not be consistency in the information reported between entities, considering the diverse purposes and operating models of the entities. As a result, comparability and possibly some transparency may be sacrificed. In addition, not all such information is subject to assurance, given the location of the disclosures. This leads to questions about whether the disclosed information is a faithful representation of what it purports to represent.

The Board considers reporting of service performance information useful to users of the financial statements of all not-for-profit entities. The Board discussed the complexity of developing proposals on service performance information, noting that several other jurisdictions have already developed requirements that the Board could adopt or use as a starting point. Considering feedback and learnings from the initial consultation activity and ED 270 *Reporting Service Performance Information*, the Board acknowledged that complexities in developing proposals on such information might disproportionately delay progress on a differential reporting framework. Further, the Board observed that its current work on its differential reporting framework project is targeted at only not-for-profit private sector entities, but that information about service performance is relevant to all not-for-profit entities. Ultimately, the Board is not keen to unnecessarily expand the project scope for this particular aspect, now observing the momentum and urgency to provide reporting relief for certain not-for-profit private sector entities. Therefore, the Board has reached a preliminary view that it will not develop proposals on reporting service performance reporting proposals as part of its differential reporting framework project.

<u>Continuing to develop requirements about an entity's service performance</u>

In reaching its preliminary view, the Board considered whether simplified financial statements could be viewed as providing adequate information to users of the financial statements for decision-making in the absence of accompanying information about the entity's service performance. The Board is strongly of the view that information about a not-for-profit entity's service performance is critical to understanding how efficiently and effectively a not-for-profit private sector entity's management has discharged its responsibilities to use the entity's economic resources. Hence, while the Board's proposals as part of this project may result in a reduction in the financial reporting information that certain entities may have to prepare, the Board intends to continue to progress a separate project on developing requirements on service performance reporting for application by not-for-profit entities preparing general purpose financial statements that follow Australian Accounting Standards. The Board intends to continue to consider the role of performance reporting in meeting the needs of users of not-for-profit general purpose financial statements, and it may be that the Board develops further proposals in the future, including possibly requiring the preparation of a performance report rather than a general-purpose financial report. The outcome of that project may be that different service performance information is needed for each reporting tier.

A separate project on service performance reporting is not expected to commence until the second half of 2023.

Other information integral to financial reporting in the not-for-profit sector

Commented [A14]: Note for Board members:
The text in this section reflects the proposed staff approach set out in M185 Agenda Paper 11.1 (Feb 2022).

1.13 For similar reasons to those leading it to form its view on forming requirements about service performance information, the Board has reached a view that it will not develop proposals on other non-IFRS information that might provide useful information to users of not-for-profit general purpose financial statements as part of a differential reporting framework project. These include reporting information in the following areas: remuneration, fundraising, and volunteer services. The Board also does not intend to consider extending disclosures about an entity's related parties as part of this project, except in the context of its proposed disclosure approach to Tier 3 general purpose financial statements.

1.14 In addition, regarding feedback received on its recent agenda consultation, the Board does not plan to undertake separate projects on the above matters during 2022 – 2026.

Interaction with other AASB projects[5]

Commented [A15]: Note for Board members:
At the February 2022 meeting, staff received feedback that this section was too technical a read for the discussion paper, noting the intended audience.

This section has since been revised for currency.

Staff would welcome feedback whether this section remains too technical a read.

Conceptual Framework: Not-for-Profit Amendments

Commented [A16]: Note for Board members:
The text in this section has largely been informed by M180 Agenda Paper 3.2 (April 2021) and the Board's discussion at its April 2021 meeting.

1.15 The Board is currently conducting a 2-stage project relating to its conceptual framework applicable to not-for-profit entities:

(a) Stage 1: The primary purpose of this stage is to extend the application of the *Conceptual Framework for Financial Reporting* to all not-for-profit entities. This stage is expected to incorporate the not-for-profit modifications detailed in the *Framework for the Preparation and Presentation of Financial Statements* into the *Conceptual Framework for Financial Reporting*, essentially unchanged. Following this Stage, for a not-for-profit private sector entity, "reporting entity" will no longer be defined by SAC 1 Definition of the Reporting Entity but will reference, simply, the entity preparing the financial statements; and

(b) Stage 2: The primary purpose of this stage is to address more significant and complex conceptual issues affecting not-for-profit entities. As part of this stage, the Board intends to review the objective of general purpose financial reports of not-for-profit entities and the users of those financial statements. Specifically, the Board intends to consider:

i) the emphasis given to management stewardship (or accountability) as part of the objective of general purpose financial reporting of not-for-profit entities; and

ii) whether the 'users' of a not-for-profit private sector entity's general purpose financial statements should be more broadly regarded (for example, whether users always include regulators and advisors of members of parliament).

1.16 Stage 1 of the Board's Conceptual Framework: Not-for-Profit Amendments project is progressing concurrently with the Board's work on this stage of its review of the Australian Financial Reporting Framework (this project). Stage 2 of the Board's Conceptual Framework: Not-for-Profit Amendments project will not be expected to commence until after this project is complete. However, the Board welcomes feedback as part of this Discussion Paper on the matters that the Board's Conceptual Framework project will address. Such feedback may help inform the Board's future deliberations on this project as it provides input to the 'benefit' component of the Board's cost-benefit considerations.

5 In June 2019, the Board proposed making amendments to the definition of a not-for-profit entity. Those amendments, if finalised, would have impacted identification of the entities affected by this project. In April 2021, considering feedback received on its exposure draft, the Board decided to discontinue its project revisiting the definition of a not-for-profit entity. In June 2022, the Board decided not to revisit this topic as part of its 2022 – 2026 work program.

1.17 Considering paragraph 1.15 above, the Board notes that when forming its preliminary views on Tier 3 reporting requirements, it considered:

(a) the primary users of the financial statements of a not-for-profit entity currently described in the Framework for the Preparation and Presentation of Financial Statements; and

(b) the entity is assumed to be a going concern and will continue operation for the foreseeable future.

AASB 1058 *Income of Not-for-Profit Entities*

1.18 The Board has an active project on its work program for the post-implementation review of AASB 1058 *Income of Not-for-Profit Entities*.

1.19 A post-implementation review's purpose is to evaluate a Standard's overall effectiveness and efficiency in meeting its original objectives, including whether a pronouncement remains appropriate. It is not a reconsideration of the entire Standard. The stakeholder feedback gathered during 2021 on the operability of the Standard informed the Board's post-implementation review of AASB 1058. The public consultation period of the Board's post-implementation review of AASB 1058 coincides with the consultation period on this Discussion Paper.

1.20 More information on the projects, including timing, can be found on the AASB website. The Board expects that its work on the projects may inform its decisions on Tier 3 revenue recognition requirements in future stages of this current Board project. However, the Board's preliminary views in this Discussion Paper may not necessarily change as a consequence of work on the projects.

Service performance reporting

1.21 Following feedback on its recent agenda consultation, including that the Board should develop voluntary guidance to help not-for-profit private sector entities prepare service performance information that meets user needs, the Board intends to restart a project on reporting service performance information. The project is expected to commence in the second half of 2023. Considering the likely timing of completion of a separate project on service performance reporting, any outcomes of that project are unlikely to impact this current Board project.

Sustainability reporting

1.22 Following its recent agenda consultation, the Board decided to add a standard-setting project on sustainability reporting to its 2022 – 2026 work program. Outcomes of that separate project are unlikely to impact this current Board project, but could have future implications for the extent of reporting required in a not-for-profit private sector entity's general purpose financial statements.

Differential reporting framework for public sector entities

Commented [A17]: <u>**Note for Board members:**</u>
The text in this section reflects the proposed staff approach set out in M185 Agenda Paper 11.1 (Feb 2022).

1.23 The Board's review of the Australian financial reporting framework is being conducted in phases. Consequently, a project considering the appropriateness of the existing reporting framework for public sector entities is being conducted separately on a different timeline to the timeline for not-for-profit private sector entities.

1.24 The Board's deliberations contained in this Discussion Paper relate to not-for-profit private sector entities only. Therefore, the Board is not actively seeking feedback on the impact of its preliminary views on public sector entities as the Board's decisions on this project will not necessarily be the same decisions as the Board makes when discussing public sector entity reporting requirements. The cost-benefit assessment may be different, or the Board might base its decision-making on different principles. Feedback received on this Discussion Paper relevant to the public sector financial reporting framework will be considered as part of that separate project.

Interaction with other developments

Efforts to reduce the reporting burden for certain Australian not-for-profit entities

1.25 In November 2021, the *Australian Charities and Not-for-profits Commission Regulations 2013* was amended in response to recommendations from the Australian Charities and Not-for-profits Commission Legislation Review 2018. The amendments:

(a) raise the revenue thresholds for classifying charities as 'small', 'medium' and 'large'. This impacts the entity's reporting obligations to the ACNC; and

(b) require charities to report information about their related party transactions. The extent of information required varies depending on the entity size and other circumstances.

1.26 In its discussions about the form and accounting requirements of its proposed further differential reporting tier, the Board considered the revised ACNC revenue thresholds. The ACNC-'medium' size band (entities with revenue of $500,000 or more and less than $3 million) provided the Board with a reference point for identifying transactions and balances that might commonly be undertaken by entities that may, in the future, be able to prepare general purpose financial statements that comply with its Tier 3 reporting proposals. The Board notes that this reference was made to help it identify matters for inclusion in an accounting standard. The size band does not identify the entities that are able to access the requirements or for whom the reporting tier might be appropriate.

1.27 The Board expects to consider the specific applicable disclosures that may form part of Tier 3 general purpose financial statements, including information about an entity's transactions and balances with related parties, only as part of a future stage of this project. The Board expects relevant disclosure to be informed by stakeholder feedback on its preliminary views on recognition and measurement. However, the Board has formed a preliminary view as to the disclosure approach it intends to adopt for its Tier 3 reporting requirements (see Section 6).

Subsidiaries without public accountability

1.28 The Board noted the current IASB project considering disclosures in the financial statements of a subsidiary when forming its preliminary view as to its approach to developing disclosures in its proposed further reporting tier. That IASB project, when finalised, is expected to introduce requirements to permit eligible subsidiaries to apply IFRS Standards with reduced disclosure requirements in their financial statements.

1.29 Considering the Board's proposed disclosure approach (refer Section 6), the IASB project is not expected to significantly impact this project unless it results in amendments to AASB 1060.

Second comprehensive review of the *IFRS for SMEs* Accounting Standard

1.30 The IASB is presently conducting a review of the *IFRS for SMEs* Accounting Standard, and is expected to propose amendments to the Standard. The proposals are expected to include amendments to align certain requirements and principles in the *IFRS for SMEs* with recently issued IFRS Standards. Concerning the recently issued IFRS Standards, in some cases, the IASB is expected to propose not revising existing *IFRS for SMEs* requirements.

1.31 The Board was informed by developments in the IASB project when forming its preliminary views set out in this Discussion Paper. Some of the amendments to the *IFRS for SMEs*, when finalised, may impact this project (for example, regarding estimating fair value – see Section 5).

International Financial Reporting for Non Profit Organisations Consultation Paper

1.32 The Board observed that the International Financial Reporting for Non Profit Organisations (IFR4NPO) is seeking to issue guidance for not-for-profit entity financial reporting that will be "relevant in different contexts and useful for a variety of readers". While the focus of the IFR4NPO's work is not described as being specific to an entity's size or the complexity of its transactions, but rather, on financial reporting matters relevant to not-for-profit private sector entities in general, the IFR4NPO guidance was initially targeted at addressing the needs of those not-for-profit entities with more complex operations and transactions. Nevertheless, as part of the development of this Discussion Paper, the Board considered issues highlighted in the IFR4NPO Consultation Paper.

1.33 The Board expects this and other AASB projects will be informed in the future by continuing developments in the IFR4NPO project.

Timing of any final proposals

Commented [A18]: **Note for Board members:** The text of this section reflects the Board's deliberations on M178 Agenda Paper 3.1 (November 2020) and its decision at its April 2021 meeting about the interaction between the effective dates of various Board projects (refer April 2021 minutes).

1.34 The Board is conscious of the interaction between this project, other AASB projects and the government's work to streamline and improve reporting by not-for-profit entities.[6] It is important that any resultant changes will be easy to understand and apply. Consequently, the Board intends to consider the timing of the effectiveness of any resultant proposals on this project together with decisions on the effective date of its final proposals on its Conceptual Framework for Not-for-Profit Entities project and other projects, to provide clarity for entities and so as not unduly to burden entities. This does not necessarily mean that the effective dates of all the Board's final proposals will be aligned; merely that the Board will consider the practical impacts for entities in setting effective dates on any final proposals.

1.35 Notwithstanding the above, the Board has tentatively formed a view that the effective dates of any possible:

(a) Tier 3 reporting requirements;

(b) amendments to extend the application of Australian Accounting Standards to a broader set of not-for-profit entities; and

(c) amendments to the Australian Conceptual Framework resulting from Stage 1 of the Board's Conceptual Framework for Not-for-Profit Entities project;

will be aligned such that Tier 3 reporting requirements will be available immediately for those entities preparing general purpose financial statements for the first time. Further, this ensures only a single consistent description of 'reporting entity' will apply when this 'suite' of proposals become operative.

1.36 The Board is desirous to facilitate a smooth transition for entities in the sector. In setting the effective date of any final proposals, the Board will allow for sufficient implementation time and the development of education materials, where necessary.

6 For example, actions to effect the Government response to Australian Charities and Not-for-profits Commission Legislation Review 2018 including fundraising requirements harmonisation.

Questions for respondents

Question 1

Paragraphs 1.3 to 1.9 discuss the Board's view that it should not develop 'reporting thresholds' to specify the form of general purpose financial statements that a not-for-profit private sector entity should comply with, at a minimum.

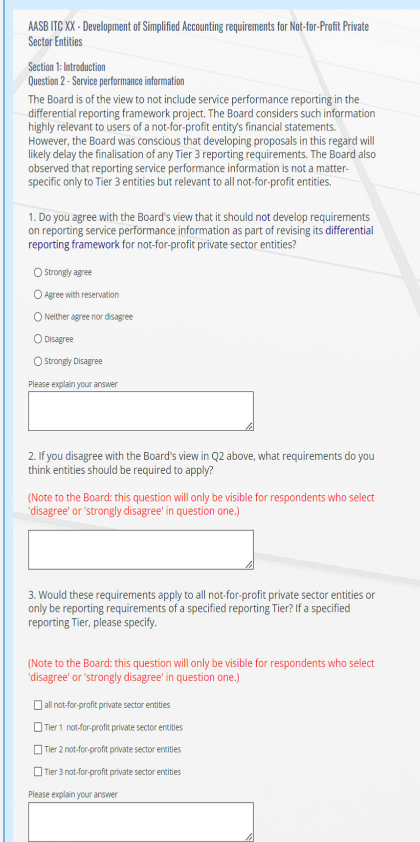
Do you agree? Why or why not? If you disagree with the Board's view, how do you propose the Board stratify entities amongst the available reporting Tiers?

Question 2

Paragraphs 1.10 to 1.12 discuss the Board's view that it should not develop requirements on reporting service performance information as part of revising its differential reporting framework for not-for-profit private sector entities.

Do you agree? Why or why not? If you disagree with the Board's view, what requirements do you think entities should be required to apply? Would these requirements apply to all not-for-profit private sector entities or only be reporting requirements of a specified reporting Tier?

Commented [A19]: **Note for Board members:**
Staff will be developing a survey instrument based on the questions in the DP. The questions will be the same except for the presentation. Staff have provided a mockup of the survey of the first question below.


AASB ITC XX - Development of Simplified Accounting requirements for Not-for-Profit Private Sector Entities

Section 1: Introduction
Question 2 - Service performance information

The Board is of the view to not include service performance reporting in the differential reporting framework project. The Board considers such information highly relevant to users of a not-for-profit entity's financial statements. However, the Board was conscious that developing proposals in this regard will likely delay the finalisation of any Tier 3 reporting requirements. The Board also observed that reporting service performance information is not a matter-specific only to Tier 3 entities but relevant to all not-for-profit entities.

1. Do you agree with the Board's view that it should not develop requirements on reporting service performance information as part of revising its differential reporting framework for not-for-profit private sector entities?

- Strongly agree
- Agree with reservation
- Neither agree nor disagree
- Disagree
- Strongly Disagree

Please explain your answer

2. If you disagree with the Board's view in Q2 above, what requirements do you think entities should be required to apply?

(Note to the Board: this question will only be visible for respondents who select 'disagree' or 'strongly disagree' in question one.)

3. Would these requirements apply to all not-for-profit private sector entities or only be reporting requirements of a specified reporting Tier? If a specified reporting Tier, please specify.

(Note to the Board: this question will only be visible for respondents who select 'disagree' or 'strongly disagree' in question one.)

- all not-for-profit private sector entities
- Tier 1 not-for-profit private sector entities
- Tier 2 not-for-profit private sector entities
- Tier 3 not-for-profit private sector entities

Please explain your answer

Question 3

The 'objective' and 'primary users' incorporated in the *Framework for the Preparation and Presentation of Financial Statements* are based on the most recently superseded version of the *Conceptual Framework for Financial Reporting* but include modifications for not-for-profit entities.

Paragraphs 1.15 to 1.17 discuss the Board's Conceptual Framework: Not-for-Profit Amendments project and how it interacts with this project. Do you agree that the *Framework for the Preparation and Presentation of Financial Statements* (including the modifications for not-for-profit entities) appropriately:

(a) depicts the objective of general purpose financial reporting for not-for-profit private sector entities; and

(b) identifies the set of primary users of the financial statements of a not-for-profit entity.

Why or why not? If you disagree, what is your reasoning for differing?

Do you have any other concerns about applying the framework set out in the *Conceptual Framework for Financial Reporting* to smaller not-for-profit private sector entities that have not already been noted? If so, please describe them.

Question 4

As noted in paragraph 1.35, the Board intends to align the timing of any new Tier 3 reporting requirements with the timing of any extension of the Australian Accounting Standards to a broader set of not-for-profit private sector entities.

Do you agree? Why or why not?

Section 2: Extending the differential reporting framework for not-for-profit private sector entities

Section snapshot

- The Board wants to improve the quality and comparability of reporting by entities that currently prepare SPFS. To do so, the Board intends to extend the set of entities to which Australian Accounting Standards apply by superseding (in part) SAC 1 – this reduces the number of entities that are able to prepare SPFS
- However, the Board is also cognisant that some stakeholders contend that existing accounting requirements are too onerous for some entities. Consequently, the Board intends to introduce a 'simpler' further differential reporting tier for not-for-profit private sector entities

Main concerns with existing reporting requirements

2.1 When developing its Reduced Disclosure Requirements regime[7] in 2010, the Board was conscious that stakeholders were concerned that the Australian reporting requirements were overly complex for application by smaller not-for-profit private sector entities. At that time, the Board sought to mitigate the concern by not requiring these entities to apply Tier 1: Australian Accounting Standards.

2.2 Since 2010, the following changes have occurred to the reporting environment in Australia for not-for-profit entities:

(a) the introduction of new accounting standards that changed previously applicable recognition and measurement criteria. Some of these Standards are regarded by some practitioners as being complex to understand and apply, especially for smaller entities;

(b) the Board's proposal in ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (May 2018) to no longer limit the application of Australian Accounting Standards to reporting entities as defined by SAC 1 *Definition of the Reporting Entity* (in addition to those entities who elect to present general purpose financial statements); and

(c) government initiatives to ease the reporting burden for less economically significant entities. For example, the quantitative thresholds used to determine an entity's reporting obligations have been revised upwards.

2.3 In March 2020, the Board replaced Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements with Tier 2: Australian Accounting Standards – Simplified Disclosures. As part of its stakeholder consultations leading to those revised requirements, the Board acknowledged that stakeholders continue to be concerned that Australian reporting requirements are not commensurate with the abilities and resources available to smaller not-for-profit private sector entities or user interests (that is, they are not 'fit for purpose'). As a consequence, such requirements might impose disproportionate costs for certain not-for-profit private sector entities when regarded against the benefits of that information.

2.4 Considering the feedback received from stakeholders and its research findings, and on reflection of its reasons for initially deciding against developing further differential reporting requirements for not-for-profit private sector entities and changes in the reporting environment since that time, the Board decided it should review its past decisions on the extent of the differential reporting framework applying to not-for-profit private sector entities.

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7 AASB 1053 *Application of Tiers of Australian Accounting Standards* introduced the two 'Tiers' of general purpose financial statements into the Australian Accounting Standards.

+ More information

The Board observed that it specifically considered whether to develop further reporting requirements for not-for-profit entities as part of developing AASB 1053, to acknowledge the larger not-for-profit entity population required to prepare financial statements. Paragraphs BC22 to BC24 from the Basis of Conclusions to AASB 1053 summarised the Board's conclusions:

"BC22 The Board considered whether a third tier of reporting requirements for general purpose financial statements should be introduced to provide simpler financial reporting requirements for smaller not-for-profit entities since those entities might find the adoption of Tier 2 requirements overly burdensome on cost-benefit grounds. The Board noted that many [not-for-profit] entities in the private sector are established as companies limited by guarantee under the Corporations Act or as associations under relevant Incorporated Associations Acts in each State and Territory. Moreover, many non-trading cooperatives are regulated by State or Territory Acts. Considering this legislation, the Board noted that a reason for contemplating the need for a third tier was that there is generally no [not-for-profit] equivalent to the outright exemption from reporting that exists for small proprietary companies …

BC23 The Board noted that while there is some support from constituents for creating a third tier, there are different views about the requirements of such a tier and the way entities applying those requirements should be identified. The Board also considered the proposals for reporting relief in the Discussion Paper published by the Australian Government in June 2007 titled Financial Reporting by Unlisted Public Companies in relation to the creation of a third tier of reporting requirements for companies limited by guarantee.

BC24 The Board decided not to introduce a third tier of reporting requirements on the basis that:

(a) the Government intended to alleviate the reporting burden of small companies limited by guarantee through amendments to the Corporations Act; and

(b) Tier 2 requirements for preparing general purpose financial statements would help reduce the disclosure burden of [not-for-profit] entities significantly."

However, various developments, and further research conducted by the AASB, following the issue of AASB 1053 have since caused the Board to revisit its conclusions as to whether there is a need for further differential reporting for not-for-profit private sector entities. These developments include:

(a) the Board's desire to resolve the inconsistency between use of 'reporting entity' in the IASB's *Conceptual Framework for Financial Reporting* (revised 2018) and SAC 1 *Definition of the Reporting Entity* (refer paragraph 1.15(a)), which may require the Board to 'fill the gap' if it were to act to limit the ability of entities to prepare special purpose financial statements. Without further Board intervention, the consequential impact of such Board action is that more not-for-profit entities will be required to prepare general purpose financial statements that comply with Tier 2 reporting requirements;

(b) the issue of several accounting standards since 2010, including AASB 9 *Financial Instruments*, AASB 15 *Revenue from Contracts with Customers* and AASB 16 *Leases*;

(c) the Australian and New Zealand governments announced their commitment to explore a long-term vision for a seamless trans-Tasman business environment of a Single Economic Market, including, that as a medium-term goal, not-for-profit entities would be able to use a single set of accounting standards and prepare only one set of financial statements to satisfy reporting requirements in both jurisdictions; and

(d) the introduction by the New Zealand External Reporting Board of a four-tier differential reporting framework for New Zealand not-for-profit public benefit entities.

Further, the Board observed that a sizable percentage of not-for-profit private sector entities continue to lodge special purpose financial statements with the Australian Charities and Not-for-profits

Commented [A20]: __Note for Board members:__
The text in this section has in part been informed by or drawn from M179 Agenda Paper 5.4 (February 2021) and the Board's discussion at its February 2021 meeting

Commission rather than Tier 2 general purpose financial statements. This finding suggests to the Board that Tier 2 reporting requirements either do not currently meet the needs of users or are not 'attractive' to apply. The Board considered that developing proposals that simplify existing AASB accounting requirements for smaller entities may facilitate entities in preparing general purpose financial statements in the future, thereby improving public regard of the overall quality of financial reporting in this sector.

Main considerations in identifying the number of reporting tiers

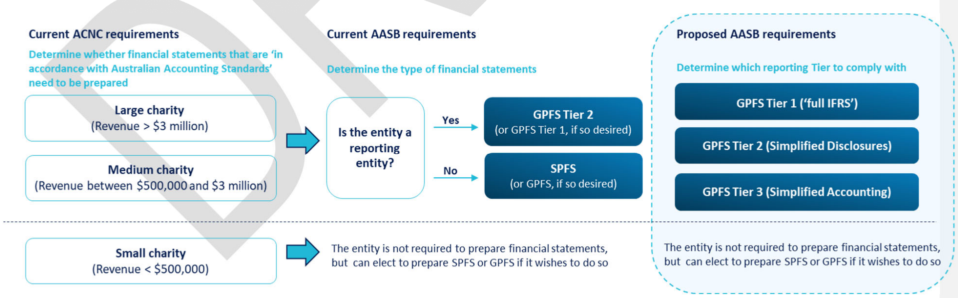
Proposal to extend the population of entities required to prepare general purpose financial statements – superseding the reporting entity concept

2.5 As part of Stage 1 of its Conceptual Framework: Not-for-Profit Amendments project, the Board intends to introduce the term 'reporting entity' into the Australian not-for-profit lexicon in usage different to 'reporting entity' as defined by SAC 1 *Definition of the Reporting Entity*. To not inadvertently increase complexity for entities through the inconsistent use of the term, the Board proposes to, at the same time, supersede (in part) SAC 1 for not-for-profit private sector entities.

2.6 These Board actions are consistent with its past actions in AASB 2020-2 Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities to effect such amendment for for-profit private sector entities. The Basis for Conclusions to AASB 2020-2 explains the Board's decisions, which applies equally to the not-for-profit private sector.

2.7 The effect of the Board proposal is that Australian Accounting Standards will subsequently apply to a broader set of not-for-profit private sector entities. The "and is a reporting entity" application provision that forms part of most Standards will cease to have any substance. More entities will be required to prepare general purpose financial statements when the entity is compelled to prepare financial statements that comply with Australian Accounting Standards. Figure 2.1 illustrates this by reference to ACNC financial reporting obligations.

Figure 2.1: Illustrative example of how the proposal to change use of the term 'reporting entity' will affect not-for-profit private sector entities



Stakeholder feedback on cost-benefits of Tier 2 reporting requirements

2.8 In its preliminary discussions with stakeholders informing the development of this Discussion Paper, many stakeholders expressed some support for developing at least one further differential reporting tier for not-for-profit private sector entities, especially if the SAC 1 reporting entity concept is removed. These stakeholders are of the view that existing cost-benefit tensions necessitate the introduction of further differential reporting requirements that are simple and easy to understand.

2.9 The stakeholder concern is exacerbated when the population is increased (through the proposal to remove the SAC 1 reporting entity concept), as a wider population of not-for-profit entities will consequently be required to prepare financial statements that comply with the requirements specified by Australian Accounting Standards. The population is expected to be larger because the relevant legislation often sets a lower threshold for such reporting obligations than the legislation governing common legal structures employed by a for-profit entity. For example, the revised ACNC reporting thresholds are still lower than those applying to a for-profit entity that reports to the Australian Securities and Investments Commission.

Proposal to introduce a further reporting tier – Tier 3 reporting requirements

2.10 The Board noted that introducing one or more further tiers of reporting requirements might not be appropriate for reasons including:

(a) making it harder for some entities to determine their reporting obligations, especially if revenue or assets are calculated differently between the reporting tiers;

(b) possibly making it more difficult for practitioners to move between entities of different sizes;

(c) resources will need to be dedicated to the maintenance of a further tier of reporting requirements;

(d) departure from its policy of sector neutrality;

(e) whether the resultant financial statements can be held out to be general purpose financial statements; and

(f) it does not address whether there is a need for financial statements in the first place.

2.11 However, the Board is conscious of the additional costs that might be borne by a not-for-profit private sector entity as a result of the difference in the extent of reporting obligations made on similar-sized entities in the for-profit and not-for-profit sector. The Board also had regard of its objective of improving the quality of financial reporting by entities in the sector. Consequently, the Board has formed a preliminary view that there is a need to develop at least one further differential reporting tier at the same time as it supersedes the reporting entity concept for not-for-profit private sector entities. This further reporting tier will serve as a proportionate response for smaller-sized entities with less complex transactions and events that are required to prepare financial statements that comply with Australian Accounting Standards. In forming its preliminary view, the Board considered that:

(a) there is a need to provide a proportionate response for smaller not-for-profit private sector entities that may no longer be able to present special purpose financial statements;

(b) a further tier of reporting accords the Board an opportunity to review consolidation and other reporting requirements that are anecdotally reasons why some entities are currently not preparing general purpose financial statements; and

(c) some of the more recent Australian Accounting Standards specify accounting that might be regarded as overly complex for the operations and abilities of smaller not-for-profit private sector entities.

2.12 The Board decided to form a preliminary view that it would develop a further reporting Tier ('Tier 3 reporting requirements') for application by not-for-profit private sector entities. The set of accounting requirements specified by Tier 3: Australian Accounting Standards – Simplified Accounting are to be easier to understand and apply than those specified by Tier 1 and Tier 2 Australian Accounting Standards, reflecting its reasoning for proposing this introduction. These general purpose financial statements should meet the needs of users of the financial statements of smaller not-for-profit private sector entities.

Tier 3
Simpler recognition & measurement, supplemented by disclosures

2.13 The proposed further reporting tier is intended to serve as a response proportionate to the abilities of certain not-for-profit private sector entities and the needs of users of their financial statements. However, it is not intended to limit the ability of such entities to prepare general purpose financial statements that comply with Tier 1 or Tier 2 Australian Accounting Standards, should the entity elect to do so.

Commented [A21]: **Note for Board members:**
June 2021 Board decision. Refer M181 Agenda Paper 3.2.

Distinction from the reporting framework for-profit private sector entities

2.14 Some respondents to ITC 39 suggested that further differential reporting was necessary for for-profit private sector entities beyond Tier 2 reporting requirements. In reaching its conclusions about the form of the differential reporting framework applying to for-profit private sector entities, the Board considered that transition costs, and the ongoing costs of training and maintenance of multiple forms of general purpose financial statements, would outweigh any potential benefits when considering research indicating the standards apply only to 1.3% of actively trading for-profit entities. Further, respondents to ITC 39 had indicated a preference for the different reporting tiers to require compliance with the full recognition and measurement requirements in Australian Accounting Standards as it would enhance the comparability, consistency and transparency of the financial statements. AASB Research Report 12 also found that a majority of specified for-profit entities that were lodging special purpose financial statements with the ASIC were complying with recognition and measurement requirements in Australian Accounting Standards. Resultantly, the Board considered that, for for-profit private sector entities, a move to reporting requirements that are not based on compliance with all recognition and measurement requirements in Australian Accounting Standards would be counter-intuitive when trying to improve the consistency, comparability, usefulness and credibility of financial reporting in Australia.[8]

2.15 As outlined in paragraph 2.11 of this Discussion Paper, the Board has formed contrasting preliminary views concerning not-for-profit private sector entities given the larger population of entities that would need to comply with Australian Accounting Standards. Also, the Board observed that:

(a) not-for-profit entities preparing special purpose financial statements do not necessarily comply with all recognition and measurement requirements in Australian Accounting Standards; and

(b) some stakeholders are of the view that the comparability and transparency of the financial statements of a not-for-profit entity could be enhanced through departure from certain Tier 1 accounting requirements.

2.16 The effect of the Board's preliminary view is to provide not-for-profit private sector entities with access to different reporting requirements compared to for-profit private sector entities. At present, it will also accord not-for-profit private sector entities access to reporting requirements that are not available to not-for-profit public sector entities.

8 For more information, refer the Basis for Conclusions paragraphs BC99 – BC109 accompanying AASB 2020-2.

Development of a fourth differential reporting tier

2.17 The Board observed that, without change to relevant legislation, some very small not-for-profit entities will continue to be, or may in the future be, required to prepare general purpose financial statements. Consequently, the Board considered whether there was a need to develop even further differential reporting proposals aimed at the smallest not-for-profit reporters (that is, 'Tier 4' reporting requirements).

Example

Certain small Aboriginal and Torres Strait Islander corporations that report revenue greater than $100,000 and public companies limited by guarantee that do not meet the definition of a 'small company limited by guarantee' are required to prepare general purpose financial statements.

2.18 The Board received mixed feedback from its preliminary outreach on whether it should develop a suite of "basic" accounting requirements. Some stakeholders were supportive of developing further 'proportionate' cash-basis requirements that economically insignificant entities could apply. These stakeholders considered that the Board should be responsible for specifying the requirements for all entities required by legislation to prepare financial statements – including micro entities – and therefore that there should be requirements set at a level appropriate to the abilities of the entity and needs of users of its financial statements. These stakeholders point to how some other standard-setters have developed cash basis accounting requirements and to statutory requirements that permit some entities to lodge cash basis financial information, and contend that the Board developing similar accounting requirements will reduce reporting complexity through providing clarity for preparers and users alike, and facilitate consistency and comparability in the reporting of cash-basis financial statements.

2.19 Other stakeholders questioned the existence and needs of users (if any) of the financial statements of such entities, and whether there was a case for the Board dedicating resources to such effort. These stakeholders were concerned that the resulting financial statements might not be 'fit for purpose'.

2.20 The population of micro entities that are required to prepare financial statements that are in accordance with Australian Accounting Standards is unlikely to be large. Noting this, and for the reasons noted in paragraph 2.10 above, the Board has decided not to develop a fourth differential reporting tier of accounting. In particular, the Board considered:

(a) it is likely that such further differential reporting tier, if developed, would have to reflect a cash basis of accounting. The Board considers that general purpose financial statements must be based on accrual principles to present fairly an entity's results and financial position. Consequently, the investment required is not justifiable when considered against the additional benefits to stakeholders. The Board observes that there are few, if any, further accrual-based recognition and measurement criteria simplification actions that could be taken by the Board beyond those that the Board is proposing to develop as part of its Tier 3 reporting requirements; and

(b) introducing a further differential reporting tier will introduce additional complexity for entities when determining their regulatory reporting obligations, where the threshold for such is based on quantitative accounting numbers (e.g. revenue or assets). Without changes to legislation, it may not be clear on which recognition and measurement base such thresholds should be calculated.

Example

Under the *Associations Incorporation Act 2015* (Western Australia), a 'Tier 2' Western Australia incorporated association is obliged to prepare financial statements in accordance

Commented [A22]: <u>**Question 5 to Board members:**</u>
The text in this section reflects the proposed staff approach set out in M185 Agenda Paper 11.1 (Feb 2022). At that meeting, the Board did not explicitly decide not to develop a fourth differential reporting tier. Board members observed that whether a fourth tier could be other than cash-basis accounting depending on the nature and extent of its proposed Tier 3 simplifications.

Now that the Board has completed the discussion of its proposed Tier 3 simplifications, staff are seeking Board confirmation that the Board does not intend to develop a fourth further differential reporting tier for not-for-profit private sector entities.

Do Board members confirm not to propose developing a fourth further differential reporting tier for not-for-profit private sector entities?

with Australian Accounting Standards. The incorporated association is classified as Tier 2 if it reports revenues between $250,000 and $1 million.

The timing of the recognition of donation income under the Board's preliminary views in Section 5 of this Discussion Paper (later) and AASB 1058 *Income of Not-for-Profit Entities* (earlier) differs. Consequently, for entities 'at the edges', it is possible that revenue threshold for classification as Tier 2 may be reached – or not reached – depending on the measurement basis used to measure revenues.

Transition between the reporting tiers

Commented [A23]: **Note for Board members:**
The text in this section reflects the proposed staff approach set out in M185 Agenda Paper 11.1 (Feb 2022).

2.21 The Board's project to revise the differential reporting framework for not-for-profit private sector entities is still at an early stage. Any decision about transitioning between reporting tiers will likely be informed by stakeholder support or otherwise of its proposed preliminary views in this Discussion Paper. As such, the Board has not yet considered whether and if so, how an entity might transition to or from Tier 3: Australian Accounting Standards – Simplified Accounting to Tier 1: Australian Accounting Standards or Tier 2: Australian Accounting Standards – Simplified Disclosures.

2.22 For the same reason, the Board has not yet discussed:

(a) transitional provisions that might apply on the first-time preparation of general purpose financial statements that comply with Tier 3: Australian Accounting Standards – Simplified Accounting; or

(b) whether an entity may change an existing accounting policy to a Tier 3-compliant accounting policy when it first prepares Tier 3-compliant financial statements.

Example

The Board has heard anecdotally that some entities would revert from measuring property on the revaluation basis to a cost basis if allowed to do so. The Board has not yet discussed whether to allow this treatment when Tier 3 general purpose financial statements are prepared for the first time as the Board is at this time seeking feedback on its preliminary view that both the revaluation basis and cost basis should be available accounting policies for the measurement of property, plant and equipment in Tier 3 financial statements.

Transitional provisions will be necessary if the Board subsequently develops proposals requiring property to always be measured on the cost basis. Contrastingly, transitional provisions may be developed if the Board decides to develop proposals consistent with its preliminary view and there is a case for such relief to be introduced.

Questions for respondents

Question 5

Paragraphs 2.5 to 2.7 discuss the Board's view to extend the set of not-for-profit private sector entities to which Australian Accounting Standards apply by superseding (in part) SAC 1. The effect of the Board's proposal is that more entities will be required to prepare general purpose financial statements when the entity is compelled to prepare financial statements that comply with Australian Accounting Standards.

Do you agree? Why or why not? If not, what alternative approach do you suggest?

Question 6

Paragraphs 2.10 to 2.13 discuss the Board's view to introduce a 'simpler' further differential reporting tier (Tier 3) for not-for-profit private sector entities, which serve as a proportionate response for smaller sized entities with less complex transactions and events and who are required to prepare financial statements that comply with Australian Accounting Standards.

Do you agree? Why or why not? If not, what alternative approach do you suggest?

Question 7

Paragraphs 2.17 to 2.20 discuss the Board's view to not develop a fourth differential reporting tier of accounting for not-for-profit private sector entities.

Do you agree? Why or why not? If not, what alternative approach do you suggest?

Section 3: Tier 1 and Tier 2 reporting requirements

Commented [A24]: __Note for Board members:__
The text in this section has been largely developed from the Board's discussion at its February 2021 meeting (ref M179 Agenda Paper 5.2).

Section snapshot

- Tier 1 and Tier 2 reporting requirements will continue to have the same meaning for both for-profit entities and not-for-profit private sector entities (full 'IFRS' and simplified disclosures, as modified for application by not-for-profit entities)

Main considerations in deciding whether to change Tier 1 and Tier 2 reporting requirements

3.1 The Board noted that considering the differential reporting framework for not-for-profit private sector entities provides the opportunity to review the Board's previous decisions as to the reporting requirements that apply to not-for-profit entities. When making AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*, the Board observed that the revised Tier 2 disclosure framework may still be relevant to not-for-profit entities as one of the tiers of reporting for the sector even after a revised not-for-profit financial reporting framework is developed.

3.2 Having formed a view to propose a three-tier differential reporting framework for not-for-profit private sector entities, the Board considered whether to revise its Tier 1 and Tier 2 reporting requirements as currently applicable to Australian not-for-profit private sector entities. The Board noted that it had, as part of its pre-2020 research-gathering activities, received feedback whether the existing Tier 1 and Tier 2 reporting requirements should continue to be available to not-for-profit private sector entities. The Board's decisions in this regard informs its preliminary views on reporting requirements under its proposed new reporting tier.

3.3 The Board observed that Tier 1 reporting requirements in their current form are well understood by Australian constituents as being the equivalent of 'full IFRS', modified as necessary for application by not-for-profit entities. Retaining these Tier 1 reporting requirements also:

(a) facilitates comparability with for-profit private sector entities operating in the same industry;

(b) does not require any additional maintenance costs beyond those that would already currently be required under the current status; and

(c) acknowledges recent research and a view held by some stakeholders that some not-for-profit private sector entities (e.g. those of 'public interest') should prepare Tier 1 general purpose financial statements.

3.4 Therefore, the Board is not proposing to develop different Tier 1 reporting requirements for application by not-for-profit private sector entities.

3.5 The Board noted that in 2020, it had decided to further reduce the reporting burden of not-for-profit private sector entities as part of the issue of AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (March 2020). Scoping not-for-profit private sector entities into AASB 1060 was done to give these entities immediate access to similar reporting requirements as would apply to for-profit private sector entities, and which were considered a 'reduction' of those disclosures applying under the Reduced Disclosure Regime.

3.6 The Board observed that its deliberations resulting in AASB 1060 were in the main focused on the needs of users of for-profit private sector entity financial statements, consistent with the focus of its project culminating in the issue of AASB 1060. However, the Board is aware that a not-for-profit entity may have only recently revised their financial statements to comply with AASB 1060 before a revised differential reporting framework for not-for-profit private sector entities is finalised. Hence, the Board considered it would be preferable and more practical if there remained a single set of Tier 2 reporting requirements, as this helps with the general comprehension of the quality and comparability of such financial statements. Therefore, the Board has formed a preliminary view to also not develop further revised Tier 2 reporting requirements for application by not-for-profit private sector entities.

3.7 The effect of the Board's preliminary views is that there are no changes to the existing requirements specified by Tier 1 and Tier 2 Australian Accounting Standards, as presently modified for not-for-profit private sector entities. That is:

(a) Tier 1 general purpose financial statements prepared by a not-for-profit private sector entity should fully comply with all the requirements specified by Australian Accounting Standards, as modified for application by not-for-profit entities; and

(b) Tier 2 general purpose financial statements prepared by a not-for-profit private sector entity should comply with all the presentation, recognition, measurement and classification specified by Australian Accounting Standards (limited exceptions apply, for example, a statement of financial position at the beginning of the earliest comparative period presented and a statement of changes in equity are not required) – but require fewer disclosures.

Questions for respondents

Question 8

Paragraphs 3.1 to 3.7 discuss the Board's view to not making any changes to the existing requirements specified by Tier 1 and Tier 2 Australian Accounting Standards, as presently modified for not-for-profit private sector entities. That is:

(a) Tier 1 general purpose financial statements prepared by a not-for-profit private sector entity should fully comply with all the requirements specified by Australian Accounting Standards, as modified for application by not-for-profit entities; and

(b) Tier 2 general purpose financial statements prepared by a not-for-profit private sector entity should comply with all the presentation, recognition, measurement and classification specified by Australian Accounting Standards – other than with respect to the statement of changes in equity – but require fewer disclosures

Do you agree? Why or why not?

PART B: PROPOSED TIER 3 REPORTING REQUIREMENTS

Section 4: Set-up and interaction with other reporting Tiers

Section snapshot

- The Board intends to develop a single stand-alone accounting standard, written simply, and that serves as the main reference for Tier 3 GPFS. It will be accompanied by template financial statements
- Update of a Tier 3 Standard will occur on a different timing to Tier 1 and Tier 2 developments
- The Board has not yet formed a view whether to allow entities to 'opt up' to an accounting policy specified by other Australian Accounting Standards

Main considerations in developing the reporting tier

4.1 The demand for simpler accounting requirements for smaller entities stems from stakeholder application challenges with existing Australian Accounting Standards, including:

(a) the language used in, and length of, Australian Accounting Standards;

(b) the accounting technical expertise of less-resourced not-for-profit private sector preparers, and their ability to explain the results to their users;

(c) the understandability and relevance of the resultant financial statements for primary users who are not "accounting experts" and whose investing (donation) decisions may be less dependent on entity performance and stewardship as reflected by the financial statements; and

(d) the comparability of the results and financial position of similar entities.

4.2 Paragraph 2.11 described the Board's intent for the additional reporting tier to serve as a proportionate response for smaller-sized entities with less complex transactions and events that are required to prepare financial statements that comply with Australian Accounting Standards. Consequently, the Board observed that its Tier 3 reporting requirements would have to address these stakeholder application challenges in order for the additional reporting tier to be regarded as meeting the needs of the entities and users for which it is being developed (i.e. whether the reporting tier is 'fit for purpose').

4.3 This Section sets out the Board's preliminary views on the proposed features of the additional reporting tier in response to the matters noted in paragraphs 4.1(a) and 4.1(b). It addresses the questions "Where will the accounting requirements be set out?" and "How will the accounting requirements be presented?"

4.4 Further Board preliminary views responding to the matters noted in paragraph 4.1(b) – (d) – or the "What will the accounting requirements look like?" – are addressed in Section 5 and Section 6.

A stand-alone accounting standard

Commented [A25]: <u>**Note for Board members:**</u> The text in this section has been based on the Board's decisions after consideration of M181 Agenda Paper 3.2 (June 2021).

4.5 The presentation of any resultant reporting requirements is a key consideration for the proposed new reporting tier. The Board has formed a preliminary view to contain Tier 3 reporting requirements in a single stand-alone accounting standard, rather than in a separate suite of accounting standards or as modifications to the existing Australian Accounting Standards. While such approach has its shortcomings (for example, see paragraph 4.17 – 4.20 below), in forming its view, the Board prioritised the approach it considered would be the most user-friendly for the intended audience.

4.6 Presenting the Tier 3 reporting requirements in a stand-alone accounting standard is consistent with the Board's recent decision to develop AASB 1060 as a separate Tier 2 Standard in response to stakeholder feedback; a revision of its previous approach of containing the reduced disclosures as an Appendix within the body of each Australian Accounting Standard. The feedback from the Board's preliminary outreach suggested that stakeholders would support this approach also for Tier 3 reporting requirements.

4.7 The stand-alone accounting standard is intended to:

(a) specify accounting requirements relevant to transactions and other events and circumstances that are common to a smaller not-for-profit private sector entity;

(b) in the main, not require an entity to refer to requirements set out in other Australian Accounting Standards; and

(c) express accounting requirements in a manner that is easy to understand by preparers and users who do not consider themselves to be "accounting experts".

Commented [A26]: <u>**Note for Board members:**</u>
The feature detailed in subparagraph (a) was not noted in the Board minutes from the June 2021 meeting but was described as a proposed aspect of the stand-alone accounting standard approach in the related agenda paper. The features detailed in subparagraphs (b) and (c) are Board decisions captured in the Board minutes from that June 2021 meeting.

With regard to subparagraph (c), staff note that staff have re-expressed the related Board decision. The Board decision captured in the Board minute stated:

"The Board decided to propose developing Tier 3 reporting requirements as a single stand-alone pronouncement that will: (a) be drafted in simple language using terminology tailored to NFP private sector entities of the size contemplated by the Board for Tier 3 entities …"

Example

A Tier 3 Standard might not include accounting requirements that specifically address sales of trade receivable balances to a debt collector because transfers of financial assets are not expected to be widespread amongst smaller not-for-profit private sector entities.

This does not mean that an entity that sells a trade receivable balance to a debt collector will need to refer to the criteria and guidance specified by AASB 9 to assess whether the sale qualifies for derecognition. Rather, except if the transaction is outside the scope of the Tier 3 Standard, the entity assesses the sale of the trade receivable balance for derecognition against only the Tier 3 specified criteria and any accompanying Tier 3 guidance.

Example

A Tier 3 Standard might describe how to measure fair value rather than directing an entity to comply with AASB 13 *Fair Value Measurement* for any fair value measurements.

Example

A Tier 3 Standard might direct an entity to recognise a "provision for doubtful debts" and "bad debts" in respect of its receivables, rather than an "allowance for expected credit losses".

Example

Paragraph 13 of AASB 119 *Employee Benefits* reads as follows:

An entity shall recognise the expected cost of short-term employee benefits in the form of paid absences under paragraph 11 as follows:

(a) in the case of accumulating paid absences, when the employees render service that increases their entitlement to future paid absences

(b) in the case of non-accumulating paid absences, when the absences occur.

A Tier 3 Standard might express the requirement in the following manner:

"An expense is recognised for accumulating (roll over) annual leave (and similar employee benefits) as the employee becomes entitled to that leave. An expense is recognised for non-accumulating paid leave such as maternity leave (and similar 'use it or lose it' employee benefits) when the employee uses the entitlement."

4.8 Generally, not requiring an entity to refer to other Australian Accounting Standards requirements means the resultant accounting standard could be lengthier. However, the Board considered that this effect was more than compensated by expected reduced compliance costs, through:

(a) an expected reduction in the extent to which a not-for-profit entity preparing Tier 3 general purpose financial statements has to consider other Australian Accounting Standards;

(b) expected savings in the time taken to understand and apply the specified requirements, facilitated by the use of language and terminology familiar to the sector, and targeted guidance and examples.

Accompanying guidance, including template financial statements

Commented [A27]: **Note for Board members:** The text in this section reflects the Board decision at the February 2022 meeting. For more information, see M185 Agenda Paper 11.1 (Feb 2022).

4.9 The Board intends to develop guidance to facilitate consistency in applying its proposed requirements. For example, this could take the form of explanatory text to help explain specified requirements or accompanying application guidance, implementation guidance or illustrative examples.

4.10 The Board has formed a preliminary view to develop template financial statements, including accompanying notes ('model' financial statements). Providing preparers with an illustrative depiction of what general purpose financial statements complying with Tier 3 Australian Accounting Standards: Simplified Accounting could look like is an avenue the Board can take to make the pronouncement more user-friendly. The Board observed that developing template financial statements will facilitate comparability between entities and remove an element of judgement required by the preparer. However, some relevant financial information may be lost.

Conceptual framework

Commented [A28]: **Note for Board members:** The text in this section reflects the approach set out in M185 Agenda Paper 11.1 (Feb 2022), as agreed by the Board.

4.11 The Board's preliminary view is that the Tier 3 reporting requirements will operate within a single conceptual framework applying to all not-for-profit entities. That is, the Board does not intend for the proposed stand-alone pronouncement to be so self-contained that it needs its own abbreviated conceptual framework. The Board expects to be further informed on this matter by its work on its Conceptual Framework project.

Ability to opt up to an accounting policy permitted by Tier 1 or Tier 2 Australian Accounting Standards

Commented [A29]: **Note for Board members:** The preliminary views in this section reflect the Board's decisions made at its September 2021 meeting.

4.12 An entity may already comply with several or all the accounting policies prescribed by the Australian Accounting Standards. Certain of these accounting policies may be 'simplified' in Tier 3 Australian Accounting Standards. For example, an entity that is a lessee might presently recognise a right-of-use asset and lease liability for a lease of property. A lessee does not recognise such assets and liabilities if the Board's preliminary view on leases is finalised. However, some entities may want to continue to do so.

4.13 Consequently, the Board considered whether it should develop requirements that would permit an entity preparing Tier 3 general purpose financial statements to apply instead an accounting policy permitted by Tier 1 or Tier 2 Australian Accounting Standards for transactions and other events addressed by the Board as part of a possible Tier 3 Standard. Noting that a smaller not-for-profit private sector entity that wishes to prepare Tier 1 or Tier 2 compliant financial statements is not restricted from doing so, the Board considered whether it should develop Tier 3 requirements to:

(a) allow an entity to always 'opt up' to a recognition or measurement policy permitted by the Tier 1 or Tier 2 Australian Accounting Standard applying to the transaction or other event (a 'free choice' approach);

(b) allow an entity to 'opt up' to a recognition or measurement policy permitted by the Tier 1 or Tier 2 Australian Accounting Standard applying to the transaction or other event only when specifically permitted by the Board as part of the Tier 3 accounting standard (in effect, a 'cross reference' approach); or

(c) restrict an entity preparing Tier 3 financial statements to only those accounting policies specified by the Tier 3 Standard for transactions and other events within the scope of the Tier 3 Standard (i.e. 'opt up' is not permitted).

4.14 Conceptually, an accounting policy permitted by a higher reporting tier also provides relevant and faithfully representative information, and comparability does not mean that entities must all apply the same accounting policy. However, the Board is conscious that some stakeholders consider that Tier 3 reporting requirements should facilitate comparability between entities by restricting an entity's accounting policy choices rather than provide for flexibility. These stakeholders think that doing so would make Tier 3 reporting requirements easier for preparers to understand and apply, reducing the costs of compliance with accounting standards.

4.15 The Board has not formed a preliminary view as to whether it should restrict the range of available accounting policies available to an entity preparing Tier 3 compliant financial statements, or develop requirements that would allow opt-up in some, or any, circumstances. The Board thinks it should be informed by stakeholder feedback as to the usefulness of the resultant financial statements should 'opt up' be permitted, considering the range of its preliminary views on Tier 3 reporting requirements (refer Section 5). For example, the timing of impairment losses is likely to be later for a Tier 3 entity compared to a Tier 1 or Tier 2 entity. It is unclear whether users will be served by divergent practice between Tier 3 entities.

4.16 The significance of the Board's future decisions will depend in part on the feedback received on the preliminary views set out in Section 5.

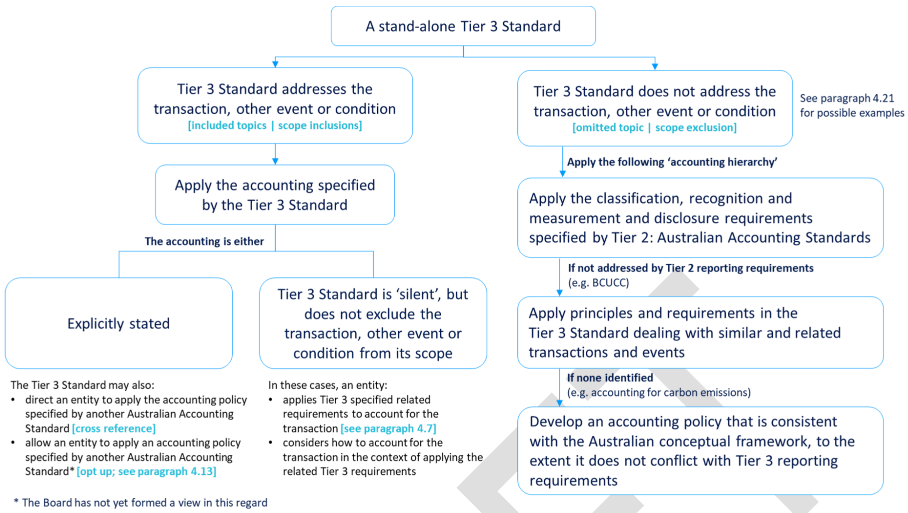
Transactions and other events omitted from Tier 3 reporting requirements

Commented [A30]: **Note for Board members:** The preliminary views in this section reflect the Board's decisions made at its September 2021 meeting and June 2022 meeting (disclosures). The remainder of the text in this section has been drafted to provide the DP readers with context and clarity.

4.17 A stand-alone accounting standard containing Tier 3 reporting requirements cannot be expected to address the whole breadth of transactions, other events and conditions contemplated in Tier 1: Australian Accounting Standards. To do so might 'clutter' the Tier 3-Standard with requirements that are not relevant to many smaller entities – this would not be consistent with the Board's 'proportionate' and 'simple' objectives in undertaking this project.

4.18 Figure 4.1 below summarises the Board's preliminary views regarding the accounting for a transaction or other event or condition occurring during the period.

Figure 4.1: Tier 3 transactions and other events and conditions



4.19 As long as they are 'scoped in', transactions and other events need not be specifically 'mentioned' in the Tier 3 Standard to be considered an included topic. For example, cryptocurrency holdings and employee termination benefits need not be highlighted for these items to be treated consistently to other intangible assets and other employee benefits. Additionally, the Board might not develop requirements to address a particular scenario, for example, a reversal of previously recognised impairment losses. To the extent the item remains 'scoped in', the entity does not consider AASB 136 *Impairment of Assets* to identify how to account for the reversal. Rather, the entity considers how to account for the transaction in the context of applying the related Tier 3 requirements.

4.20 Similarly, transactions and other events may be explicitly or implicitly omitted from Tier 3 reporting requirements. For example, the Board might determine to explicitly scope out financial guarantee contracts from the scope of its Tier 3 requirements. Conversely, the Board might decide not to develop Tier 3 requirements for biological assets, which are neither property, plant and equipment, nor financial assets. This does not mean that financial guarantee contracts and biological assets are not recognised in Tier 3 financial statements, but rather that the entity will have to develop an appropriate accounting policy to account for the item.

4.21 At this project stage, the Board is consulting on its preliminary view on adding a possible further reporting tier and the recognition and measurement simplifications from Tier 2: Australian Accounting Standards that it intends to develop. Consequently, the Board has not formed a preliminary view on the Tier 1-addressed transactions that it will omit from Tier 3 reporting requirements. Also, for example, rather than as an 'omitted item', the Board may, on consideration of feedback received, decide to scope into its Tier 3 Standard:

(a) a transaction, but direct that the item is accounted for in accordance with a specified Australian Accounting Standard. (That is, adopt a cross-reference rather than omitted topic approach – the resultant accounting is similar);

(b) a transaction, and develop specific Tier 3 accounting requirements for that item; or

(c) a transaction, and require the transaction to be accounted for similarly to other common transactions.

Commented [A31]: __Question 6 to Board members__:
At its May 2022 and June 2022 meetings, the Board decided to specifically 'scope in' only simple financial instruments when considering financial instruments. The Board has not discussed whether a similar approach applies to other aspects of its Tier 3 reporting requirements.

Figure 4.1 and the draft text in paragraph 4.19 reflect the staff view that some transactions and other events and conditions may be within the scope of a Tier 3 Standard without needing to be specifically mentioned.

An alternative position is that all transactions and other events and conditions must be explicitly identified or addressed to be considered within the scope of the Tier 3 Standard.

Staff think that the effect of this alternative position is that all non-identified or addressed transactions will need to be accounted for in accordance with a topic-based Australian Accounting Standard.

Do Board members agree with Figure 4.1 and the draft text in paragraph 4.19?

If not, do Board members think that all transactions and other events and conditions must be explicitly identified or addressed by the Tier 3 Standard?

4.22 The Board's future decision-making will partly depend on the Discussion Paper feedback and the Board's further efforts to understand the types of transactions and other events and conditions common to smaller not-for-profit private sector entities. However, the types of items that the Board might scope out of a Tier 3 Standard include:

(a) biological assets, and agricultural produce at the point of harvest;

(b) issued insurance contracts, held reinsurance contracts, and investment contracts with discretionary participation features;

(c) expenditures incurred in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource is demonstrable;

(d) business combinations;

(e) obligations arising under a defined benefit superannuation plan;

(f) share-based payment arrangements;

(g) the accounting by an operator in a service concession arrangement; and

(h) financial assets and financial liabilities other than those identified in Section 5 of this Discussion Paper.

Commented [A32]: **Question 7 to Board members**: Staff ask Board members to consider the items listed in paragraph 4.22 as potential scope exclusions from its Tier 3 Standard. Some, but not all, of these items have been previously considered by the Board.

Do Board members agree with including the listed items in the draft Discussion Paper? If not, are there listed items that Board members think should be excluded from this list?

Commented [A33]: **Note for Board members**
In M181 Agenda Paper 3.3 (June 2021), staff recommended that the Board not simplify business combination accounting requirements. Board members did not discuss the staff proposal during the meeting.

Staff have carried forward the staff recommendation into the Discussion Paper by identifying it as a potential topic that might be omitted from a Tier 3 Standard.

Accounting policy hierarchy

4.23 The Board considered it necessary to provide entities with direction to develop an appropriate accounting policy for those transactions and other events falling outside the scope of the Tier 3 reporting requirements. The Board has formed a preliminary view that entities preparing Tier 3 general purpose financial statements should:

(a) first, apply the classification, recognition and measurement and disclosure requirements specified by Tier 2: Australian Accounting Standards – Simplified Disclosures for transactions outside the scope of the Tier 3 Standard; and

(b) otherwise, apply judgement in developing its accounting policy by reference to the following sources in descending order:

i) the principles and requirements in Tier 3 reporting requirements dealing with similar and related issues; and

ii) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Australian conceptual framework, to the extent they do not conflict with Tier 3 reporting requirements.

In forming an appropriate accounting policy, an entity may also consider the principles and requirements in Tier 1 and Tier 2 reporting requirements dealing with similar and related issues, the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework, other accounting literature and accepted industry practices, to the extent these do not conflict with Australian Accounting Standards.

Commented [A34]: **Note for Board members:**
The relevant Board minute references 'similar and related transactions and events'. In the text here, staff have referred instead to 'similar and related issues', which is the wording used in AASB 108.11.

Commented [A35]: **Question 8 for the Board:**
While not part of the Board discussion and decision at the September 2021 Board meeting (refer to minutes of the 183rd meeting (September 2021)), staff have included text that an entity may consider "the principles and requirements in Tier 1 or Tier 2 reporting requirements dealing with similar and related issues". This text clarifies that an entity should also consider the principles and requirements in the existing Australian Accounting Standards dealing with similar and related issues when forming an appropriate accounting policy.

Staff thinks this provides consistency with the hierarchy approach as depicted in AASB 108.

Do Board members agree with the inclusion to consider the principles and requirements in Tier 1 and Tier 2 reporting requirements with similar and related issues when forming an appropriate accounting policy for those transactions and other events falling outside the scope of the Tier 3 reporting requirements?

Example

Under the proposed 'accounting policies hierarchy' and assuming the Board decides not to develop any Tier 3 requirements for such transactions, an entity preparing general purpose financial statements complying with Tier 3: Australian Accounting Standards – Simplified Accounting would:

(a) apply the recognition and measurement requirements set out in AASB 141 *Agriculture* for any biological assets held, AASB 2 *Share-based Payment* to account for any share-based payments granted, and make the corresponding disclosures in AASB 1060; and

(b) develop an accounting policy for business combinations under common control by reference first to the principles and requirements in Tier 3 reporting requirements dealing with similar and related transactions or events.

4.24 In forming its preliminary view, the Board contemplated requiring an entity first to consider the accounting specified by Tier 3 requirements dealing with similar and related issues. Doing so would be more consistent with a notion of Tier 3 as an independent, separate reporting tier. However, the Board decided that requiring an entity first to apply the accounting specified by an existing topic-based Australian Accounting Standard better facilitates comparability between entities as it provides more direction and requires less judgement of preparers. Consequently, the Board formed a view that the proposed hierarchy in paragraph 4.23 provides the best framework for developing accounting policies for matters not addressed as part of its proposed Tier 3 accounting standard.

4.25 The costs of developing an accounting policy under the Board's preliminary view may be comparatively higher as it requires consideration of other Accounting Standards and adopting accounting policies that may be comparatively more challenging to apply. However, the Board observed that these costs should be limited, as the Board would not expect entities preparing Tier 3 general purpose financial statements to ordinarily need to consider such accounting policy hierarchy.

Maintenance and update of Tier 3 reporting requirements

4.26 The Board considers that to be consistent with its objective of developing reporting requirements that are easy to understand and apply, those requirements need to present as a stable reporting platform. Following any revisions from a post-implementation review of the Tier 3 reporting requirements,[9] the Board has formed a preliminary view to limit revisit of aspects of its Tier 3 reporting requirements to no more than once every AASB agenda consultation cycle (5 years), and only if there is a case, in accordance with the AASB *Due Process Framework*, for doing so.

Example

The Board may revisit a particular specified requirement if it becomes aware of an issue that is widespread and there is diversity in accounting practice. The Board is unlikely to revisit its specified requirements if it does not understand an issue to be widespread, even if clarification could improve the application of the requirements.

4.27 Under the Board's preliminary view, new or amended requirements resulting from an IFRS or domestic standard-setting project – for example, on reporting service performance information – may be added to Tier 1 and Tier 2 reporting requirements before they are included (if considered appropriate) as part of the Tier 3 reporting requirements. Similarly, revisions to the disclosures informing the specified Tier 3 disclosures (refer Section 6) may not necessarily result in a corresponding Board project to amend Tier 3 disclosures.

4.28 In establishing whether there is a case for reconsideration of aspects of the Tier 3 reporting requirements, the Board expects to consider developments since the time the pronouncement was last amended and also be informed by feedback from its periodic agenda consultations. The Board observed that limiting its maintenance and update commitments has the additional

9 The purpose of a post-implementation review is to evaluate the overall effectiveness and efficiency of a pronouncement in meeting its original objectives. In accordance with the AASB *Due Process Framework*, a post-implementation review normally begins two years after application of an accounting pronouncement.

Commented [A36]: __Question 9 for Board members:__
At its June 2021 meeting, the Board decided to consider its maintenance (and update) proposals for its Tier 3 pronouncement after forming its preliminary views on Tier 3 reporting requirements.

At that meeting, staff proposed that the Board adopt a maintenance cycle consistent with the AASB Due Process Framework and post-implementation review requirements. Staff have refined that staff proposal, as reflected in the drafting here. Staff continue to think that it would be useful for the Board to form a preliminary view of its approach to the maintenance of Tier 3 reporting requirements. Further, staff think this approach provides stakeholders with insight into how often Tier 3 reporting requirements will likely change.

Do Board members agree with the staff recommended maintenance and update proposals reflected by the draft text in this section?

If not, what maintenance proposals do Board members support, or would Board members prefer to exclude consideration of maintenance proposals from the Discussion Paper?

benefit of freeing up Board resources to enable it to progress on other standard-setting and research projects.

4.29 The Board does not intend to conduct periodic comprehensive reviews of the Tier 3 standard. This approach is consistent with how other issued Australian Accounting Standards are not subject to a regular comprehensive review.

Questions for respondents

Question 9

Paragraphs 4.5 to 4.11 discuss the Board's view to specify Tier 3 reporting requirements in a single centralised accounting standard. The stand-alone pronouncement is expected to:

(a) specify only accounting requirements for transactions, events and conditions that are common to a smaller not-for-profit entity;

(b) in the main, not require an entity to refer to requirements set out in other Australian Accounting Standards; and

(c) express accounting requirements in a manner that is easy to understand by preparers who do not consider themselves to be "accounting experts" and other less financially literate users.

Do you agree? Why or why not? If you disagree with the Board's view, which aspect(s) of the stand-alone accounting standard as listed in (a) – (c) above concerns you the most? Please explain.

Question 10

As discussed in paragraphs 4.12 to 4.16, the Board has not yet formed a view on whether it should restrict the range of available accounting policies available to an entity preparing Tier 3 compliant financial statements.

In your opinion, should an entity preparing Tier 3 compliant financial statements be permitted with the ability to opt up to an accounting policy permitted by Tier 1 or Tier 2 Australian Accounting Standards for:

(a) transactions, events and circumstances not covered in the Tier 3 reporting requirements; or

(b) all transactions, events and circumstances, regardless of whether they are covered in the Tier 3 reporting requirements?

Please explain your answer.

Question 11

Paragraphs 4.17 to 4.22 discuss the Board's preliminary view on the transactions and other events and conditions that may not to be covered in a Tier 3 Standard.

Do you agree? Why or why not? If you disagree, which of the balances, transactions and events do you think should be included in the Tier 3 Standard?

Question 12

Paragraphs 4.23 to 4.25 discuss the Board's preliminary view on the hierarchy to develop accounting policies for entities preparing Tier 3 general purpose financial statements for transactions and other events outside the scope of the Tier 3 requirements.

Do you agree? Why or why not? If you disagree with the Board’s view, do you prefer any alternative accounting policies hierarchy for these transactions and events?

Question 13

Paragraphs 4.26 to 4.29 discuss the Board’s view to limit revisit of its Tier 3 reporting requirements to no more than once every AASB agenda consultation cycle (5 years) and only if there is a case, in accordance with the AASB Due Process Framework, for doing so.

Do you agree? Why or why not? If you disagree with the Board’s view, how often do you suggest the Board to revisit its Tier 3 reporting requirements? Please explain.

Section 5: Accounting requirements

5.1 Section 5 sets out the Board's preliminary views on key presentation, recognition and measurement aspects of a proposed Tier 3 Standard, focusing primarily on any proposed simplification from the requirements specified by Tier 1 and Tier 2 Australian Accounting Standards. A proposed disclosure approach is discussed in Section 6. As this is a Discussion Paper, not all topics that would be included in an exposure draft or final pronouncement are covered. Similarly, the Board has not discussed all aspects of its preliminary view that it would need to consider at an exposure draft stage.

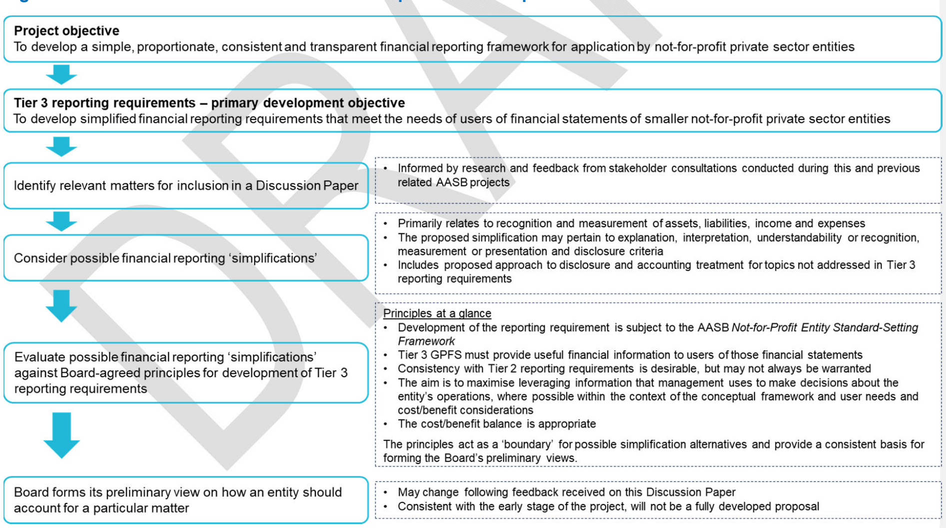
5.2 At a Discussion Paper stage, the Board seeks feedback on the accounting approach it intends to take for what it has identified as the common transactions and other events and conditions of a smaller not-for-profit private sector entity. The feedback will help inform the Board whether to develop its proposals into a future exposure draft.

5.3 A summary of the Board's preliminary views is outlined in Appendix A to the Discussion Paper.

Topics covered and how the Board formed its preliminary views

5.4 Figure 5.1 illustrates the Board's process of developing the Discussion Paper. Having determined its primary objectives for the proposed additional differential reporting Tier (see paragraph 2.11) and how Tier 3 reporting requirements would be presented (see Section 4), the Board next considered the key accounting requirements for public consultation as part of the Discussion Paper.

Figure 5.1: Illustration of how the Discussion Paper was developed



5.5 In identifying the relevant matters for inclusion in a Discussion Paper, the Board was informed by AASB and academic research and feedback from initial outreach conducted during this and related AASB projects. The matters forming part of this Discussion Paper are those which:

(a) were identified as topics of significant interest or concern to stakeholders; for example, the accounting requirements for subsidiaries and recognition of income;

(b) could have an overarching impact on the development of the Tier 3 reporting requirements; for example, the accounting requirements for changes in accounting policies or correction of errors; and/or

(c) have otherwise been identified as a common transaction, other event or condition of a Tier 3 entity for which the accounting requirements could be simplified; for example, the requirements for property, plant and equipment and employee benefits.

5.6 The primary objective of the Tier 3 Standard is to develop simplified accounting requirements that meet the needs of users of smaller not-for-profit private sector entities, and paragraph 4.1 explains why there is a demand for simpler accounting requirements. The Board considered accounting requirements could be potentially simplified from those specified by Tier 1 and Tier 2 Australian Accounting Standards via one or more of the following approaches:

(a) explanation – requirements are presented in a manner that is easier to understand by stakeholders who do not consider themselves to be "accounting experts" or financial accountants;

(b) recognition – requirements that could be less subject to judgement or require simpler conditions to be met;

(c) measurement – requirements that could be less subject to judgement or less complex to apply;

(d) presentation and disclosures – disclosure requirements that appropriately complement the simplified recognition and measurement requirements;

(e) interpretation – application of requirements easier to interpret by reducing managerial discretion and with lower risk of significant interpretation diversity; and

(f) understandability – requirements result in financial reporting outcomes that are easier to understand or easier for management to explain to users of the financial statements.

5.7 When discussing potential simplifications it could take on a topic, the Board considered the accounting requirements applying to smaller not-for-profit private sector entities in several other jurisdictions.[10] The Board also considered current practices, including whether there is any known diversity in practice amongst smaller not-for-profit private sector entities.

5.8 In forming its preliminary views, the Board evaluated the possible approaches it could take on a topic by reference to an agreed set of principles. These principles acted as a boundary for possible approaches that could be taken and provided the Board with a consistent basis for forming its preliminary views. The agreed principles for developing Tier 3 reporting requirements are outlined in Appendix B to this Discussion Paper.

10 The selected other jurisdictions were considered on the basis of the international pronouncements compared in the AASB Staff Paper: *Comparison of Standards for Smaller Entities* and requirements in other jurisdictions that were reviewed in the AASB Research Report 5 *Financial Reporting Requirements Applicable to Charities* in consideration of the different approaches that already exist for particular areas of financial reporting for the purpose of developing the Tier 3 reporting requirements. The selected jurisdictions include: the *IFRS for SMEs,* United Kingdom FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland,* United Kingdom FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime,* United Kingdom *Statement of Recommended Practice: Accounting and Reporting for Charities,* Hong Kong *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard*, New Zealand *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit)* (New Zealand Tier 3 reporting requirements) and Canadian *Accounting Standards for Not-for-Profit Organisations* in Part III of the CPA Canada Handbook, Singapore *(Charities Accounting Standard)*, United States Financial Accounting Standards Board Accounting Standards Codification Topic 958.

Costs versus benefits

5.9 As summarised in AASB Research Report 16 *Financial reporting by non-corporate or small entities*, academic research shows donors are more interested in non-financial information; integrating these into their donation decision-making. There is also academic research positing that users of the financial statements of smaller entities may find simpler financial statements more useful. These research findings suggest to the Board that the benefits of the reporting requirements specified by Tier 1 and Tier 2 Australian Accounting Standards may be more limited when regarding smaller not-for-profit private sector entities.

5.10 In developing accounting requirements, the benefits of the accounting requirement must exceed its costs. This consideration forms part of the Board's agreed principles for developing Tier 3 reporting requirements. Certain costs of applying Tier 1 and Tier 2 Australian Accounting Standards reporting requirements are mostly static (for example, costs of engaging an external valuer) and, therefore, relatively more considerable for a smaller not-for-profit private sector entity. It may also take smaller not-for-profit private sector preparers longer to understand and apply certain accounting requirements, for example, because they have been written for a different target audience.

5.11 The Board observed that its cost-benefit assessment might differ when considering smaller private sector entities in particular, compared to the not-for-profit sector as a whole. Consequently, it may form a different view about the applicable accounting for Tier 3 reporting requirements as these are developed with smaller not-for-profit private sector entities in mind. In some instances, a different measurement basis is proposed. In other instances, the Board has formed a preliminary view that disclosure is an appropriate substitute for recognition and/or measurement.

General purpose financial statements

5.12 The Board is developing reporting requirements that will form the basis of a set of general purpose financial statements; or Tier 3 general purpose financial statements. General purpose financial statements comprise a complete set of financial statements, being:

(a) all the specified financial statements (for example, a statement of financial position);

(b) accompanying notes to the financial statements; and

(c) comparative information for the preceding reporting period.

(d) Financial statements that do not contain all these elements are not general-purpose financial statements.

5.13 The Board is aware that some simplifications may result in the non-recognition of certain assets and liabilities that meet the definition of such within the conceptual framework. However, the Board considers that its preliminary views will overall result in Tier 3 financial statements that will meet the needs of users of smaller not-for-profit private sector entities.

Primary financial statements

> **Section Snapshot**
>
> - The Board's preliminary view is that Tier 3 primary financial statements should consist of:
>   - A statement of profit or loss and other comprehensive income;
>   - A statement of financial position;
>   - A statement of cash flows that:
>   - covers both cash and cash equivalents
>   - reports cash flows from operating activities using the direct method
>   - does not require cash flows from investing and financing activities to be presented separately
> - Tier 2 reporting requirements will continue for the information presented on the face of the statement of financial position and statement of profit or loss and other comprehensive income. Guidance will be developed to provide clarity to preparers of the flexibility inherent in those requirements.
> - The Board has not yet decided whether a statement of changes in equity would be required as part of Tier 3 reporting requirements.

5.14 A financial report or 'complete set of financial statements' is generally understood as comprising specified financial statements and accompanying notes. When considering the possible future Tier 3 reporting requirements, the Board thought it would be desirable to maximise consistency with Tier 2 accounting principles where possible with the view that Tier 2 requirements act as 'the cap'. Accordingly, the Board decided to consider whether the presentation of financial statements as set out in AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Entities* could be further simplified. Currently, Tier 2 general purpose financial statements comprise of:

(a) a statement of financial position;

(b) a statement of profit or loss and other comprehensive income presented as either one or two statements;

(c) a statement of changes in equity with the option of presenting a statement of income and retained earnings if the entity's equity movements relate only to profit or loss for the period, payments of dividends, correction of prior period errors or changes in accounting policies;

(d) a statement of cash flows; and

(e) notes to the financial statements.

5.15 The Board considered that it is generally accepted that some form of statement about the entity's financial result for the period and financial position, including notes, must be presented. These statements should continue to be required in Tier 3 reporting requirements to provide financial information to the users about the entity. However, the Board observed that for smaller entities, there is less consensus about the usefulness of presenting information 'upfront' about other comprehensive income, movements in the entity's equity/accumulated funds, and cash flow. Accordingly, the Board decided to consider possible simplification approaches for the statement of comprehensive income, statement of changes in equity and the statement of cash flows, and the presentation requirements for those statements.

Commented [A37]: **Note for Board members:** The text in this section is drawn from M184 Agenda Paper 7.2 (November 2021) and reflects the Board's discussions and decisions made at its November 2021 meeting.

Statement of profit or loss and other comprehensive income (Statement of comprehensive income)

5.16 The Board discussed whether simply requiring a statement of profit or loss would be a proportionate response for a lower-level differential reporting tier, as many entities preparing Tier 3 financial statements may not have items of other comprehensive income to report. Doing so would provide clarity to preparers who do not adopt accounting policies that result in the items presented in other comprehensive income. The Board also observed that information about other comprehensive income for the period could be presented as part of another financial statement or disclosed within the notes to the financial statements.

5.17 The Board has formed a preliminary view that a statement of profit or loss and other comprehensive income – either a one-statement or two-statement approach – should continue to be required similarly to the current Tier 2 general purpose financial statement requirements.

5.18 In forming its preliminary views, the Board reflected that presenting a statement of profit or loss and other comprehensive income remains to be useful to users without imposing significant costs to preparers, noting that:

(a) by not requiring the presentation of other comprehensive income, it could inadvertently be imposing additional costs on subsidiaries of a parent entity that prepares Tier 1 or Tier 2 compliant financial statements as a result of a mismatch in presentation requirements; and

(b) while many smaller not-for-profit private sector entities are unlikely to incur other comprehensive income, some smaller not-for-profit private sector entities revalue items of property, plant and equipment, and certain financial assets. Therefore reporting other comprehensive income information continues to be useful to preparers and helps align the reporting practice of smaller not-for-profit private sector with those of larger NFP entities.

5.19 As part of its deliberations, the Board observed that research and initial stakeholder feedback suggests that users of the financial statements may not fully understand that other comprehensive income items are, in general, unrealised gains and losses. As such, users might not know that these “profits” do not necessarily correspond to amounts available for use by the entity. This could potentially impact their donation decision-making. The Board noted that there is merit in keeping users focused on more decision-useful performance measures such as the profit or loss of the entity. However, the Board reflected that users may be educated to understand what other comprehensive income represents, and benefit from the provision of more complete and transparent information about the entity’s performance.

5.20 The Board also recognised that, while it may not be uniformly required, there exists governing legislation or other regulatory articles that currently requires the provision of other comprehensive income information. As such, not requiring the presentation of the statement of profit and loss and other comprehensive income may be seen as a backward step in transparency. It may also confuse preparers due to the misalignment of the specified financial statements and the information required for regulatory purposes.

Statement of changes in equity

5.21 The Board has heard that the statement of changes in equity may assist stakeholders in assessing the integrity of the financial statements, including by providing information on the effects of adjustments to equity resulting from changes in accounting policies and correction of errors. Initial stakeholder feedback also indicated that preparers are not concerned with the cost of presenting a statement of changes in equity. Some stakeholders considered the statement important to provide prominence to information about movements in the entity’s equity accounts.

5.22 However, the Board noted that for many smaller not-for-profit private sector entities, the profit or loss might be the entity's only change in equity for the reporting period. Also, stakeholders have indicated that the information presented in the statement of changes in equity could otherwise be disclosed as part of the notes to the financial statements, which would be sufficient to meet users' needs. As such, the Board observed that not requiring a statement of changes in equity may be a proportionate response to the Tier 3 reporting requirements.

5.23 Noting the differing perspectives above, the Board has not yet formed a view on whether a statement of changes in equity should be required as part of the specified set of Tier 3 primary financial statements. Accordingly, the Board is interested in obtaining further stakeholder feedback on the usefulness to users of the statement of changes in equity.

Information to be presented on the face of the statement of financial position and statement of profit or loss and other comprehensive income

5.24 The Board heard feedback from some stakeholders calling for better consistency and comparability of the face of the primary financial statements. For example, some stakeholders supported the development of presentation requirements with more specificity of the line items to those specified by AASB 1060 or AASB 101 *Presentation of Financial Statements*. Consequently, the Board considered whether it should – and if so, how – it could make the presentation of the financial statements simpler for preparers without sacrificing usefulness to users.

5.25 The Board discussed three approaches it could take in a Tier 3 accounting standard:

(a) a "checklist" approach – prescribe the set of line items and totals that must be presented, without alteration;

(b) a "tailoring" approach – amend and prescribe the minimum line items specified by AASB 1060 to recognise that Tier 3 reporting tier is intended for use by entities with less complex transactions, and use terminology that may be more commonly employed by smaller not-for-profit private sector entities; or

(c) a "supplementary material" approach – develop requirements for presentation on the face of the financial statements consistent with AASB 1060.[11] These requirements would be supplemented by explanatory guidance and education materials that explain the flexibility in the presentation of financial information, including further aggregation or disaggregation or use of different titles and labels when appropriate.

5.26 The Board has formed a preliminary view to develop requirements consistent with a "supplementary material" approach. While the approach accords entities more subjectivity (and potentially requires more judgement compared to the "tailoring" or "checklist" approaches), this approach:

(a) maintains the consistency of presentation requirements across all reporting tiers;

(b) better invites the entity to use the financial statements to 'tell their story'; and

(c) recognises that a "tailoring" or "checklist" approach could impose more requirements and possibly require more mandatory information to be presented about the entity compared to an entity complying with AASB 1060 (for example, because there is more specified disaggregation of information on the face of the financial statements).

5.27 The Board observed that a "tailoring'' or "checklist'' approach could be expected to facilitate consistency in reporting and thereby enhance comparability between entities. Depending on

11 AASB 1060 requirements would be adapted to reflect other preliminary views of the Board set out in this Discussion Paper. For example, the Board might not develop a requirement for separate presentation of assets held for sale or deferred tax balances on the face of the statement of financial position as the Board is not intending to develop related recognition requirements.

requirements on the extent of disaggregation on the face of the financial statements, these approaches may better communicate useful information to users who may not necessarily read the notes to the financial statements. Board decisions would likely provide preparers with better clarity of the reporting requirements, simplifying the preparation of the financial statement (and so, minimising costs). However, the Board also observed that in developing AASB 101, the Board has determined that no amendment was necessary to apply the Standard by not-for-profit entities. Further, information to be presented in the financial statements, including the aggregation or disaggregation of line items presented on the face of the statement of financial position, should be based on management's judgement in meeting the needs of their users.[12]

5.28 Ultimately, the Board considered that the "supplementary material" approach was preferable to a "tailoring" approach because many of the benefits of the "tailoring" approach can also be achieved via a "supplementary material" approach. The "supplementary material" approach may be able to educate preparers and 'looks ahead' to the entity growing, rather than catering to existing accounting literacy.

5.29 The Board does not expect its proposals to change many entities' existing presentation. An exception will be cases where an entity's existing detail on the face of its financial statements does not currently provide users with a relevant understanding of the entity's financial performance and financial position (for example, because it is too condensed or too detailed). However, the Board considers that the explanatory material will limit the costs incurred by a preparer from needing to change its existing practice.

5.30 In forming its view, the Board reflected that many smaller entities regard the financial statements as primarily a regulatory compliance exercise. Consistent with this premise, the Board considered it could adopt a "checklist" approach and develop requirements that force an entity to present its assets, liabilities, equity, income and expenses using only the prescribed line items. Any further disaggregation would have to be presented in accompanying notes to the financial statements.

5.31 This approach is no different to completing a tax return or other form and attaching supplementary information to explain that form. Such presentation is arguably a proportionate response, as it provides clear direction to preparers, reduces the need for management judgement, is neutral, and facilitates comparability between entities. However, for the following reasons, the Board rejected developing such a requirement:

(a) limiting the role of financial statements as simply a regulatory compliance exercise ignores its importance and value as a communication and accountability discharge tool to satisfy users' needs; and

(b) presentation of prescribed categories of income and expenses could be difficult to apply in practice. It may not easily address the needs of all users, as not-for-profit entities operate across a broad range of fields.

Information to be presented on the face of the statement of cash flows

5.32 The Board observed that many preparers regard the statement of cash flows as one of the more challenging financial statements to prepare. However, stakeholders have indicated that the statement of cash flows is a necessary component of Tier 3 financial statements as it provides users with useful information on the entity's cash flows, including understanding the entity's solvency. Consequently, in recognition of developing Tier 3 as a proportionate response, the Board intends to propose minor amendments to the form of the statement of

12 In clarification of this point, in 2015 the AASB deleted the words "as a minimum" from AASB 101. These words previously preceded the listing of statement of financial position line items.

cash flows specified by AASB 1060 to alleviate some costs incurred by preparers in presenting the statement.

5.33 The Board has formed a preliminary view to require the statement of cash flows to present:

(a) cash flows from operating activities separately from other cash flows. There will be no need to separately distinguish cash flows from investing activities from cash flows relating to financing activities; and

(b) cash flows from operating activities using the direct method. Under the direct method, major classes of gross cash receipts and gross cash payments are disclosed. There will be no requirement to disclose a reconciliation of the net cash flows from operating activities to the profit or loss (the indirect method) in the notes to the financial statements.

5.34 The Board decided not to require a distinction between investing and financing cash flows. The benefits of retaining the distinction appear limited given the Board's expectation that these cash flows will likely be limited in nature and as each major class of gross cash receipts and gross cash payments remain separately disclosed. Eliminating this distinction:

(a) reduces an element of judgement from preparation of the financial statement which may, in turn, reduce potential confusion of the preparers and users;

(b) recognises that users of the financial statements are likely to be more interested in whether the entity has deployed cash in a manner consistent with the entity's not-for-profit objectives and in its ability to continue to operate; and

(c) recognises that management of smaller not-for-profit private sector entities are unlikely to monitor cash flows to such detail.

5.35 The Board observed that comparability of the financial statements to those of a higher reporting tier is not impaired as only separate subtotals for investing and financing cash flows are not presented, and the core information is still available to users. Consequently, there is no real loss of benefit to users of the proposed amendment while providing a small cost saving to preparers.

5.36 Specifying only a single manner of reporting cash flows from operating activities provides clear direction to preparers. Based on a limited sample, the direct method currently appears to be predominately applied by management and improves comparability between entities. The direct method gives users and management more visibility of where cash has been spent compared to the indirect method. Overall, the Board considered that the benefits of requiring the report of cash flows from operating activities using only the direct method exceed the costs of limiting existing optionality.

5.37 The Board is also interested in seeking feedback whether other possible simplifications can be considered for the statement of cash flows. For example, some stakeholders have indicated that the requirement in Interpretation 1031 to present cash flows arising from operating activities in the statement of cash flows on a gross basis, including those relating to the GST component recoverable from, or payable to, the taxation authority, can be challenging for smaller entities. As such, the Board would like to seek feedback on whether other possible simplifications, including whether all cash flows should be presented net of GST could be considered.

Cash flows forming part of the statement of cash flows

5.38 The Board observed that cash and cash equivalents include demand deposits, overdrafts and short-term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value (e.g. short-term term deposits). There may be diversity in practice as to whether such investments are included in the statements of cash flows as some entities may not associate these investments as part of cash available for use by the entity.

5.39 To provide clarity and eliminate any diversity in practice, the Board considered whether it would be a proportionate response for its Tier 3 reporting requirements to limit the statement of cash flows to the reporting of solely cash and overdrafts. That is, for example, to exclude all term deposits regardless of whether the deposit was originally of a 1-month maturity term or 12-month term.

5.40 Ultimately, the Board decided not to propose such a requirement but to retain consistency with the statement of cash flows specified by AASB 101 and AASB 1060. The Board considered that the costs of departing from other reporting Tiers would exceed the benefits of a more straightforward exercise for preparers for the following reasons:

(a) cash equivalents are largely similar to cash and should be equally reflected in the statement of cash flows. The exclusion of cash equivalents from the statement of cash flows potentially misrepresents the solvency of the entity to users;

(b) the Board would need to clarify how cash management activities (conversion of cash into cash equivalents, or vice versa) are reported in the statement of cash flows;

(c) transactions involving cash equivalents are likely to occur less regularly than cash and should be difficult to identify. Hence, any costs of manual adjustments to recognise accounting software limitations could be expected to be limited; and

(d) while management may not necessarily consider the entity's holdings of cash equivalents when monitoring cash flows or reviewing available cash, having inconsistent requirements to Tier 1 and Tier 2 statement of cash flows introduces unnecessary complexity for users in an area that preparers have not identified as being of concern.

Consolidated financial statements

Commented [A38]: **Note for Board members:**
The Board discussed its approach to accounting for subsidiaries at its June 2021 meeting. The text in this section reflects the Board's discussion and decisions, and is based, where relevant, on M181 Agenda Paper 3.3 (June 2021).

The Board's decision regarding disclosure by the parent of its significant relationships is contained within the subsection "Separate financial statements of the parent" below.

Section snapshot

- The Board's preliminary view is to optionally exempt a parent entity from presenting consolidated financial statements. A parent entity may present separate financial statements as its only set of financial statements
- The separate financial statements will include information about the parent's significant relationships.

5.41 Consolidation is one of the areas of challenge for many entities. The Board is aware that there are smaller not-for-profit private sector entities that are parent entities. The Board is also conscious that avoiding consolidation may be a reason some entities presently elect to prepare special purpose financial statements. Consequently, the Board considered it necessary to address whether Tier 3 reporting requirements should require the consolidation of subsidiaries.

5.42 From its initial outreach, the Board observed that complexities with presenting consolidated financial statements appear to be less about the mechanics of consolidation accounting and more about identifying subsidiaries. The complexities shared with the Board included:

(a) challenges and costs in identifying a complete set of subsidiaries; for example, because information is not readily available to the not-for-profit entity; and

(b) a stakeholder view that consolidated financial statements do not provide useful information compared to entity-level financial statements for each entity in the group. This is either because users are interested only in a particular activity at an entity level or because the preparer disagrees with identifying an entity as a subsidiary subject to consolidation.

> **Example**
>
> The Board heard that some stakeholders noted that some users of the financial statements of a church that owns and operates a school may be interested only in financial information about the church's religious activities or only in the school's financial performance and position.
>
> Some stakeholders hold the view that the church should not consolidate the school because the school operates independently of the church.

5.43 In developing Tier 2 reporting requirements, the Board decided to continue to require the preparation of consolidated financial statements. This decision was made considering the findings from AASB Research Report 13 *Parent, Subsidiary and Group Financial Reporting* (October 2019). The Research Report suggested that users of the financial statements find consolidated financial statements useful for their decision-making. The Board noted, in its Basis for Conclusions to AASB 2020-2 Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities, that "The feedback … provided further support to the Board's view that consolidated financial statements are essential to provide users with transparent and complete information about the financial position and financial performance of the group and the entities in the group."

5.44 The Board has not changed its view about the usefulness of consolidated financial statements in reporting the reality of an entity's structures and arrangements. Also, the Board observed that the matters noted in paragraph 5.42 above are not unique to smaller not-for-profit private sector entities. Therefore, the Board considered consolidating subsidiaries an appropriate accounting requirement even for smaller not-for-profit private sector entities.

5.45 However, the Board has formed a preliminary view to develop a requirement that allows a parent entity the choice of presenting:

(a) consolidated financial statements; or

(b) separate financial statements as its only set of financial statements (see also paragraph 5.60 below). Separate financial statements are entity-level financial statements in which subsidiaries are not consolidated.

5.46 In forming its view, the Board considered its objectives in developing an additional differential reporting tier. The Board decided to allow a parent entity an accounting policy choice on consideration of factors including:

(a) the costs incurred by a smaller not-for-profit private sector entity to prepare consolidated financial statements are likely to be relatively larger. The Board also observed that management might not use consolidated information;

(b) in some instances, unconsolidated financial statements are presently accepted to satisfy legislative requirements. This suggests that the legislation requirements regard management's accountability for the entity as being sufficiently discharged through the provision of such financial statements; and

(c) in many instances, a not-for-profit private sector entity that is a subsidiary must lodge financial statements even if it forms part of the consolidated financial statements of its parent entity.

5.47 The Board noted that an entity might still need to calculate its consolidated assets, consolidated revenue or another amount to determine its legislative reporting obligations (including whether it has to prepare financial statements that comply with Australian

Accounting Standards). Also, some entities may elect to present consolidated financial statements to access relief from lodging financial statements for each subsidiary entity.

5.48 The Board did not discuss other exemptions and exceptions to presenting consolidated financial statements (for example, the investment entity exception) as it is only consulting on its general approach to accounting for interests in subsidiaries at this stage of its project. However, in keeping with its objectives for developing Tier 3 reporting requirements, the Board is unlikely to require a parent preparing Tier 3-compliant financial statements to consolidate a subsidiary where such accounting is not required by an investor preparing financial statements that comply with Tier 1 or Tier 2 Australian Accounting Standards.

Control

5.49 The Board observed the feedback from its initial outreach does not suggest that consolidation should be based on a notion other than control. The Board considers that 'control' should have the same meaning in a Tier 3 Standard as in Tier 1 and Tier 2 Australian Accounting Standards. Whether an entity controls another entity should be evaluated consistently irrespective of the reporting Tier.

5.50 However, the Board discussed whether to develop a list of objective criteria that must be present for control to exist. Such a list would eliminate some subjectivity and complexity from the evaluation process and provide more certainty to preparers of Tier 3 financial statements. The Board rejected doing so for the following reasons:

(a) it is a departure from principles-based standard-setting;

(b) it could create potential differences from the conclusion drawn at a different reporting Tier; and

(c) it might be difficult to develop suitable criteria where control is not via an ownership interest.

5.51 From its initial outreach, the Board understands that some stakeholders have implementation concerns about the guidance on control in AASB 10 *Consolidated Financial Statements*. These concerns impact not-for-profit private sector entities of all sizes. Consequently, the Board will consider these concerns as part of the Board's post-implementation review of the application guidance for not-for-profit entities in AASB 10, rather than this project.

Consolidation of some, but not all, subsidiaries

5.52 The Board considered whether it should develop a requirement to permit an entity to consolidate some, but not all, its subsidiaries. The partially consolidated financial statements would be supplemented by summary financial information.

5.53 The Board rejected this approach for reasons including:

(a) it does not improve comparability between entities, as different entities may make different consolidation choices in respect of subsidiaries of a similar nature. This adds to user costs of understanding the financial statements. In addition, there is reduced comparability with entities complying with Tier 1 or Tier 2 reporting requirements; and

(b) the potential for abuse of the requirement through selective consolidation choices, which could be relevant for solvency and future grant funding assessments or for determining the entity's legislative reporting obligations.

Interaction with the Board's proposals for setting reporting thresholds

5.54 The Board is not proposing to specify reporting thresholds (refer paragraph 1.5). Consequently, it is possible that some larger not-for-profit private sector entities or entities conducting activities of public interest present unconsolidated financial statements that comply with Tier 3 reporting requirements. In the Board's view, a larger not-for-profit private sector entity will not usually be the type of entity preparing financial statements that comply with Tier 3 reporting requirements. The reporting tier is not being developed with these entities in mind.

Separate financial statements of the parent

5.55 The Board has formed a preliminary view to develop a requirement for a parent that presents separate financial statements to measure its interests in subsidiaries at either:

(a) cost;

(b) at fair value through other comprehensive income; or

(c) applying the equity method of accounting.

Commented [A39]: <u>Question 10 to Board members:</u>
The accounting in separate financial statements was considered at the June 2021 meeting (refer to M181 Agenda Paper 3.3). The Board did not discuss the accounting in separate financial statements at the meeting. In that paper, staff initially recommended that these interests be measured at cost in separate financial statements.

The Board member discussed the accounting for an interest in a subsidiary in separate financial statements as part of M188 Agenda Paper 12.2.1 (June 2022). The Board did not specifically form a view at its June 2022 meeting. However, staff think that the Board discussion suggests that the accounting specified by AASB 127 would apply.

Consequently, staff have drafted a proposed preliminary position that would be consistent with this, amended to reflect consistency with the Board's decision to require fair value gains and losses on a basic financial asset to be presented only in other comprehensive income (rather than FVTPL with the option to make an irrevocable FVTOCI election).

Alternatively, the accounting in separate financial statements could look like:

1Specifying a single measurement basis

2Requiring a parent apply the accounting specified by AASB 127 via a cross-reference from a Tier 3 Standard to AASB 127. (Staff have not suggested this as an approach as AASB 127 cross-references further to AASB 9)

Do Board members agree with the proposed preliminary view and drafting?

If not, how would Board members like for staff to approach this topic in the discussion paper?

5.56 The Board expects that smaller not-for-profit private sector entities presenting separate financial statements will, in the main, measure any interests in subsidiaries at cost. Measurement at cost may be an appropriate proportionate accounting policy as the entity's interest in a subsidiary will, in many instances, be an avenue for furthering the entity's not-for-profit objectives rather than as a financial investment vehicle.

5.57 As an alternative to measurement at cost, the Board decided to permit a parent entity to measure its interest in its subsidiaries at fair value through other comprehensive income in the entity's separate financial statements. This allows a parent entity to treat its interests in its subsidiaries in the same manner as required under the Board's preliminary proposals for financial instruments which are held to generate both an income and capital return for the entity. This measurement basis could provide relevant information to users of a parent entity's financial statements where the entity determines the substance of its interest in its subsidiaries is a financial investment.

5.58 The Board also decided to permit a parent entity to measure its interest in its subsidiaries using the equity method of accounting as an alternative to measurement at cost. This allows a parent entity to treat its interests in its subsidiaries in the same manner as required under the Board's preliminary proposals for an entity's investments in associates. This measurement basis could provide relevant information to users of a parent entity's financial statements where the parent determines that the substance of its interest in its subsidiaries is more akin to that of an associate interest, even though legally or contractually the parent has power over those other entities and the ability to use its power to affect its returns.

5.59 However, the Board observed that, especially in the not-for-profit sector, control might be by contract or other relationship rather than by a shareholding giving the entity voting power in the subsidiary entity. Consequently, the cost or equity accounted interest in a subsidiary may be nil or a nominal amount.

5.60 The Board considered that measurement at cost or equity-accounted amount without accompanying consolidated financial information about the subsidiary does not provide financial statement users with sufficient information about the parent entity's structures and arrangements. Without mitigating disclosures, it might be difficult to view the separate financial statements as general purpose. Resultantly, the Board has formed a preliminary view to develop disclosure requirements that would provide users of the financial statements with information about a parent entity's significant relationships. These disclosures would form part of a parent entity's separate financial statements, where these are the only set of financial statements presented.

5.61 The Board is seeking feedback about its preliminary view to allow a parent to elect not to present consolidated financial statements but to present only separate financial statements accompanied by disclosures about the entity's significant relationships. Consequently, the Board has not discussed the form or extent of these disclosures, nor the subsidiaries for which information would be required. However, these disclosures could include general detail about the subsidiaries and possibly, summary financial information about the entity.

Changes in accounting policies and accounting errors

Section snapshot

- The Board's preliminary view is to require a modified retrospective basis to recognising a voluntary change in accounting policy and correction of prior period error. Rather than revising the previously reported comparative financial statements, any 'catch up' is recognised as an adjustment to the current period's opening financial position
- A change in accounting estimate will continue to be accounted for prospectively

5.62 AASB 108 *Changes in Accounting Policies, Accounting Estimates and Errors* requires the effect of voluntary changes in accounting policies and correction of prior period accounting errors to be reflected retrospectively in the presented financial statements, unless it is impracticable to do so. In these instances, the entity is required to reflect the new accounting policy or correct the prior period error:

(a) at the beginning of the earliest period for which retrospective application is practicable, and make a corresponding adjustment to the opening balance of each affected component of equity that period (a 'modified retrospective' basis); or

(b) if it is not practicable to determine such cumulative effect, to apply the new policy or correct the error prospectively from the earliest date practicable.

Changes in accounting policies

5.63 The Board considered that an entity preparing Tier 3 general purpose financial statements should be able to voluntarily change its accounting policy to another available accounting policy (e.g. from the cost basis to the revaluation basis), provided the change results in the financial statements providing more reliable and relevant information about the effects of transactions, other events or conditions on the entity's financial position, performance or cash flows. Consequently, the Board discussed whether it is necessary to require the accounting treatment specified by AASB 108 for changes in accounting policies and correction of errors in Tier 3 general purpose financial statements.

5.64 The IASB often permits a modified retrospective approach in setting transitional provisions for new IFRS Standards, usually for cost-benefit reasons. While the Board's initial outreach has not suggested that entities find the accounting specified by AASB 108 to be difficult to apply, the Board has formed a preliminary view to developing a similar general requirement for changes in accounting policies in its Tier 3 reporting requirements. It considers this option strikes an appropriate cost-benefit balance for smaller entities as it:

(a) is more straightforward to apply; while

(b) continues to distinguish the cumulative effects of transactions and events about a prior period from the impact of transactions and events occurring in the current period.

5.65 Some comparability is sacrificed under the proposed approach as the comparative financial statements will not be restated. However, the benefits of having restated comparative information are expected to exceed the costs of restating the prior period's financial statements. This is due to the once-off nature of the adjustment and the expectation that users of Tier 3 not-for-profit private sector entity financial statements are unlikely to be interested in such restatement.

Commented [A40]: <u>**Note for Board members:**</u>
The text in this section is drawn from M182 Agenda Paper 4.3 (August 2021) and reflects the Board's discussions and decisions made at its August 2021 meeting.

Example

During the 20X3 financial year, XYZ Inc ('XYZ') decides to change its accounting policy for land from the cost basis to the revaluation basis. The change in accounting policy is effective 1 July 20X2.

The cost of the land is $3 million. The fair value of land at 30 June 20X3, 1 July 20X2 and 1 July 20X1 is $5 million, $4.2 million and $4.1 million respectively.

The reconciliations below illustrate the accounting for a change in accounting policy under the Board's proposals, and on a fully retrospective or prospective basis.

	Land ($mil)					
	Fully retrospective (AASB 108)		Modified retrospective (Tier 3 proposal)		Prospective	
	20X3	20X2 (restated)	20X3	20X2	20X3	20X2
Opening balance	4.2	3.0	3.0	3.0	3.0	3.0
Change in accounting policy	-	1.1	1.2	-	-	-
Restated opening balance	-	4.1	4.2	-	-	-
Change in accounting policy	-	-	-	-	1.2	-
Revaluation increase during period (OCI)	0.8	0.1	0.8	-	0.8	-
Closing balance	5.0	4.2	5.0	3.0	5.0	3.0

5.66 The Board did not discuss the treatment of changes in accounting policies should it add to, or amend, its proposed stand-alone accounting standard in the future (a 'mandatory' change in accounting policy). The Board expects transitional provisions, including those referred in paragraph 2.22 regarding first-time application, to be developed at those times, if necessary.

Accounting errors

5.67 For the reasons set out in paragraphs 5.63 – 5.65, the Board similarly proposes to develop a requirement for a modified retrospective approach to applying to corrections of accounting errors.

Changes in accounting estimates

5.68 The Board intends to develop a requirement for changes in accounting estimates to be accounted for prospectively, consistent with AASB 108. It has not identified any reason to develop a different requirement for Tier 3 general purpose financial statements.

Financial instruments

Section snapshot

- The Board's preliminary view is develop simpler requirements only for basic financial instruments. An entity will be directed to apply the accounting specified by AASB 9 for more complex financial instruments
- In general, the Board plans to require basic financial instruments other than some investments to be measured at cost, less impairment. Impairment will be based on an incurred loss model. Investments not measured at cost are measured at FVTOCI. Interest is to be calculated by reference to the contractual interest rate
- The Board needs further information about certain topics, including the existence of embedded derivatives in contracts entered into by smaller not-for-profit private sector entities, before it determines how to address these aspects in a Tier 3 Standard

Commented [A41]: Note for Board members:
A NFP Panel member queried whether the proposed accounting treatment would affect an auditor's ability to provide a clean audit opinion on the current year financial statements, given that there is a known error in the comparative financial statements.

Staff have sought feedback from AUASB staff as to whether the Board decision could impact the ability of an auditor to provide a clean audit opinion. Staff understand that auditors will still be able to provide a clean audit opinion, as long as the audit opinion directly refers to the Tier 3 framework as the basis of preparation, which permits such accounting treatment.

Similarly, staff do not think the Board decision impacts the ability of a director to make a declaration that the financial statements provide a true and fair view of the entity. Staff note that AASB 108 already allows a similar accounting treatment.

Staff think that it is unnecessary to include text commenting on the above in the DP. Staff note that stakeholders may provide feedback in this regard when responding to the proposed Question regarding whether Tier 3 financial statements, incorporating the proposed simplifications, could be appropriately regarded as GPFS.

Commented [A42]: Note for Board members:
The Board discussed financial instruments at its May 2022 and June 2022 meetings. This section reflects staff's understanding of the Board discussion and its decisions.

The related staff papers are M187 Agenda Papers 5.2.1 and 5.2.2 (May 2022), and M188 Agenda Papers 12.2.1, 12.2.2, 12.2.3 and 12.2.4 (June 2022).

5.69 The Accounting Standards specifying the recognition and measurement of financial instruments in Tier 1: Australian Accounting Standards are:

(a) AASB 9 *Financial Instruments*;

(b) AASB 132 *Financial Instruments: Presentation*; and

(c) AASB 139 *Financial Instruments: Recognition and Measurement*.

5.70 Many stakeholders regard AASB 9 to be a complex accounting standard. This view is consistent with the breadth of its scope being to provide useful information to users of the financial statements of financial instruments held by financial institutions and non-financial institutions, financial instruments held by start-ups and other simple businesses and those held by entities employing more complex financial management strategies. Hence, the Board considered that it is necessary to develop simpler reporting requirements for financial instruments compared to those specified by the Tier 1 reporting requirements.

5.71 The Board's proposed accounting for financial instruments in a Tier 3 Standard is summarised in Table 5.1 below:

Table 5.1: Proposed accounting for financial instruments

Topic	Summary of the proposed accounting for financial instruments
Scope	Simpler reporting requirements will be developed for identified 'basic' or 'simple' financial instruments. The Board will not develop requirements or guidance for certain instruments and transactions addressed by AASB 9, AASB 132 and AASB 139. The Board intends to require other financial instruments to be accounted for in accordance with AASB 9, AASB 132 or AASB 139, as appropriate. However, hedge accounting will not be permitted.
Initial recognition of basic financial assets and basic financial liabilities	Consistent to AASB 9, a basic financial asset and financial liability is recognised when the entity becomes party to the contractual provisions of the financial instrument.
Initial measurement of basic financial assets and basic financial liabilities	A basic financial asset (including donated assets) and financial liability is initially measured at its fair value. Transaction costs and fees incurred by the entity are expensed immediately.
Classification of basic financial assets and basic financial liabilities	An entity will not be required to classify basic financial assets and financial liabilities in the manner specified by AASB 9.
Accounting policy choices	An entity will not be able to choose how a basic financial asset or financial liability is subsequently measured. The accounting policy for financial assets and financial liabilities will be dictated by their nature.
Subsequent measurement of basic financial assets	Basic financial assets are subsequently measured as follows: financial assets that are held to generate both income and capital return for the entity – at fair value through other comprehensive income; and all other basic financial assets – at cost, less any accumulated impairment. Any initial premium or discount on acquisition of the asset is amortised over the expected life of the financial asset.

Topic	Summary of the proposed accounting for financial instruments
	Interest earnt on a basic financial asset is recognised as income when the entity is entitled to the interest. Interest is measured by reference to the instrument's contractual interest rate.
Subsequent measurement of basic financial liabilities	Basic financial liabilities are subsequently measured at cost. Any initial premium or discount is amortised over the expected life of the financial liability. Interest charged on the financial liability is recognised as an expense when incurred. Interest is measured by reference to the instrument's contractual interest rate.
Impairment	A basic financial asset is impaired when it is probable that the carrying amount will not be collectible. (That is, impairment is assessed by reference to an 'incurred loss' model.)
Derecognition of a basic financial asset	A basic financial asset is derecognised when either: the contractual rights to the cash flows form the financial asset expire or are settled; or the entity otherwise loses control of the financial asset.
Derecognition of a basic financial liability	A basic financial liability is derecognised when the obligation is discharged, cancelled or expires. An entity treats a modification of the terms of a financial liability or an exchange of a debt instrument for a different debt instrument as an extinguishment of the original financial liability.

5.72 The Board's preliminary views are discussed further in the remainder of this section of the Discussion Paper.

Scope

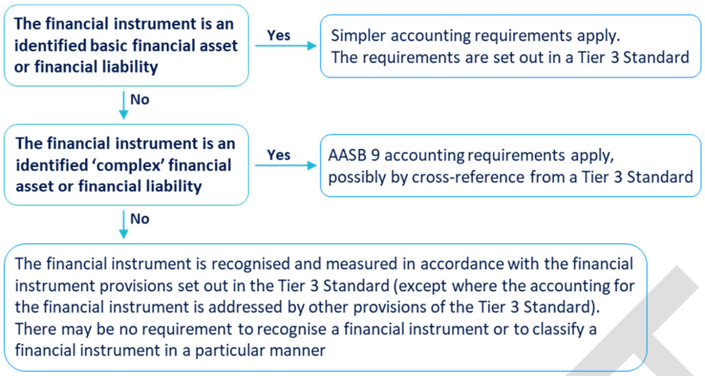
5.73 The Board observed the limited variety and basic nature of the financial instruments within the scope of AASB 9 that are expected to be commonly held by smaller not-for-profit private sector entities. In response, the Board considered that to be consistent with its objectives for the stand-alone Tier 3 Standard (see paragraph 4.7) it should develop simpler requirements for only such financial instruments.

5.74 Figure 5.2 below summarises the Board's proposed approach for financial instruments. Paragraphs 5.75 to 5.83 provide further explanation, including the Board's rationale for its preliminary views.

Commented [A43]: Question 11 to Board members:
Staff think that Figure 5.2 reflects the Board's 'cut', 'lift' or 'revise' approach discussed at its June 2022 meeting.

Do Board members agree that Figure 5.2 reflects the Board's proposed approach to financial instruments?

Figure 5.2: Proposed approach to accounting for financial instruments



5.75 The Board has formed a preliminary view that a Tier 3 Standard will identify the basic financial instruments for which simpler requirements will apply. The Board does not intend to develop requirements that would apply to all financial instruments with similar characteristics or fall into the same category (see the example immediately below). For example, the Board does not intend to develop simpler requirements for all financial assets that receive cash flows that are "solely payments of principal and interest on the principal amount outstanding".

Example

Category/ Characteristics	Example financial products
Debt instrument where which the rate of return is fixed or variable over the life of the instrument. The instrument does not contain any contractual provision for early repayment or which could result in the holder losing the principal amount or any accrued interest.	• Term deposit • Bond that pays a variable market interest rate, up to an interest rate cap • Convertible bond
Derivative financial instrument	• Interest rate swap • Forward exchange contract • Loan commitments that can be settled net in cash

5.76 While recognising that this could result in financial instruments of a similar nature to the entity being treated differently, the Board considered it more important that a Tier 3 Standard provides clear direction to preparers regarding the simpler requirements of specific financial products.

5.77 From its work to date on this project, the Board has identified the following basic financial assets and financial liabilities for which it intends to develop specified simpler reporting requirements as part of its Tier 3 reporting requirements:

(a) cash and cash equivalents;

(b) trade and other receivables;

(c) security bonds and similar debt instruments;

(d) term deposits and government bonds;

(e) units held in managed investment schemes, unit trusts and similar other investment vehicles;

(f) ordinary shares held in listed and non-listed entities;

Commented [A44]: __**Question 12 to Board members:**__
At its June 2022 meeting, Board members added ordinary shares held in private companies to the list of basic financial instruments. In addition, staff propose extending this listing to include government bonds and to acknowledge that units might be held in forms other than MIS schemes and unit trusts.

Staff note that its review of its sample set of financial statements did not indicate such holdings. Panel members also did not specifically highlight such financial asset holdings (other than a reference to commercial bills and bonds). However, staff think the listing appeared unbalanced without these inclusions.

Do Board members agree with the staff recommendation to extend the listing to include government bonds and to acknowledge that units might be held in forms other than MIS schemes and unit trusts (as shown in the drafted text)?

(g) trade and other payables; and

(h) loans.

5.78 Loans might be interest-bearing at a fixed or variable amount, interest-free, or include terms that create leverage. They may be provided to the entity from unrelated third parties or from a related party.

5.79 As indicated by paragraphs 5.73 and 5.74 above, the list in paragraph 5.77 is meant to comprise the typical basic financial assets and financial liabilities held by smaller not-for-profit private sector entities. Feedback received on this Discussion Paper and further AASB research efforts during the public consultation period may inform the Board of other financial instruments that should be added to this list.

Other financial assets and financial liabilities

5.80 In the Board's view, an entity that holds 'more complex' financial instruments (i.e. financial instruments other than those identified in paragraph 5.77 above) will not usually be the type of entity preparing financial statements that comply with Tier 3 reporting requirements. The reporting tier is not being developed with these entities in mind. Hence, the Board expects that an entity that engages in transactions or other events giving rise to holdings of complex financial instruments should be able to apply the more complex accounting specified by existing Australian Accounting Standards to those instruments.

5.81 However, the Board does not want to create a situation whereby many Tier 3 preparers will need to consider a Tier 3 Standard and AASB 9, AASB 132 and AASB 139 to understand whether the entity has financial instruments to recognise. Neither does the Board want entities to unnecessarily search for potential financial instruments, especially if a not-for-profit private sector entity is unlikely to enter into a transaction or other event that gives rise to such financial instruments. Requiring entities to invest their limited resources towards identifying potential financial instruments or consider AASB 9 is not consistent with the Board's objectives in developing the additional reporting tier.

5.82 Consequently, the Board has formed the following preliminary views:

(a) to develop a requirement for certain 'more complex' financial instruments to be accounted for under AASB 9 (or other Australian Accounting Standard, as appropriate) if not otherwise addressed by a topic-based Tier 3 requirement (e.g. employee benefit obligations); and

Example

The Board has not formed a preliminary view on the extent of items or transactions that would fall into this category. However, examples of financial instruments for which the accounting might be 'lifted' from AASB 9 include:

(a) purchased debt instruments such as listed corporate bonds and convertible notes;

(b) acquired equity instruments such as preference shares;

(c) financial guarantee contracts;

(d) interest rate swaps and forward exchange contracts; and

(d) commitments to provide a loan at a below-market interest rate.

(b) for Tier 3 reporting requirements not to specifically highlight or address particular financial instruments or transactions considered in AASB 9, AASB 132 and AASB 139, because these items and transactions are not common to not-for-profit private sector entities; and

Commented [A45]: <u>**Note to Board members:**</u>
At the June 2022 meeting, Board members asked staff what financial instruments/ topics would be "cut" from AASB 9, AASB 132 and AASB 139.

Staff think it is not possible to provide a fulsome listing of such content at this time as it is dependent on the feedback on the Board's approach to financial instruments. However, it could include:

<u>AASB 132</u>
All requirements and guidance (including the accompanying application guidance) other than that regarding (1) classification of a financial instrument in accordance with the substance of the contractual arrangement and (2) the treatment of interest, dividends, losses and gains. This includes requirements pertaining to:
(a) classification of components of a financial instrument
(b) measurement of a compound financial instruments
(c) classification of puttable financial instruments as equity
(d) classification of financial instruments that oblige the issuer to deliver a pro rata share of net assets only on liquidation as equity
(e) treasury shares

<u>AASB 139</u>
All content, as it pertains only to hedge accounting.

<u>AASB 9</u>
The following financial assets and financial liabilities:
(a) commitments to provide a loan at a below-market interest rate
(b) loan commitments that can be settled net in cash or by delivering or issuing another financial instrument
(c) contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments
(d) financial instruments relating to a topic that is omitted from a Tier 3 Standard, for example, cash-settled share-based payment obligations

Requirements and guidance on the following topics: (a) regular way purchase or sale of financial assets

Staff note that some guidance may no longer be relevant because different Tier 3 accounting requirements have been proposed, including:
- derecognition of a financial asset when it has been transferred
- classification of a financial asset or financial liability (including guidance on applying the business model and SPPI tests)
- embedded derivatives
- reclassification of a financial asset
- amortised cost measurement
- impairment requirements

Example

The Board has not formed a preliminary view on the extent of items or transactions that would fall into this category. However, examples of unaddressed items and transactions could include issued compound financial instruments, puttable financial instruments, treasury shares, loan commitments and contracts to buy or sell a non-financial item that can be settled net in cash, and transfers of financial assets.

If such items are present, an entity would need to consider how to account for the item consistent with Tier 3 financial instrument requirements. For example, this may mean that an issued compound financial instrument is classified wholly as equity rather than separated into its component parts, and that contracts to buy or sell a non-financial item that can be settled net in cash are not treated as financial instruments.

5.83 Regarding paragraph 5.82(a) above, the Board has not yet discussed how such requirements, would be operationalised in its Tier 3 reporting requirements. For example, the Tier 3 Standard could specify that an entity applies the accounting prescribed by AASB 9 to the financial instrument (i.e. incorporation by cross-reference, for example, for financial guarantee contracts), or specify requirements within the Tier 3 Standard that correspond to the requirements of AASB 9 (for example, for derivatives). The Board is at this stage only seeking feedback on its preliminary view to require the accounting specified by AASB 9 for financial instruments that are not basic financial instruments.

Embedded derivatives

5.84 The Board observed that an entity might hold derivative financial instruments that are not immediately obvious, as they are not 'stand-alone' acquired derivatives. For example, various loan commitments may meet the definition of a derivative. Also, some contracts include terms that embed a derivative within the contract, e.g. an entity may enter into a lease arrangement where the lease payments are linked to a consumer price index or assume a debt instrument that is subject to an interest rate floor.

5.85 The Board is conscious that the benefits from recognition of derivative financial instruments other than interest rate swaps, forward exchange contracts and similar instruments may be more limited for a smaller not-for-profit private sector entity compared to other private sector entities. Also, as noted in paragraph 5.81 above, the Board does not want entities to unnecessarily incur costs searching for potential financial instruments. Additionally, the Board observed that:

(a) analysing the terms of an embedded derivative, once identified, to determine the appropriate accounting under AASB 9 can be challenging even for a larger preparer; and

(b) the embedded derivative need not be separately recognised for the 'cash' impacts of the embedded derivative to be reflected in the entity's financial statements.

5.86 Consequently, the Board considered that a proportionate response for Tier 3 reporting requirements might be not to require an entity to separately recognise certain derivative financial instruments that are not immediately obvious, including any embedded derivatives. The Board decided to form a preliminary view in this regard.

5.87 Notwithstanding the Board's preliminary view in paragraph 5.82(b) above, the Board noted that, if so, preparers and other users of the Tier 3 Standard would benefit from a clear direction not to search for these derivative financial instruments. However, the Board does not want to develop such direction if unnecessary, as this adds complexity to a Tier 3 Standard. Therefore, the Board is seeking feedback to help inform it of the extent to which a smaller not-for-profit private sector entity is likely to have derivatives embedded within its contracts or enter into arrangements or contracts that result in a derivative financial instrument.

Commented [A46]: **Questions 13 to Board members:**
The Board discussed the accounting for embedded derivatives at its June 2022 meeting (refer M188 Agenda Paper 12.2.2). At the same meeting, the Board considered the accounting for loan commitments and net settled contracts that might meet the definition of a derivative (refer M188 Agenda Paper 12.2.1).

Question 13(a)
This Section reflects the Board's decisions to seek feedback to understand the extent to which embedded derivatives are present in contracts entered into by smaller NFP private sector entities. In addition, staff have styled the text as the Board having formed a preliminary view not to recognise embedded derivatives.

Do Board members agree with the staff recommendation to describe that the Board has formed a preliminary view not to recognise embedded derivatives? (If not, staff will revise the section to reflect that the Board has not yet made a decision whether to require embedded derivatives to be identified and recognised)

Question 13(b)
At the June 2022 meeting, the Board commented that Tier 3 reporting requirements might not address some topics/financial instruments covered in AASB 9, rather than requiring an entity to account for all non-basic financial instruments under AASB 9.

Staff have identified loan commitments that meet the definition of a derivative but are not immediately evident, as a possible item that might fall into this category.

Reflecting on the Board comment and having regard to the Board's discussion on embedded derivatives, staff think that the Board's embedded derivative decisions should be extended to commitments and contracts that meet the definition of a derivative, but which are not immediately identified as such. Otherwise, entities might similarly be required to look for these items (and depending on the Board's decisions, apply the accounting in AASB 9).
The staff view is reflected in the present drafting of the section.

Do Board members agree with the staff recommendation to extend the Board's decisions on embedded derivatives to derivative financial instruments that are not immediately obvious? (Otherwise, staff will revise the section to remove references to such instruments.)

Hedge accounting

5.88 The Board observed that it is possible some smaller not-for-profit private sector entities could acquire a derivative financial instrument to hedge an exposure as part of the entity's financial management strategy. For the following reasons, the Board has formed a preliminary view not to allow hedge accounting as an accounting policy choice as part of its Tier 3 reporting requirements:

(a) retaining the hedge accounting requirements in AASB 9 and AASB 139 would not be consistent with its objectives in developing Tier 3 reporting requirements as an proportionate response for smaller not-for-profit private sector entities; and

(b) hedge accounting is unlikely to be a practice adopted by many smaller not-for-profit private sector entities. Consequently, the Board thinks it is unnecessary to direct its resources to developing simpler conditions for hedge accounting, as it is unlikely to have widespread use.

5.89 As a result of the Board's preliminary views, derivative financial instruments will be measured at fair value. Gains and losses on the instrument are recognised in profit or loss over the life of the instrument.

Initial measurement of basic financial assets and financial liabilities

5.90 The Board does not have any evidence suggesting that the fair value on initial recognition of a basic financial asset and financial liability by a smaller not-for-profit private sector entity would, in many cases, be an amount different to the transaction price. Therefore, the Board was not convinced that it is necessary to differentiate Tier 3 reporting requirements from AASB 9. Hence, the Board formed a preliminary view to developing a requirement for basic financial assets and financial liabilities to be recognised at fair value.

5.91 The Board expects to be informed by stakeholder feedback as to whether such measurement basis is likely to result in disproportionate costs for smaller not-for-profit private sector entities, for example, because of an increasing use of buy-now-pay-later or instalment payment arrangements by these entities.

5.92 However, the Board has formed a preliminary view to require the entity's directly attributable transaction costs and fees to acquire a financial asset or assume a financial liability to be immediately expensed. The Board made this decision considering that the relative amount of transaction costs would generally be insignificant to the financial statements. Requiring these costs to be immediately expensed eliminates costs of identifying, monitoring and amortising the costs while unlikely to result in any material misrepresentation of the financial instrument.

Subsequent measurement of basic financial assets and financial liabilities

Commented [A47]: **Note to Board members:** Subsequent measurement of basic financial assets and financial liabilities was discussed by the Board at its May 2022 and June 2022 meetings. The related staff papers are M187 Agenda Paper 5.2.2 (May 2022) and M188 Agenda Paper 12.2.4 (June 2022).

5.93 Under AASB 9, the following measurement bases would, in the main, apply to the basic financial instruments identified in paragraph 5.77:

(a) current value (fair value) – cash and cash equivalents, units held in managed investment schemes, unit trusts and similar other investment vehicles, and ordinary shares held in listed and non-listed entities; and

(b) historical cost – trade and other receivables, security bonds and similar debt instruments, term deposits and government bonds, trade and other payables, and loans.

5.94 The feedback from the Board's preliminary outreach activity and on ITC 47 *Request for Comment on IASB Request for Information on Post-implementation Review of IFRS 9 Financial Instruments – Classification and Measurement* has not highlighted stakeholder concern with the appropriateness of the above split between cost and fair value measurement bases. Hence, the Board considered that these measurement bases provide a suitable base to develop its simpler requirements for basic financial assets and liabilities.

5.95 The Board was not inclined to develop requirements that would provide an entity with the flexibility to elect to measure any financial asset at fair value. The Board considered it unnecessary to do so as it expects that smaller not-for-profit private sector entities are, in the main, unlikely to want to adopt such policy for financial assets and financial liabilities traditionally held at amortised cost. Specifying only a single accounting method for a particular form of a financial asset or financial liability clarifies the accounting for the preparer and improves comparability between entities.

Basic financial assets that are held to generate both income and capital investment return

5.96 Under AASB 9, debt instruments such as government bonds (but not units in a unit trust) may be measured at fair value through other comprehensive income, rather than at amortised cost, provided certain conditions are met. Similarly, equity instruments such as shares may qualify to be measured at fair value through other comprehensive income. Some stakeholders responding to ITC 47 suggested that an entity usually makes this election when it does not think that the fair value movement in the profit and loss would provide useful information to users of its financial statements.

5.97 Based on ITC 47 and its preliminary outreach feedback on this project, the Board understands that some stakeholders think that fair value gains and losses on units held in a unit trust or managed investment scheme should similarly be recognised outside profit or loss. Stakeholder reasons for such accounting include:

(a) their view that an entity's indirect investment in a managed pool of shares should be treated consistently as if the entity had directly acquired those share investments; and

(b) that recognition of the gain or loss in other comprehensive income provides users of the financial statements with insight into the stewardship of the entity's longer-term investments. It also avoids introducing volatility (in the form of unrealised fair value gains and losses) to the profit or loss.

5.98 The Board observed that aligning the accounting for units held in a managed investment scheme with that of ordinary shares makes the application of accounting requirements more straightforward. Little information is "lost" to users of the financial statements because fair value movements on the financial asset continue to be recognised. Therefore, the Board considered that a proportionate response for its Tier 3 reporting requirements would require basic financial assets that are held to generate both income and a capital return (those assets for which the principal is subject to loss) to be measured consistently.

5.99 The Board discussed whether to develop a requirement to measure such financial assets at fair value through profit or loss, or at fair value through comprehensive income. Ultimately, the Board formed a preliminary view to developing a requirement for basic financial assets that are held to generate both income and a capital return to be measured at fair value through other comprehensive income. The Board made this decision for the following reasons:

(a) it acknowledges that the entity's primary interest in holding these financial assets is to obtain a periodic return to fund the entity's not-for-profit activities rather than to generate capital gains; and

(b) keeping the fair value gains and losses on financial assets outside the profit or loss separates the entity's 'non-operating' activity gains and losses from its operating activities. This distinction may provide less sophisticated users with more understandable information.

5.100 Other than dividends and interest return, all gains and losses on the financial asset are recognised outside the profit or loss. This includes crystalised gains and losses on the sale or disposal of the financial asset.

Cost as an appropriate measurement basis for shares, units and other investments

5.101 In its deliberations before forming its preliminary view in paragraph 5.99, the Board discussed whether it should develop a requirement for all basic financial assets (including listed shares) and financial liabilities to be optionally or mandatorily measured at cost, less any related impairment. Such a requirement would recognise that estimating fair value may be more costly or challenging for smaller not-for-profit private sector entities. In the main, such requirement would only affect the measurement of financial assets that are held to generate both an income and a capital return for the entity.

5.102 The Board observed that smaller not-for-profit private sector entities are less likely to hold financial assets for trading purposes. Rather, these assets are more likely to be primarily held to create a stable passive income stream to help fund the ongoing activities of the entity. Measuring all of these financial assets, including listed and non-listed shares held, at cost could be more representative of how the entity manages the asset and recovers their value; similar to the entity measuring investment property or property, plant and equipment at cost. Hence, measurement at cost could equally provide users of the financial statements of a smaller not-for-profit private sector entity with relevant information while being less costly to apply than fair value measurement.

5.103 However, holding shares and units in managed investment schemes primarily to develop a passive income stream is not unique to smaller not-for-profit private sector entities. An entity also invests in these assets for their potential capital return. As such, measuring these assets at fair value is more transparent and provides users of the financial statements with more relevant information. Consequently, the Board rejected cost as an appropriate potential measurement basis.

5.104 The Board observed that, in some cases, the cost of shares held in an unlisted company may be an appropriate estimate of its fair value. For example, when the investment has been made at or close to the reporting date. (See also paragraphs 5.127 and 5.128 below)

Other basic financial assets and financial liabilities measured at cost

5.105 AASB 9 requires various financial assets and financial liabilities to be measured at amortised cost using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. An effective interest rate may differ from the contractual interest rate as an effective interest rate takes into consideration any fees that are an integral part of the effective interest rate (e.g., origination fees), points paid or received, transaction costs and other premiums or discounts on acquisition of the financial instrument.

5.106 The Board discussed whether to develop a similar requirement for basic financial assets and financial liabilities as it observed that:

(a) amortised cost may not be as immediately understandable to preparers who are not accounting experts; and

(b) the effective interest method can be complex to apply.

5.107 The Board's preliminary outreach has not indicated stakeholders have application concerns with such measurement. However, this may be reflective of the characteristics of the financial instruments held by smaller not-for-profit private sector entities rather than the ease of

Commented [A48]: __Note to Board members:__
This alternative reflects Option A in Simplification #3 & #4 in M187 Agenda Paper 5.2.2. Option A (free choice of accounting for all financial assets and financial liabilities at cost or FVTPL) was rejected by the Board in favour of its preliminary view.

Board members also discussed, as a potential approach, cost as the sole measurement basis for all financial assets and financial liabilities at its June 2022 meeting. The Board did not change its preliminary view (nor has it formed a view whether it could accept listed shares not being measured at fair value), but indicated that it would like to see this incorporated into the discussion paper.

application of the effective interest method. Basic financial assets and financial liabilities other than loans will often be non-interest bearing.

5.108 The Board has formed a preliminary view to developing a requirement for:

(a) basic financial assets and liabilities other than investments in managed investment schemes, ordinary shares, and similar financial instruments are to be measured at cost. So that an asset is not recognised at an amount greater than the future economic benefits it is expected to return to the entity, the cost of a financial asset is written down if the asset is impaired;

(b) interest income and interest expense to be recognised as amounts are earnt or incurred, calculated by reference to the contractual interest rate; and

(c) any initial premium or discount on the acquisition of a basic financial asset or financial liability to be amortised on a straight-line basis over the life of the instrument, unless another systematic basis or shorter period is more reflective of the period to which the premiums or discounts relate.

5.109 The Board considered that requiring interest income and interest expense to be measured by reference to the contractual interest rate is more straightforward to apply. Therefore, even though, in many cases, the accounting result under amortised cost using the effective interest method and measurement in accordance with the Board's preliminary views in paragraph 5.108 above could be expected to be the same, the Board determined to develop this simpler reporting requirement.

5.110 For those cases where they are not, for a smaller entity, the Board considered that the benefits of more faithfully representative interest representation do not appear to justify the costs involved in identifying transaction costs and fees that are an integral part of the effective interest rate, calculating an effective interest rate, and monitoring changes in the effective interest rate over the life of the financial instrument. The impact of any difference between the measurement models on the financial statements is likely to be insignificant.

5.111 Following the Board's preliminary views on the treatment of initial transaction costs and fees and measurement of interest, the Board observed that referencing amortised cost is likely unnecessary. Therefore, the Board decided that it would simply require the basic financial assets and financial liabilities to be measured at cost.

Impairment of basic financial assets measured at cost

Commented [A49]: **Note to Board members:** Impairment was discussed by the Board at its June 2022 meeting. The related agenda paper is M188 Agenda Paper 12.2.2 (June 2022).

5.112 The Board observed:

(a) that impairment loss provisions in AASB 9 are unduly complex when regarding the basic financial assets held by smaller not-for-profit private sector entities for which it is proposing to develop simpler financial instrument reporting requirements; and

(b) its preliminary view requiring a non-financial asset to be written down to its impaired amount only when the asset has been physically damaged or when its service potential has been adversely affected by a change in the entity's strategy or changes in external demand for the entity's services (refer paragraph 5.163(b)). That is, only when the entity has objective evidence of impairment, and the event giving rise to the impairment loss is unlikely to be temporary.

5.113 Consequently, the Board decided to develop simpler impairment requirements for basic financial assets measured at cost. Consistent with its preliminary view on impairment of non-financial assets, the Board decided to form a preliminary view to developing a requirement for impairment to be recognised only when it is probable that some or all of the amount owed will not be collectible. The impairment loss is to be measured at the anticipated uncollectible amount.

5.114 The impairment model proposed by the Board is an incurred loss model and, as such, expected to be more straightforward to apply. The impairment loss is arguably more relatable to users of the financial statements as the impairment loss can be directly corresponded to an individual debtors' credit status. In addition, there is flexibility for the impairment amount to be determined by reference to either a probability-weighted estimate or a 'most likely outcome' scenario, as most appropriate to the circumstances.

5.115 In forming its preliminary view, the Board discussed whether to require impairment losses to be instead recognised and measured using the simplified expected credit loss model in AASB 9 applying to trade receivables. This would provide users with more timely credit loss information as it is more forward-looking than an incurred loss model. The Board rejected developing such requirement as it considered that this would not represent a sufficient proportionate response for smaller not-for-profit private sector entities that are unlikely to have sophisticated credit risk management policies.

Example

- Incurred loss model – write down the asset when the entity has been informed that the debt is not recoverable in full
- Expected credit loss model – write down the asset when it is overdue because the entity has historical evidence suggesting that 5% of all overdue debts will become bad

Derecognition of basic financial assets

5.116 The feedback received on ITC 47 suggests that stakeholders have found that applying the derecognition criteria of AASB 9 can be difficult, especially with regards to assessing pass-through transactions and whether the entity retains a continuing involvement in a financial asset. The Board noted that it expects smaller not-for-profit private sector entities would, in the main, derecognise an asset because the contractual rights to the cash flows from the financial assets have expired, rather than enter into transactions that involve the transfer of the entity's contractual rights to the cash flows of the financial asset. Therefore, the Board considered that it would be an appropriate proportionate response for its Tier 3 derecognition criteria to focus on the expiry of cash flows predominantly.

5.117 The Board formed a preliminary view to developing a requirement that a financial asset is derecognised only when either the contractual rights to the cash flows from the financial asset expire or are settled, or the entity otherwise loses control of the asset. The effect of the Board's preliminary view is that:

(a) the derecognition of the original financial asset is treated as a separate transaction to the recognition of any 'new' assets and liabilities in a related transaction; and

(b) an asset may only qualify for derecognition at a later point in time compared to under AASB 9.

5.118 In developing its preliminary view, the Board considered and rejected:

(a) developing a requirement to allow an entity to derecognise a financial asset if the derecognition criteria specified by AASB 9 were met; and

(b) developing derecognition criteria that specifically acknowledges transfers of financial assets but which is simpler to apply compared to AASB 9.

5.119 The Board considered that these approaches would introduce unnecessary complexity to a Tier 3 Standard as it does not expect this sort of transaction to occur frequently.

Derecognition of basic financial liabilities

5.120 The Board discussed whether the benefits of requiring an entity to acknowledge an exchange of financial liabilities or modification to the terms of a financial liability (e.g., extending a loan term from 2 years to 3 years) as an adjustment of the original financial liability would continue to exceed its costs for a smaller not-for-profit private sector entity. It observed that, given its preliminary views on the treatment of initial transaction costs, subsequent measurement and the calculation of interest expense, the accounting impact is unlikely to differ significantly whether or not the transaction or other event is treated as the derecognition of the original financial instrument and recognition of a new financial instrument, or as an adjustment of the original financial liability.

5.121 Consequently, the Board formed a preliminary view not to address instances of debt instrument exchanges or modification of the terms of a financial liability as part of its Tier 3 Standard. An entity treats a modification of the terms of a financial liability or an exchange of a debt instrument for a different debt instrument as an extinguishment of the original financial liability. As such, there will generally be no gain or loss arising at the time of the exchange of financial liabilities or modification of the financial liability. The gain or loss is, in effect, deferred and recognised over the life of the replacement financial instrument.

Fair value measurement

Commented [A50]: <u>**Note for Board members:**</u>
The text in this section is based on M188 Agenda Paper 12.2.2 (June 2022) and M186 Agenda Paper 4.2 (April 2022), and reflects the Board's decisions made at those meetings.

> **Section snapshot**
> - The Board's preliminary view is to define and measure fair value consistently to AASB 13. However, it intends to communicate how to estimate the fair value of an item in an manner that is easier for smaller not-for-profit private sector entity preparers to understand

5.122 As the Board intends to develop requirements that will allow or require the fair value measurement of certain financial instruments and non-financial assets, as part of its deliberations in developing this discussion paper it considered the extent to which fair value should be determined consistently to AASB 13 Fair Value Measurement. AASB 13 sets out a framework and guidance for measuring the fair value of both financial and non-financial assets and liabilities and equity.

5.123 The Board has formed a preliminary view that fair value should have the same meaning as in AASB 13. That is, as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date". This retains consistency in specification and understanding of the measurement basis as an exit value between Tier 3 reporting requirements and Tier 1 and Tier 2 reporting requirements. As such, potential costs of misinterpretation and re-training can be avoided.

5.124 Like maintaining the same definition, the Board thinks it is likewise important for fair value measurement in Tier 3 financial statements to be determined in a manner consistent with the framework set out in AASB 13, including estimating by reference to a specified hierarchy and to a non-financial asset's highest and best use. This enhances comparability between the financial statements of Tier 3 entities. However, the Board is aware from other AASB projects that measuring fair value following the framework set out in AASB 13 may pose more application complexity for not-for-profit entities compared to for-profit entities. Further, estimating fair value is likely to be relatively more costly for a smaller not-for-profit private sector entity compared to a larger entity when observable (e.g. listed) prices are not available.

5.125 Consequently, and noting that smaller not-for-profit private sector entities are likely to have a more limited range of items that are measured at fair value, the Board has formed a preliminary view to express the AASB 13 framework in a Tier 3 Standard in a manner that is easier for preparers who are not accounting experts to follow.

5.126 As part of the IASB's current project reviewing the IFRS for SMEs, the IASB is expected to propose amendments to align that Standard more closely with IFRS 13 *Fair Value Measurement*. As AASB 13 incorporates IFRS 13, the Board expects that these amendments may provide a suitable base for informing the Board of the basis and extent of fair value requirements and guidance to develop in an exposure draft, should the AASB's project proceed to that next stage.

Cost as an appropriate estimate of the fair value of financial assets

Commented [A51]: **Question 14 to Board members:**
While not explicitly considered by the Board at its meetings, staff think it is helpful for the Discussion Paper to highlight expectations for using cost as a proxy for fair value.

Do Board members agree to include this section, including the intention set out in paragraph 5.128?

5.127 Per the Board's preliminary view set out in paragraph 5.99, an entity's unlisted share investments will be measured at fair value. AASB 9 notes that, in many cases, the cost of the shares is unlikely to be representative of their fair value because of internal or external changes impacting the entity since the time the shares were acquired. As stated in AASB 9, cost may be an appropriate estimate of fair value when there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range. Cost may also be an appropriate estimate of the fair value of equity instruments if there are no indicators (e.g. change in the economic environment in which the entity operations) present to suggest otherwise, and there is insufficient more recent information available to measure fair value.

5.128 The Board does not intend to extend the instances for which the cost of a financial instrument provides an appropriate estimate of its fair value as doing so may misrepresent the item to users of the financial statements. However, the Board is consulting on its preliminary view to measure unlisted share investments at fair value (refer paragraph 5.99).

Other valuation bases as a proxy for the fair value of non-financial assets

5.129 As part of its deliberations on this discussion paper, the Board considered whether to permit other current value measurement bases as an appropriate estimate of fair value (a valuation 'shortcut'). For example, the Board considered whether it should allow an entity to use a rateable or other government valuation or the recent market selling price of similar asset as an appropriate estimate of the fair value of the property.

5.130 However, these other valuation measures all have their own shortcomings and may not necessarily faithfully represent, for financial reporting, the asset held. For example, different real estate platforms may price the same similar property differently, and rateable value may be calculated differently between states and territories. How such measurements interact with the fair value hierarchy specified by AASB 13 would also need to be considered.

5.131 Ultimately, the Board observed that an entity is not forced to apply a revaluation model to its non-financial assets. Consequently, the Board determined not to allow other current value measurement bases as an appropriate estimate of fair value. The costs of electing a fair value measurement-based accounting policy should be considered by management as part of management's selection of an appropriate accounting policy for the item.

Inventory

Commented [A52]: **Note for Board members:**
The text in this section is drawn from M186 Agenda Paper 4.2 (April 2022) and reflects the Board's discussions and decisions made at its April 2022 meeting

Section snapshot

- The Board's preliminary view is to allow donated inventory to optionally be measured at cost (i.e. nil or nominal amount) or current replacement cost
- Other inventory is accounted for consistent with AASB 102 *Inventories*

5.132 Most operating entities, regardless of their size, will hold some inventory. Therefore, the Board determined that it must develop requirements to account for inventory. From its preliminary outreach, the Board has not identified there to be, in the main, any significant cost or an area of concern by preparers for the accounting of inventory. Consequently, for inventories other than donated inventory, the Board has formed a preliminary view to develop Tier 3 recognition and measurement requirements that are consistent with the requirements in AASB 102 *Inventories*. That is, for:

(a) inventories held for distribution – to be measured at cost, adjusted where applicable for any loss of service potential; and

(b) all other inventories – to be measured at the lower of cost and net realisable value.

5.133 However, recognising that calculating any loss of service potential associated with inventories held for distribution could be challenging for smaller not-for-profit entities, the Board intends to develop guidance and illustrative examples to assist Tier 3 entities with applying this concept.

Donated inventory

5.134 A not-for-profit entity may acquire inventory for free or a nominal amount. Under AASB 102, such inventory must be initially measured at its current replacement cost. The Board has formed a preliminary view to allow an entity to optionally initially measure such inventory at cost, as discussed further in paragraphs 5.152 – 5.156.

Biological assets

5.135 If the accounting for biological assets is not scoped out from a Tier 3 Standard, then agricultural produce should be recognised and measured according to the inventory requirements. Any inventory requirements in the Tier 3 Standard will take precedence over the specific requirements and guidance in AASB 141 for agricultural produce, as discussed in paragraph 4.20.

Investments in associates and joint arrangements

Section snapshot

- The Board's preliminary view is to require an investor to apply the equity method of accounting to its interests in associates and joint ventures, except where the investor is a parent that has elected to present only separate financial statements

5.136 Under AASB 128 *Investments in Associates and Joint Ventures*, interests 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. The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss, and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

5.137 The Board has not heard any stakeholder concerns with present accounting requirements for an entity's interests in its associates and joint ventures. Consequently, the Board considered it may be an appropriate proportionate response for the Board to continue to require the equity method in most instances.

5.138 However, the Board observed that it would be peculiar if it were to develop a requirement for a smaller not-for-profit private sector entity to measure its interests in its associates and joint ventures using the equity method of accounting in instances where the entity's subsidiaries are not consolidated. Therefore, the Board has formed a preliminary view to develop a requirement for interests in associates and joint ventures to be measured as follows:

Commented [A53]: __Question 15 to Board members:__
Staff brought discussion regarding the accounting for associates and joint ventures as part of M181 Agenda Paper 3.3 (June 2021). The Board did not discuss the accounting for associates and joint ventures at the meeting. In that paper, staff initially recommended that these interests be accounted for using the equity method except if consolidated financial statements were not prepared.

At its August 2021 meeting, the Board agreed with the staff recommendation for the accounting for investments in associates and joint ventures to be primarily based on NZ *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit)* (the NZ Tier 3 Standard) (refer M182 Agenda Paper 4.1).

The requirements of the NZ Tier 3 Standard for interests in associates and joint ventures are largely consistent with that specified by AASB 128.

Staff have developed text in this section, including a recommended preliminary view, having regard to the NZ Standard requirements and the Board's previous decisions on consolidation. Staff think this proposed preliminary view is consistent with the NZ Tier 3 reporting requirements.

Regarding the accounting by a parent that presents separate financial statements as its only financial statements (paragraph 5.138(c)) although the equity method is an option, (as would be an accounting policy option under AASB 128 and the NZ Tier 3 Standard) staff have excluded this option as it is inconsistent with the Board's consolidation decision.

Do Board members agree with the proposed preliminary view, including requiring an investor that is not a parent to prepare equity-accounted financial statements (paragraph 5.138(b))?

Alternatively, would Board members prefer to allow a not-for-profit private sector entity that is not a parent a choice between applying the equity method of accounting to measure its interests in associates and joint ventures and preparing separate financial statements as its only financial statements, similar to the relief proposed for parent entities?

(a) if the not-for-profit private sector entity is a parent that presents consolidated financial statements – the not-for-profit private sector entity applies the equity method of accounting to its interests in associates and joint ventures;

(b) if the not-for-profit private sector entity is not a parent – the not-for-profit private sector entity applies the equity method of accounting to its interests in associates and joint ventures; and

(c) if the not-for-profit private sector entity is a parent that presents separate financial statements as its only financial statements (i.e. does not consolidate its subsidiaries) – the not-for-profit private sector entity does not apply the equity method of accounting to measure its interests in associates and joint ventures.

5.139 The Board did not discuss 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. However, in keeping with its objectives for developing Tier 3 reporting requirements, the Board is unlikely to require an investor preparing Tier 3-compliant financial statements to equity account an associate or joint venture where such accounting is not required by an investor preparing financial statements that comply with Tier 1 or Tier 2 Australian Accounting Standards.

Separate financial statements of the investor

5.140 The Board has formed a preliminary view to develop a requirement for an investor that presents separate financial statements – whether in addition to consolidated financial statements or equity-accounted financial statements, or as its only set of financial statements – to measure its interests in associates and joint ventures at either cost or at fair value through other comprehensive income. Measurement at cost may be an appropriate accounting policy as the entity's interest in an associate or joint venture could be an avenue to further its not-for-profit objectives rather than as an investment.

5.141 However, measuring these interests at cost without accompanying equity-accounting financial statements may not provide users of the financial statements with sufficient sight of the investor's interest. It would also be consistent with the Board's preliminary proposals for financial instruments for these interests to be measured at fair value, no different to other financial instruments which are held to generate both an income and capital return for the entity. Therefore, the Board decided to allow an accounting policy choice.

Property, plant and equipment and investment property

Section snapshot

- The Board's preliminary view is that Tier 2 reporting requirements will continue to apply except for the accounting of borrowing cost, that is:
  - Initial measurement of purchased property, plant and equipment and investment property measured at the item's cost
  - Subsequent measurement of property, plant and equipment is measured using the cost model or revaluation model. Subsequent measurement of investment property is measured at cost model or fair value model

5.142 Smaller not-for-profit private sector entities typically hold some non-current non-financial assets; primarily, property, plant and equipment. Therefore, the Board considered it necessary to develop a requirement for accounting for such assets.

5.143 Other than for borrowing costs referred to in paragraphs 5.157 – 5.159, the Board has formed a preliminary view to require property, plant and equipment and investment property to be

Commented [A54]: __Question 16 to Board members:__
Staff brought discussion regarding the accounting in separate financial statements as part of M181 Agenda Paper 3.3 (June 2021). The Board did not discuss the accounting for associates and joint ventures at the meeting. In that paper, staff initially recommended that these interests be measured at cost in separate financial statements.

At its August 2021 meeting, the Board agreed with the staff recommendation for the accounting for investments in associates and joint ventures to be primarily based on NZ *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit)* (refer M182 Agenda Paper 4.1). This would direct the interest be measured at either cost, at fair value in accordance with IPSAS 41, or using the equity method.

At its September 2021 meeting, staff signalled to the Board that staff were continuing to analyse the Board's direction. Staff indicated they would bring drafting to a future meeting.

In June 2022, staff brought discussion on the accounting for associates and joint ventures in separate financial statements as part of M188 Agenda Paper 12.2.1 (June 2022). In that paper, staff recommended that these interests be measured at cost in separate financial statements. At its June 2022 meeting, the Board did not form a view on the accounting for associates and joint ventures in separate financial statements. However, staff think the Board's discussions suggest that the accounting would follow AASB 127.

On further analysis of the NZ Tier 3 requirements and AASB 127, staff think referencing the equity method as an option would be inconsistent with the Board's decision regarding consolidating subsidiaries, and therefore have excluded this as a suitable accounting option.

In addition, on further analysis, staff think that, for consistency with the Board's decision on financial instruments, fair value gains and losses on the investment should be presented in other comprehensive income (rather than FVTPL with the option to make an irrevocable FVTOCI election).

Do Board members agree with the proposed preliminary view and drafting? Alternatively, would Board members prefer not to form a preliminary view, but to seek feedback on whether to allow an accounting policy choice in this regard (or mandate either measurement at cost or measurement at FVTOCI)?

Commented [A55]: __Note for Board members:__
The text in this section is drawn from M184 Agenda Paper 11.2 (February 2022) and reflects the Board's discussions and decisions made at its February 2022 meeting.

recognised and measured consistently to Tier 1 and Tier 2 Australian Accounting Standards. Under the Board's proposals (refer to paragraphs 5.171 – 5.179), leased property, plant and equipment, and investment property are not recognised as assets.

Initial measurement

5.144 Accordingly, the Board proposed to develop a requirement for an entity preparing Tier 3 compliant financial statements to initially measure property, plant and equipment, and investment property purchased by the entity at the item's cost. The cost of an item comprises:

(a) its purchase price;

i) 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); and

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

5.145 The Board is not proposing to amend the components that form part of the item's initial cost as the Board has not identified any widespread application difficulties in the initial measurement of purchased property, plant and equipment or investment property.

Subsequent measurement

5.146 The Board also proposed to develop a requirement for the asset to be subsequently measured for:

(a) property, plant and equipment – using the cost model or revaluation model; or

(b) investment property – using the cost model or fair value model.[13]

5.147 Under the revaluation model, a revaluation increase or decrease is recognised in other comprehensive income, as long as the carrying amount of the property remains above its depreciated historical cost. Under the fair value model, changes in fair value are recognised in profit or loss. Noting that some smaller not-for-profit entities may require further guidance for the requirement to depreciate buildings measured using the revaluation model, the Board intends to develop guidance or education material to clarify the requirement for depreciation when applying the revaluation model.

5.148 As part of its deliberations when forming its view above, the Board considered whether it was necessary to continue to require the accounting for land and buildings held for use in the conduct of the entity's operations to be distinguished from an investment property. The Board's research and initial stakeholder feedback suggest that, while less common, some smaller not-for-profit private sector entities hold property that would be accounted for under AASB 140 *Investment Property*. The Board considered that it is useful to users without imposing significant costs to preparers to maintain this distinction as doing so recognises that property may be held for different purposes. The Board expects that identifying property as an investment property or otherwise will be straightforward for smaller not-for-profit entities.

5.149 The Board also observed that some overseas jurisdictions do not permit smaller entities to revalue their non-current assets. It discussed whether Tier 3 reporting requirements should similarly restrict the accounting for property, plant and equipment and investment property (i.e. require measurement using the cost model only), noting that:

13 The Board expects to develop Tier 3 requirements for the cost model. As referenced in paragraphs 4.12 – 4.16, the Board has not yet formed a decision on whether to specify requirements for the revaluation model and fair value model as part of a Tier 3 Accounting Standard, or whether to 'permit' election of such accounting policy via an opt up to the policy permitted by AASB 116 and AASB 140.

(a) the cost model is less costly to apply compared to the revaluation model or fair value model;

(b) the cost model is the subsequent measurement approach already adopted by many entities;

(c) specifying only a single accounting policy will enhance comparability between the financial statements of entities;

(d) specifying only a single accounting policy will reduce costs of management judgement (selection of an appropriate accounting policy), stakeholder education and ongoing maintenance.

5.150 Ultimately, the Board decided it's Tier 3 reporting requirements should continue to permit the revaluation of these assets. In forming this view, the Board noted its initial stakeholder feedback indicating support for the revaluation and fair value model as an acceptable alternative accounting policy to cost and its consideration that:

(a) fair value measurement – a current value measure – provides more relevant information about an entity's financial position compared to depreciated historical cost;

(b) it might be seen as a 'backward step' to require an entity currently revaluing its assets to cease to do so;

i) contrary to its project objectives, it could inadvertently be imposing additional costs on subsidiaries of a parent entity that adopts the revaluation or fair value model; and

ii) there may be a potential loss of competitiveness and comparability to an entity that is permitted to revalue its assets.

5.151 The Board considered whether, rather than a 'free choice', it should require investment property to be measured at fair value unless the entity is not able to do so without undue cost or effort. Enhancing the comparability between entities could assist with more consistent decision-making on asset-based regulatory reporting tests. The Board has rejected this accounting approach because the resultant requirement would be more onerous than that currently available to an entity complying with AASB 140. The Board also considered that "undue cost or effort" assessments are likely to be interpreted differently by different entities.

Non-financial asset acquired for significantly less than fair value

Section snapshot

- The Board's preliminary view is to allow an entity the accounting policy choice to initially measure assets acquired for significantly less than fair value for:
  - Inventory to optionally be measured at cost (i.e. nil or nominal amount) or current replacement cost; and
  - Other non-financial assets to optionally be measured at cost or the fair value

5.152 The Board recognised that rather than a choice as currently applicable for subsequent measurement of property, plant and equipment and other non-financial assets noted in paragraphs 5.146, not-for-profit entities are required to initially measure assets acquired for significantly less than fair value, such as donated or granted non-financial asset, at fair value in accordance with AASB 13. Acknowledging that smaller entities may have difficulties in applying the principles in AASB 13 in determining the fair value, the Board's preliminary view is that an entity should be allowed the same accounting policy choice as applicable to subsequent measurement, to initially measure assets acquired for significantly less than fair value for:

Commented [A56]: Note for Board members:
The text in this section is drawn from M186 Agenda Paper 4.3 (April 2022) and reflects the Board's discussions and decisions made at its April 2022 meeting.

Commented [A57]: Question 17 to Board members:
NFP panel members provided feedback at the May 2022 NFP Panel meeting that the Board's proposals for the initial recognition and subsequent measurement requirements of non-financial assets acquired for significantly less than fair value could result in an accounting arbitrage (refer to panel meeting minutes in Agenda Paper 12.4 at the June 2022 Board meeting). This accounting arbitrage could occur where an entity elects to initially measure donated non-financial assets at cost with no impact to the profit or loss for the period and elect to subsequently measure the donated non-financial asset under the revaluation model with the revaluation difference recognised in other comprehensive income and accumulated equity under the revaluation reserve.
This could result in:

(a) the accounting policy choices accorded to initial measurement and subsequent measurement may result in the arbitrage when the difference is recognised:
i) in profit or loss at fair value on initial measurement; or
ii) as other comprehensive income at fair value on subsequent measurement. Additionally, the potential to record the initial measurement of donated assets at cost and subsequently elect to fair value the donated assets allow the entity to not recognise the income of the donated assets and ultimately not impact the size of the entity for reporting purposes;

(b) different accounting outcomes depend on whether the asset's carrying amount is measured at the revaluation difference between the asset's fair value or at cost at initial measurement, and its fair value at subsequent measurement. The latter approach appears to undervalue the asset on the balance sheet substantially; and

(c) where an entity is required to measure revaluation differences between the asset's fair value at initial and subsequent measurement, it may be impracticable to obtain the fair value of the donated assets retrospectively in determining the revaluation difference if an entity elects to measure the asset at cost initially.

Staff consider it necessary to clarify circumstances when an entity can elect to measure donated assets initially at cost and subsequently to revalue the asset.

Option A) Not permitting entities that initially measure donated assets at cost, to elect the revaluation/fair value model for subsequent measurement [staff preferred option]. Whilst this option may appear to limit the accounting policy option for subsequent measurement for entities that elect the cost model for initial measurement. However, staff think that smaller entities will unlikely apply the revaluation model for subsequent measurement, therefore the impact of not permitting revaluation should be minimal, and eliminates the potential accounting arbitrage noted above.

Option B) Requiring an entity to obtain the fair value of the donated asset on initial measurement if the entity elects to measure the asset at cost initially. This will enable the entity to determine the revaluation difference if an entity elects to subsequently revalue the donated asset. If the entity subsequently revalues the donated asset the revaluation difference should be determined based on the difference between the asset's fair value on initial measurement and its fair value on subsequent measurement. This option will still result in the accounting arbitrage as noted above and may not be considered to simplify the accounting requirements given entities are required to obtain the fair value of the asset on initial measurement. The carrying amount of the asset would substantially be undervalued. ... [2]

(a) inventory – using the cost model or current replacement cost; or

(b) other non-financial assets – either using the cost model or at fair value model.

5.153 The Board intends to develop appropriate disclosures to supplement the accounting policy choice accorded to the initial measurement of these assets.

5.154 The Board acknowledged that some stakeholders expressed concerns that the proposal to allow an entity to apply the cost model could result in donated assets being recorded at minimal or nil value in the statement of financial position. Resultantly, the associated income of these donated assets will not be recognised. Ultimately, the Board considered that allowing an accounting policy choice to initially measure donated non-financial assets at the cost model or fair value model is in keeping with its objective for developing Tier 3 reporting requirements as its proposed approach, noting that it:

(a) requires appropriate disclosures, discussed in paragraph 6.12, such as the nature and description of the donated assets would provide useful information to the expected users and allows the management of smaller entities to determine a measurement basis that they consider most appropriately reflects their users' needs; and

(b) imposes fewer costs to preparers to the current requirements to measure donated assets at fair value.

5.155 As part of its deliberations when forming its view above, the Board considered another alternative to only require assets with useful lives of 12 months or more, and where the entity intends to hold those assets for more than 12 months, to be initially measured at fair value. The Board considered that this approach would limit the assets that would be captured, such as land or buildings, or motor vehicles that are likely to be held by the entity for a longer term, therefore providing cost savings in that regard. However, the Board reflected that such an approach may not offer the desired simplification and subsequently rejected this approach, noting that:

(a) it may add an unnecessary level of complexity, especially for smaller entities, to assess whether an asset has a useful life of 12 months or more; and

(b) incremental cost savings may likely be minimal for entities that do not receive many donated non-financial assets with useful lives of 12 months or more.

5.156 Similarly, the Board understands that many NFP entities would rely on volunteers to provide their services and some entities may consider that recognising volunteer services received at fair value would provide useful information to its users. However, as noted in the Basis for Conclusions in AASB 1058, stakeholders opined that recognition of volunteer service should be optional for not-for-profit private sector entities, primarily for cost-benefit reasons. As such, the Board proposed retaining the option to permit, but not require, a smaller NFP entity to recognise volunteer services received, or a class of volunteer services, if the fair value of those services can be measured reliably.

Borrowing costs

Section snapshot

- The Board's preliminary view is for all borrowing costs to be expensed in the period incurred

5.157 Under AASB 123 *Borrowing Costs*, a not-for-profit private sector entity would ordinarily be required to capitalise, as part of the cost of the asset, borrowing costs incurred as part of the construction or acquisition of a 'qualifying asset' (e.g. construction of premises). These borrowing costs are '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'.

Capitalising such borrowing costs is a more faithful representation of the substance of that borrowing cost as a contribution to future income generation, rather than as a sunk cost.

5.158 The Board is conscious that determining whether borrowing costs are capitalisable– and by how much – can be challenging, especially when the borrowing facility is 'general' rather than specially acquired to build a specific asset. The Board thinks this accounting is not a proportionate response for smaller not-for-profit private sector entities having regard that assets typically held by these entities would not be regarded as a qualifying asset. Consequently, the Board has formed a preliminary view that Tier 3 reporting requirements should simply require all borrowing costs to be expensed in the period incurred.

5.159 Such accounting is easier to apply as it involves less judgement and fewer processes. The result could be more understandable to users that are more focussed on the cashflows and how the entity is funded as the expense is recognised earlier, at a time that is more likely to align with the cash outflow, rather than deferred and recognised as part of depreciation on the asset.

Impairment of non-financial assets

Commented [A58]: __Note for Board members:__ The text in this section is drawn from M184 Agenda Paper 4.2.0 (April 2022) and reflects the Board's discussions and decisions made at its April 2022 meeting.

Section snapshot

- The Board's preliminary view that the impairment model for Tier 3 not-for-profit private sector entities should:
  - only require non-financial assets subsequently measured at cost or deemed cost to be subject to impairment testing;
  - only consider whether non-financial assets are impairments when the asset has been physically damaged or when its service potential is adversely affected; and
  - impair a non-financial asset if its carrying amount exceeds its recoverable amount, where the recoverable amount is the higher of its fair value less cost of disposal and its value in use

5.160 The Board's preliminary research suggests that impairment losses for non-financial assets is not commonly incurred by Tier 3 entities possibly because of the nature and types of non-financial assets held were acquired some time ago or that the non-financial assets are recorded at nominal historical amounts. Some stakeholders noted that non-financial assets generally held by Tier 3 entities are impaired only when a significant event occurs and it is clear that the asset's carrying amount is no longer recoverable.

5.161 Although recognising impairment losses may not be common for Tier 3 entities, the Board considers it important for Tier 3 general purposes financial statements to represent an entity's financial position and performance faithfully. Therefore, the Board considers it is important to develop an impairment model for Tier 3 entities to ensure that their non-financial assets are not carried at too high a value.

5.162 When forming its preliminary views on an impairment model for Tier 3 entities, the Board observed that the existing impairment model in AASB 136 *Impairment of Assets* could be complex to understand and costly to apply in practice for smaller not-for-profit entities. Therefore, after considering the types of non-financial assets the Board understands Tier 3 entities commonly hold, the Board considers that requiring Tier 3 entities to comply with the AASB 136 model in full was not proportionate.

5.163 The Board's preliminary view is that the impairment model for Tier 3 entities should comprise the following elements:

(a) scope: only non-financial assets subsequently measured at cost or deemed cost to be subject to impairment testing.

(b) timing: only to consider whether non-financial assets are impaired when the asset has been physically damaged or when its service potential might have been adversely affected by a change in the entity's strategy or changes in external demand for the entity's services.

(c) methodology: a non-financial asset is impaired if its carrying amount exceeds its recoverable amount, where the recoverable amount is the higher of its fair value less costs of disposal and its value in use. However, Tier 3 reporting requirements will include a rebuttable presumption that fair value less costs of disposal is expected to be the most appropriate measure of a non-financial asset's recoverable amount because non-financial assets are generally not held by not-for-profit entities to generate cash flows; and

(d) cash generating units: non-financial assets that do not generate cash flows that are largely independent from other assets can be grouped into cash-generating units.

5.164 The Board does not intend to develop Tier 3 reporting requirements to address the reversal of previously recognised impairment losses. The Board has received feedback that when impairment losses are recognised, they are typically significant events that will not reverse, such as flood damage. Therefore, the Board considered it unnecessary to develop a requirement to account for the reversal of impairment losses.

5.165 In developing the preliminary view summarised in paragraphs 5.163 – 5.164, the Board considered a range of alternative approaches, including the arguments for and against each alternative:

(a) scope: requiring all non-financial assets or only non-current non-financial assets to be subject to impairment testing. The Board decided non-financial assets subsequently carried at fair value are less likely to be impaired given they are regularly revalued to fair value and, therefore, should not be subject to impairment testing. The Board also considered that having different reporting requirements for current and non-current non-financial assets was not warranted.

(b) timing: considering the types of non-financial assets held by Tier 3 entities, the Board did not consider it necessary to consider whether in-scope assets are impaired annually or even periodically as their recoverable amount is less likely to fluctuate from to year. The Board also considered that whilst not prescribing when in-scope assets should be assessed for impairment might allow Tier 3 entities with some flexibility regarding impairment testing; such an approach would not be helpful for Tier 3 entities because entities will be required to assess whether or not an impairment indicator exists.

(c) methodology: the Board considered developing an alternative approach for Tier 3 entities to calculate the recoverable amount of in-scope assets or to allow Tier 3 entities to determine the recoverable amount using a methodology they consider most appropriate. However, the Board concluded that developing an alternative approach or providing Tier 3 entities with too much flexibility may introduce unnecessary complexity for preparers and auditors of Tier 3 entities and give rise to inconsistencies with the principles applied in other Tier 3 reporting requirements.

Assets held for sale

5.166 The Board is not proposing to introduce any specific requirements for property, plant and equipment or other non-current assets that an entity intends to sell rather than hold for its continuing use as the Board expects such occurrences to be infrequent. Also, the requirement to write down an asset's carrying amount to its recoverable amount suggests that the carrying amount of such assets is unlikely to be significantly overstated at the reporting date.

Intangible assets

Section snapshot

- The Board needs further information about the extent of use of intangible assets by smaller not-for-profit private sector entities before it determines how to address these assets in a Tier 3 Standard

5.167 Intangible assets do not appear to be a common balance in the financial statements of smaller not-for-profit private sector entities. The Board has not received preliminary stakeholder feedback suggesting concern with accounting for intangible assets, or that smaller not-for-profit private sector entities would typically acquire or develop any significant intangible assets.

5.168 It is not clear to the Board whether the absence of intangible assets from balance sheets is because recognisable internally generated or externally acquired intangible assets are not presently being identified, or whether the entities indeed hold no intangible assets.

5.169 Consequently, the Board has not yet formed a view of how it should address intangible assets as part of its Tier 3 reporting requirements. For example, whether the Board should:

(a) develop a requirement that only acquired intangible assets (or only intangible assets that are purchased, rather than donated) are recognised, and measured on the same basis as property, plant and equipment;

(b) not require any intangible assets to be recognised; or

(c) omit intangible assets from the scope of a Tier 3 Standard, or require an entity to apply AASB 138 *Intangible Assets* to identify, recognise and measure any intangible assets.

5.170 The Board would welcome feedback that would help the Board assess the extent of use of intangible assets by smaller not-for-profit private sector entities, including typical types of intangible assets held.

Commented [A59]: __Question 18 to Board members:__
At the August 2021 AASB meeting, staff agreed to bring suggested drafting for intangible assets that is primarily based on NZ *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit) Accounting Standard* to a future meeting. Staff made this proposal because intangible assets were not highlighted to be an area of significant interest to stakeholders. Beyond terminology and language, no specific areas for simplification had been identified.

NZ reporting requirements for intangible assets are:
(1) for an intangible asset to be recognised when the asset is acquired and it has a cost or value that can be measured reliably; and
(2) as an exception to this requirement, significant intangible assets that are donated and which are difficult to value are not recognised.

Since then, staff have reconsidered the issue regarding the Board's decisions regarding property, plant and equipment (allowing the AASB 116 accounting policy options), donated assets (initially measure at cost or fair value), embedded derivatives and the initial measurement of financial instruments. In drafting, staff have identified potential alternatives to the NZ requirements which are reflected in the drafting of this section.

Staff note that the alternative position is inconsistent with the Board's previous decisions on property, plant and equipment and investment property and regarding the recognition of donated assets.

Do Board members agree with the proposed drafting of this section?

If not, do Board members support forming a preliminary view to develop a requirement that mirrors the NZ reporting requirement for intangible assets?

Leases

Section snapshot

- The Board's preliminary view is for all leases to remain off-balance sheet
- Lease payments are to be recognised on a straight-line basis over the term of the lease, unless another systematic basis is appropriate

Commented [A60]: __Note for Board members:__
The text in this section is drawn from M184 Agenda Paper 7.3 (November 2021) and reflects the Board's discussions and decisions made at its November 2021 meeting.

5.171 The Board observed that it is common for a smaller not-for-profit private sector entity to be a lessee in a shorter-term lease of property, office equipment or motor vehicles. Consequently, the Board determined that any resulting Tier 3 pronouncement must specify the accounting for lease arrangements.

5.172 The Board considered whether it should develop requirements generally consistent with AASB 16 *Leases*, but with some practical amendments to make such an approach easier to apply. It observed that:

(a) leases appear to be a common and possibly material transaction for smaller not-for-profit private sector entities and, therefore, users might benefit from more complete information on them to inform their decision-making; and

(b) the potential complications from significantly departing from an AASB 16 model for:

i) determination of an entity's reporting obligations (e.g. whether the financial statements are subject to audit or review) where a threshold test is dependent on the quantum of the entity's assets; and

ii) consolidation of the entity by a parent preparing Tier 1 or Tier 2 general purpose financial statements.

5.173 However, the Board reflected that such an approach to accounting for leases would likely continue to impose proportionately greater costs on smaller-sized lessees (for example, the valuation cost of property is unlikely to depend on the size of the entity requesting that valuation). The Board was conscious that it might not be possible to identify sufficient amendments to AASB 16 to strike an appropriate cost-benefit balance for Tier 3 reporting. It also notes the recent IASB decision to defer amending the IFRS for SMEs to incorporate a simplified IFRS 16 Leases model.

5.174 From its preliminary outreach, the Board is aware that some stakeholders are of the view that AASB 16 requirements for a lessee do not provide useful information to a not-for-profit private sector entity to users of its financial statements. The Board observed that a user may find on-balance sheet information about shorter-term leases less relevant than the benefits of recognising assets and liabilities in relation to a lease of an item for substantially all its useful life.

5.175 Consequently, the Board decided to simplify the accounting for leases. The Board has formed a preliminary view to develop a requirement to require a lessee to recognise lease payments as an expense on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern of the user's benefit. A corresponding requirement would apply to lessors. The Board intends for its proposed accounting to be supplemented by disclosure about the entity's outstanding lease commitments.

Example

XYZ Limited ('XYZ') enters into a 5-year lease of office premises. The rental agreement provides for an initial rent-free period of 3 months, and a monthly lease payment of $4,000 thereafter.

Under the Board's proposals, the total lease payment of $228,000 ($4,000 x 57 months) is recognised across 60 months; i.e. $3,800 per month. The journal entries for the first year of the lease are:

Months 1-3

DR Lease expense	$11,400	
CR Lease liability		$11,400

(Recognition of lease expense during the rent-free period: $3,800 x 3 months)

Months 4-12

DR Lease expense	$34,200	
CR Lease liability		$34,200

(Recognition of lease expense: $3,800 x 9 months)

DR Lease liability	$36,000	
CR Cash		$36,000

(Recognition of monthly lease payment: $4,000 x 9 months)

At the end of the first year of the lease, XYZ will have recognised lease expenses of $45,600 and has a lease liability of $9,600.

5.176 The proposed approach to accounting for leases arguably provides users with less transparency of the entity's underlying financial position, especially for assets that have been in essence, purchased by the entity on a payment plan. However, the Board considers that not requiring the recognition of lease assets and lease liabilities is in keeping with its objective for developing Tier 3 reporting requirements as its proposed approach:

(a) imposes fewer costs on preparers compared to an approach based on AASB 16. An element of preparer judgement is eliminated, as all leases are treated the same way; and

(b) enhances comparability between entities preparing Tier 3 general purpose financial statements;

5.177 The effect of the Board's preliminary view is that an entity will effectively be able to continue a current special purpose financial statement accounting policy of some entities not recognising lease obligations. The Board's preliminary view does not mean that the Board is not doing enough to raise the quality of the financial statements. The Board thinks its proposed approach requires relevant information to be provided to users of the financial statements, albeit in a different form to Tier 1 and Tier 2 general purpose financial statements, as:

(a) for many assets likely to be leased by smaller not-for-profit private sector entities, and considering the 'net' financial statement impact of on-balance sheet lease recognition, the bottom line result will be similar; and

(b) fulsome disclosure of an entity's lease commitments could provide the expected users of these financial statements with more understandable, and hence more useful, information.

Also, the quality of entity reporting overall will be improved as the AASB project outcomes are expected to include more entities being required to apply the same accounting policy to their leasing arrangements – improving the comparability of the financial statements of different entities.

5.178 In forming its preliminary view, the Board noted that some might consider not requiring a AASB 16 approach as a 'backward' step for those entities that have already adopted this Standard. The Board was also conscious of the complications noted in paragraph 5.172 above of departing from AASB 16. The Board observes that:

(a) an entity is not prevented from preparing Tier 1 or Tier 2 general purpose financial statements if it elects to do so; and

(b) the development of different recognition and measurement criteria is unavoidable in the development of a further differential reporting tier.

5.179 At this stage of its project, the Board has not yet considered whether to require a different treatment for certain leases; for example, rights held by a lessee under a licencing agreement. Such scoping matters will be considered by the Board only after it determines whether to proceed with developing requirements consistent with its preliminary view. Similarly, the Board has not determined that there is need to develop specific requirements for sale and leaseback arrangements, or for manufacturer or dealer lessors, nor discussed transitional provisions that might apply to lessees who currently comply with AASB 16.

Concessionary lease arrangements ('peppercorn' lease)

5.180 A lessee in a lease that at inception had significantly below-market terms and conditions principally to enable the entity to further its objectives accounts for the lease in the same manner as other leases. That is, the lessee in a concessionary lease arrangement does not recognise a right-of-use asset. The lessee also does not recognise any donation income for the difference between the below-market terms of the lease and market terms and conditions.

Commented [A61]: __Note for Board members:__
Staff have included this section to highlight the accounting for concessionary lease arrangements as an area of interest for a not-for-profit entity.

Staff think the accounting here reflects the Board's decision making to date on leases and revenue.

5.181 A not-for-profit private sector lessee that prepares Tier 1 or Tier 2 general purpose financial statements is required to initially measure a right-of-use asset in a concessionary lease arrangement at its cost or fair value.[14] The cost of the right-of-use asset comprises the initial measurement of the lease liability, any initial direct costs incurred and any expected dismantling and removal costs, and any lease payments (less lease incentives) made at or before lease commencement. Where the asset is measured at cost, the cost of the right-of-use asset will normally be nil or a nominal amount. There is no significant difference in accounting impact of the Board's preliminary views in these cases compared to AASB 16.

Income (including Revenue)

Commented [A62]: **Note for Board members:** The text in this section is drawn from M187 Agenda Papers 5.1.1 and 5.1.2 (May 2022) and reflects the Board's discussions and decisions made at its May 2022 meeting.

Section snapshot

- The Board's preliminary view is to require an entity to assess whether a transaction is based on an evidenced common understanding that an entity is expected to use the inflows of resources that results in an outflow of resources
- Income is recognised in the manner that most faithfully represents the amount and pattern of consumption by the entity of the resources received

5.182 NFP entities receive income from different sources. The Board understands that common types of income transactions of a Tier 3 not-for-profit private sector entity consist of grants from the government, donations from donors, fundraising from the public, and revenue from sales of goods or services.

5.183 From its preliminary outreach, the Board identified that many smaller not-for-profit entities find the requirements of AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities* challenging to understand and apply especially for Tier 3 private sector entities. The complexity relates to:

(a) the two-step approach to applying income recognition requirements, in which a not-for-profit entity needs to identify when an arrangement falls within the scope of revenue recognition requirements of AASB 15 or the income recognition requirements of AASB 1058; and

(b) the immediate recognition of many transfers under AASB 1058 which the entity considers it has an obligation to spend or use the transferred assets in future periods or where the transfer relates to one or more future periods.

5.184 To address stakeholder concerns noted above, the Board decided to develop an integrated income recognition approach (illustrated in Figure 5.3 below), including:

(a) whether a distinction for the accounting for different inflows of resources is required;

(b) the basis for distinguishing the different inflows of resources; and

(c) the income recognition requirement applicable for different inflows of resources;

to remove the need for a Tier 3 not-for-profit private sector entity to consider the two sets of criteria for all transfers of resources within the scope of AASB 15 and AASB 1058.

14 AASB 1058 *Income of Not-for-Profit Entities* amended AASB 16 to require a not-for-profit entity to measure a right-of-use asset arising in a concessionary lease arrangement to be measured at fair value, rather than cost. In December 2018, the AASB amended this requirement, allowing the right-of-use asset to be initially measured at cost, rather than at fair value. This amendment was intended to provide interim relief to entities, and be subject to review following the development of guidance on fair valuing right-of-use assets and the completion of the Board's Not-for-Profit Financial Reporting Framework project (this project). However, while this work is not yet complete, stakeholders have since sought certainty about the accounting policy choice. As such, following its review of the accounting policy option the Board decided In November 2021 to retain the modification unchanged for not-for-profit private sector entities. The Board intends to review the interim relief in the future for not-for-profit public sector entities.

5.185 The Board's preliminary view for income recognition should require an entity to assess whether a transaction is based on a common understanding, evidenced by the transfer provider in writing or some other form, that the entity is expected to use the inflows of resources in a particular way or act or perform in a particular way that results in outflows of resources, including:

(a) transferring goods or services;

(b) performing a specified activity;

(c) incurring eligible expenditure for a specified purpose; and

(d) using the inflows of resources in respect of a specified period.

5.186 For these transactions, the Board proposed that income should be recognised in the manner that most faithfully represents the amount and pattern of consumption by the entity of the resources received. This remains a judgement that the entity must make to determine an appropriate income recognition that faithfully represents the amount and pattern of consumption of the resources received. The following are examples of income recognition that may be used based on the type of resources received:

(a) when goods or services are transferred;

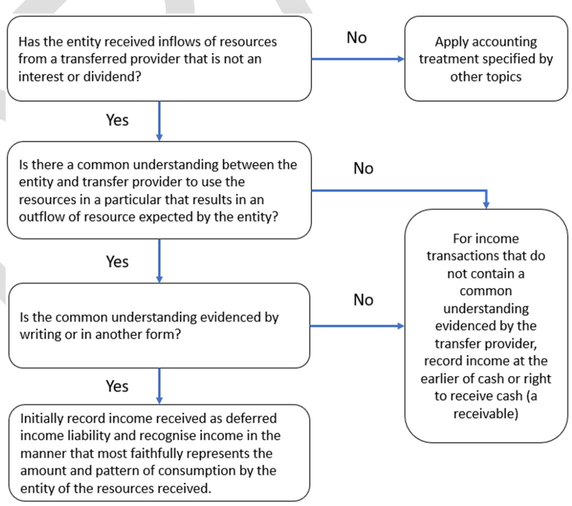
(b) when activities are performed;

(c) when eligible expenditure is incurred; and

(d) on a systemic allocation basis over the specified period.

5.187 For income transactions that do not contain a common understanding evidenced by the transfer provider in writing or some other form that the entity is expected to use the inflows of resources in a particular way or act or perform in a particular way, income should be recognised at the earlier of receiving cash or obtaining a right to receive cash (receivable).

Figure 5.3: Decision Tree: Income recognition approach for inflows of resources



Example – inflows of resources where common understanding is for transfer of goods or services

Entity B sells chocolates in a fundraising drive to raise money with no donation element. Entity B considers there is a common understanding that the customer would receive chocolate in return. Income is recognised when the chocolate is sold to the customer.

Example – inflows of resources when common understanding is for donations for general purpose with stipulation that it must be spent in the next two years

Entity A received $120,000 from a donor that specifies the donation must be used in the next two years. The entity would record deferred income of $120,000 on initial receipt of the donation and income is recognised on a systemic allocation basis for the following two years (i.e. $60,000 income recognised at the end of Year 1 and Year 2)

If the donor did not specify when the donation must be used by the entity, income is recognised at the earlier of receiving cash or the right to cash (receivable).

5.188 In developing its preliminary views discussed in paragraphs 5.185 – 5.187 above, the Board noted that the post-implementation (PIR) review of AASB 1058 and the not-for-profit guidance to AASB 15 may provide further information to improve accounting for income by not-for-profit entities in general. The Board considered that it could wait and decide its preferred view on Tier 3 income accounting requirements only when the PIR further progresses with feedback from its consultation expected to be analysed in quarter two in 2023. However, the Board reflected that awaiting outcomes of the PIR may further delay the completion of Tier 3 requirements. The Board noted that the simplification of income recognition requirements is made within the Tier 3 developing principle and are not directly applicable for Tier 1 or Tier 2 general purpose financial statement preparers.

5.189 The Board also considered other alternative approaches when developing the Tier 3 income recognition requirements including:

(a) not requiring the distinction for the accounting of inflows of resources. The Board considered this approach would remove a degree of judgement by not requiring a not-for-profit entity to consider the nature of the transaction or whether there are conditions to perform activities or incur expenditure attached to the use of the resources. However, the Board recognised this approach may not reflect that the financial reporting outcomes of smaller not-for-profit entities for transferred resources that are expected to be spent or used in a future period should be accounted for differently to general purpose donations;

(b) the distinction for the accounting of inflows of resources based on the nature of transactions, or based on the existence of documented explicit stipulations given by a transfer provider. The Board did not prefer any of these approaches noting the distinction by the nature of the transaction as being the current approach applied in AASB 15 and AASB 1058 would appear to be a similar two-step process rather than a simplification. Requiring a distinction based on documented explicit stipulations may be difficult to understand for smaller not-for-profit entities that lack the financial knowledge. The Board also considered many inflows of resources that smaller not-for-profit entities receive will not be documented in a formal agreement with explicitly stipulated conditions which may result in many transfers not meeting the criteria for income to be deferred even though the not-for-profit entity is expected to spend or use the resources in the future;

(c) requiring a not-for-profit entity to assess whether the common understanding between the entity and the transfer provider is sufficiently specific based on the criteria in AASB 15 with simplification. While the assessment of sufficiently specific criteria helps an entity to identify when an obligation is satisfied, many smaller not-for-profit entities consider assessing the sufficiently specific criteria complex and, in many cases requiring judgement leading to inconsistency in the application. Therefore, the Board decided to remove the need for the assessment of sufficiently specific criteria in its preliminary view on the income recognition model for Tier 3 reporting requirements; and

(d) require deferral for income recognition only where there are conditions attached to the inflows of resources enforceable by the transferor, such as a ‘use or return’ condition or by other means. The Board considered this approach would limit the resources required by a smaller not-for-profit entity to assess deferral of income only where enforceable conditions are present. However, the Board recognised that determining whether enforceable conditions are present does not reduce the complexity of the application for smaller not-for-profit entities. This approach may also result in less income deferrals which would not address some of the feedback that the financial reporting outcomes of smaller not-for-profit entities should reflect that the transferred resources are expected to be spent or used in a future period regardless of whether there were enforceable conditions present.

5.190 The Board is aware that some legislative threshold determination is based on an entity’s revenue. Accordingly, the Board proposes to include the definition of revenue as income arising in the course of an entity’s ordinary activities as defined in AASB 15.

5.191 The effect of the Board’s preliminary view is that any proposed changes to revenue and other income accounting may impact the determination of the size thresholds for financial reporting requirements and may impact whether an entity qualifies for a particular financial reporting tier. As such, the Board intends to work with the legislative authorities and regulators to try to provide entities with better clarity on how having two sets of recognition and measurement criteria impacts the determination of their reporting obligations, as noted in paragraph 1.8.

Employee benefits

Section snapshot

- The Board’s preliminary view is to require all short-term and long-term employee benefits to be measured on an undiscounted basis. Measurement of employee benefits relating to long-service leave should still reflect the probability that payment will be required.

5.192 In addition to services provided by volunteers, it is expected that many not-for-profit Tier 3 entities have one or more paid employees. Consequently, the Board considered it necessary to develop Tier 3 reporting requirements concerning the accounting for outstanding employee benefit obligations. Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.

5.193 From its preliminary outreach, the Board noted that some stakeholders find the AASB 119 *Employee Benefits* requirements regarding short-term paid absences and other long-term employee benefits likely to be challenging to understand and apply by Tier 3 entities, such as:

(a) measurement of the employee benefits liability – including determining expected costs and understanding which obligations are discounted to determine present value of the liability; and

(b) classification of the employee benefits liability – for example, understanding the interaction between the AASB 119 short-term and other long-term employee benefits categorisation and the current/non-current classification required by AASB 1060. Some short-term employee benefits (e.g. annual leave) may not be expected to be settled wholly before twelve months after the end of reporting period. In such a situation, even Tier 3 entities do not need to reclassify the related employee benefit, they would need still to consider whether related employee benefit liability should be measured at the present value of the estimated future cash outflows of the employer for the employee services provided up to the reporting date.

5.194 While the employee benefits may be one of the common types of expense incurred by Tier 3 not-for-profit private sector entities and of interest to users, the Board is sympathetic to concerns that applying AASB 119 does not necessarily strike the right cost-benefit balance when regarding only smaller not-for-profit private sector entities, who are expected to typically have simple employee remuneration arrangements. Accordingly, the Board considered whether it should develop simpler requirements.

5.195 The Board considered whether the requirement to treat all paid absences as non-accumulating benefits and recognise expenses when the absences occur would address the concerns. Such a requirement would be easier to understand and apply as the entity's obligation for outstanding employee benefits is not recognised as a liability. However, the Board rejected doing so as this departs from the accrual principle and as the Board was concerned that the resultant reported financial position would not provide users with a complete picture of the entity's commitments and solvency given the relative significance and occurrence of employee benefit balances.

5.196 Consequently, to strike an appropriate balance between reducing the complexities and preparation cost for Tier 3 entities and maintaining information usefulness and relevance to users, the Board has formed a preliminary view to developing the following recognition and measurement requirements for Tier 3 reporting of employee benefits:

(a) non-accumulating paid absences and termination benefits will be recognised when the event occurs; and

(b) all other employee benefits, regardless of whether the entitlement is vesting (i.e. employees are entitled to a cash payment for unused entitlement on leaving the entity) or non-vesting (i.e. employees are not entitled to a cash payment for unused entitlement on leaving the entity) will be recognised when an employee has rendered the services that entitles the employee to consideration; where

(i) an expense (unless capitalised) is measured at the undiscounted amount of the obligation to the employee; and

(ii) a liability (provision) is:

(1) recognised at the reporting date for the outstanding obligation owed as a result of these services to the employee. Changes in the liability reflecting changes in the entity's expectations of the future amounts payable are recognised as part of the employee benefit expense in the period of the change.

(2) measured at the undiscounted future outflow expected to be required to settle the present obligation (e.g. cash salary at the time leave is expected to be taken).[15] The Board observed that not requiring the liability to be measured at the present value of the obligation eliminates the need for categorisation of employee benefits related provisions as either short or long-term employee benefits for measurement purpose, and consequently addresses the complexity arising from the interaction between AASB 119 and AASB 1060;

(3) presented as current or non-current depending on whether the service conditions are met or expected to be met wholly before twelve months

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15 Similarly, under AASB 112 *Income Taxes*, deferred tax assets and deferred tax liabilities are not discounted, even though part of the temporary difference may not reverse in the next reporting period.

after the end of the annual reporting period in which the employees render the related service.[16]

Example – long service leave

The long service leave (LSL) obligation for an employee is calculated as:

LSL accrual to date (weeks) x Weekly salary at the time leave is expected to be taken x Probability employee will meet the LSL vesting conditions

The liability is classified as current if the employee has met the service conditions for long service leave, or will meet these within 12 months of the reporting date. Otherwise, the liability is classified as a non-current liability. Long-term employee benefits should reflect the probability that payment will be required and be measured on an undiscounted basis

Example – annual leave

The annual leave obligation for an employee is calculated as:

Annual leave balance (weeks) x Weekly salary at the time leave is expected to be taken

The liability is classified as a current liability as the employee has met the service conditions for annual leave at the reporting date regardless of when the employee is expected to take the leave. An entity need not reclassify annual leave provisions if the entity's expectations of the timing of settlement change temporarily.

Example – personal leave

Personal leave is recognised as a liability in two situations:

(a) where the personal leave is accumulating and vesting (i.e. the employee is entitled to the leave either throughout their employment or when they finish employment), in a similar manner to annual leave entitlements; or

(b) where the personal leave is accumulating and non-vesting, and it is anticipated the employee will take the accrued personal leave in the future.

In measuring the liability to be recognised for non-vesting accumulating personal leave, it will be necessary to recognise as a liability only that component of the entitlements accumulated as at the reporting date that is expected to be taken by the employee in the future.

An accumulating personal leave obligation for an employee is calculated as:

Personal leave balance (days) x Weekly salary at the time leave is expected to be taken x probability of the employee will take the accrued personal leave in the future

The probability should be assessed on a group basis, rather than based on individual employees.

The liability is classified as a current liability if the associated employee benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employee renders the related services.

5.197 The costs of calculating the present value of estimated future cash outflow include acquiring an appropriate discount rate, identifying when each entitlement is likely to be taken, and accounting for the unwind of the discount. The Board considered that the ability of the liability

16 As discussed in paragraphs 5.25-5.26, the Board has formed a preliminary view to develop requirements for presentation on the face of the financial statements consistent with AASB 1060.

to provide relevant information to users is unlikely to be significantly impacted by not discounting the obligation for reasons including:

(a) many obligations could be expected to be settled within a short-to-medium term timeframe;

(b) the discount for the time value of money may largely negate any future pay rises such that the present value of the obligation and its undiscounted amount are not significantly different; and

(c) the Board's expectation that entities who prepare Tier 3 financial statements are likely to have few employees means that the quantum of any difference is unlikely to misrepresent the obligation to users materially.

5.198 Consequently, the Board decided that users would not be inappropriately disadvantaged by its proposal.

5.199 The Board's proposed liability measurement requires an entity to consider future pay increases and the likelihood that an outflow would be required to settle the obligation.[17] The Board recognises that this imposes costs on the entity to make supportable assumptions. The Board is not of a mind to completely eliminate these costs, for example, by requiring the liability to be measured based on current salary and ignoring the uncertainty of achieving the entitling event, because this would not be a faithful representation of the obligation.[18] Financial reporting is 'more than' a bookkeeping or financial record keeping exercise.

5.200 However, the Board is conscious that the calculation of employee benefit liabilities can be time-consuming and may be frequently actioned by a volunteer or another preparer who may struggle to make the necessary judgement determinations. To assist preparers and introduce consistency amongst smaller not-for-profit private sector entities, the Board plans to develop requirements further, if possible, to support the assessment of the likelihood that an outflow of economic benefits will be required to settle the obligation, for example in a form of practical expedient or a rebuttable presumption. These requirements should reduce preparer costs and improve comparability between entities.

5.201 One of the forms such practical expedient or rebuttable presumption could take is the specified probability or probabilities representing deemed likelihood of employees becoming entitled to an employee benefit (e.g. long service leave). However, the Board observes that following further investigation, the Board may determine that it is not feasible for the Board to develop such guidance. Identifying a 'standard' or common set of probabilities may not be possible, or research may suggest that the future Board commitment to maintaining such a set will be more than minimal.

5.202 The Board does not intend to constrain the probability assessment to a "most likely" or an "expected value" approach. Such probability assessment remains a judgement that the entity must make. The number of employees may impact an entity's decisions.

Example

Entity XYZ assesses that 4 out of every 10 employees who have worked for 5 years by the reporting date will qualify for long service leave.

Assume Entity XYZ has 10 such employees. Before considering the likelihood a payment will be required, Entity XYZ estimates its maximum future outflow for the 5 years of services

17 For example, an outflow will always be required for annual leave obligations, because the entity must pay the employee for the leave when it is taken or when the employment ceases. However, an outflow may not be required for an unvested long service leave entitlement, because the entity expects the employee to cease working for the entity before the entitlement becomes due.

18 Per the *Conceptual Framework for Financial Reporting*, a faithful representation is neutral in depiction. Neutrality is supported by the exercise of prudence. The exercise of prudence does not allow for the overstatement of liabilities or expenses.

rendered to date to be $130,000. The liability depends on which of the two approaches below Entity XYZ adopts:

(a) Most likely approach (entity considers whether it is it is probable employees will meet the service condition): $nil [$130,000 x 0]

(b) Expected value approach: $52,000 [$130,000 x 0.4]

Employee on-costs

5.203 The Board intends to provide clarity on the accounting for on-costs as part of its Tier 3 reporting requirements, for example, in the form of application guidance, to address feedback from some stakeholders that some smaller not-for-profit entities are unclear about the accounting treatment of such costs.

5.204 Employee on-costs such as payroll tax and workers' compensation insurance are expenses incurred by an entity in conjunction with the employment of personnel. These forms of on-costs are not part of the employee benefit expense or liability because they are not payments (consideration) to the employee in exchange for the employee's services. Consequently, under the Board's preliminary views for the accounting requirements for provisions (see paragraph 5.222), these on-costs are recognised when the entity has a present obligation to make an outflow of resources to settle the obligation.

5.205 Conversely, on-costs such as annual leave loading and superannuation guarantee levy payments are treated as part of the employee benefit expense or liability as these on-costs represent consideration receivable by an employee in exchange for the employee's services. Consequently, under the Board's preliminary views in paragraph 5.196(b) above, these on-costs are recognised as part of the employee benefit liability when employees render the services and give rise to the entitlement. The measurement of the employee benefit liability considers these forms of on-costs.

5.206 The Board considers, where material to the financial statements, on-costs that are not employee benefits should not be described as part of the employee benefit expense or liability.

Example – long service leave and on-costs

Entity XYZ has 10 employees and they have worked in the entity for 3 years. Each employee has an annual salary of $100,000. Employees have worked for 10 years by the reporting date will qualify for long service leave of 8 weeks. All employees are expected to take their long service leave as soon as they are entitled. On-costs of 10% will be incurred on any leave entitlements incurred.

Assume Entity XYZ has 10 employees and they have worked in the entity for 3 years as at 30 June 20x2. Each employee has an annual salary of $100,000 and the probability that the employee will receive their long-service leave benefit (i.e. will still be employed when the long-service leave becomes payable) is 50%. The salary is expected to increase 2% every year.

The amount of long-service leave accumulated for each year of service is calculated as follows:

Long-service liability = current salary (1+ 10% on-costs) × years of service × entitlement rate × growth in salary factor (if applicable) × probability, where

Entitlement rate = 1÷ number of years of service required for long-service leave × number of weeks of long-service leave ÷ number of weeks in the year

Applying the formula above, the amount of long-service leave accumulated at 30 June 20x2 would be:

Commented [A63]: **Question 19 for Board members:**
The Board did not discuss the accounting for on-costs when discussing accounting for employee benefits. However, staff received feedback that there may be some smaller NFP entities that are unclear about the accounting treatment for such costs.

Staff note that there is no proposed difference between Tier 1 and Tier 3 reporting requirements as the Board did not decide to amend the definition of 'employee benefits' in Tier 3 reporting requirements.

Staff have mixed views on this topic.

Some staff are of the view that no guidance is required. These staff note that such guidance could be seen as contravening the Board's policy of not interpreting IFRS, as there is no proposed difference between Tier 1 and Tier 3 reporting requirements in this regard. This is because there has been no move to amend the definition of 'employee benefits' for Tier 3 reporting purposes.

However, other staff think that it may be useful to provide clarity to preparers as to the accounting for on-costs. This will help eliminate confusion and any diversity in practice, and consequently could be expected to reduce preparer costs and facilitate comparability.

Do Board members wish to form a preliminary view to provide clarity on the accounting for on-costs as part of a Tier 3 accounting standard?

Long-service liability (for a total of 10 employees) = $\$100{,}000(1+10\%) \times 3 \times (1 \div 10 \times 8 \div 52) \times (1.02)^7 \times 0.5 \times 10 = \$29{,}159$

Termination benefits and defined benefit plans

5.207 The Board observed that its intended preparers of Tier 3 general purpose financial statements were unlikely to incur termination benefits or defined benefit plans commonly. Consequently, the Board has not developed any special accounting requirements for such employee payments.

Other topics to be included in Tier 3 reporting requirements

5.208 The Board also envisaged that the possible future Tier 3 reporting requirements would include accounting guidance for transactions that may be common for Tier 3 entities listed below. The Board has not identified these topics to date as of significant interest beyond simplification to terminology.

5.209 The Board considered the principles in developing the Tier 3 reporting requirements and considered the accounting requirements in the pronouncements developed for smaller entities in other jurisdictions. The Board has formed a preliminary view to proposing Tier 3 reporting requirements primarily based on the New Zealand Tier 3 reporting requirements for the following topics:[19]

(a) commitments;

(b) events after reporting period;

(c) expenses;

(d) foreign currency transactions;

(e) income taxes;

(f) going concern;

(g) offsetting; and

(h) provisions, contingent liabilities and contingent assets.

Commitments

5.210 Commitments would be considered legal obligations to make payments in the future. Although commitments (operating or capital) are not yet recorded as liabilities, an entity would consider whether reporting commitments is essential for users of financial statements to understand the entity's future viability properly.

Events after reporting period

5.211 Events after the reporting date are favourable and unfavourable events that occur between the end of the reporting period and when the financial statements are finalised. The reporting end of the reporting period is the last day of the financial year to which the statements relate. The date of finalisation is the date on which the statements have received approval from the individual or body with the authority to authorise those statements for issue.

19 This view was formed considering the similarity of the current Tier 1 and Tier 2 reporting requirements for most of the other topics to New Zealand Tier 3 reporting requirements, the similar targeted size of the not-for-profit sector entities and the AASB's policy in the harmonisation of Trans-Tasman standard-setting.

Commented [A64]: <u>**Note for Board members:**</u>
At the Board's August 2021 meeting, the Board decided that there were possible future Tier 3 reporting requirements that will primarily be based on the NZ External Reporting Board's *Public Benefit Entity Simple Format Reporting - Accrual (Not-for-Profit)* Accounting Standards. Staff have since refined the list of topics as the Board has decided the Tier 3 reporting requirements for property, plant and equipment, inventory and fair value not to be based on the NZ Tier 3 Standards. The drafting of the Tier 3 reporting requirements for the listed topics is primarily based on the NZ Tier 3 Standards and tailored to remove references to reporting requirements unique to the NZ Tier 3 Standards, such as performance report.

Staff think that the proposed text reflects the Board's decision making.

5.212 An entity would be required to adjust the amounts recorded in its financial statements and revise the related disclosures to reflect events after the reporting date that provide evidence of conditions that existed at the reporting date.

5.213 An entity would not be required to adjust the amounts recorded in its financial statements to reflect events after the reporting period that are indicative of conditions that arose after the reporting period.

Expenses

5.214 Expenses would be recorded on the occurrence of a recognition event, where there is a legal obligation to pay cash either now or sometime in the future (normally referred to as the point at which an expense is "incurred").

Foreign currency transactions

5.215 Any foreign currency transactions would be required to be translated using the rate at the transaction date or at the end of the reporting period for monetary assets and liabilities.

Income tax

5.216 Tax expenses (where relevant) would be based on income tax payable without any allowance for deferred tax assets or deferred tax liabilities.

Going concern

5.217 The financial statements are typically prepared assuming that the entity will continue its operation for the foreseeable future (normally considered to be a minimum of 12 months from the end of the reporting period). This assumption may not be appropriate in some circumstances. For example, in may not be appropriate if the governing body determines after the balance date either that (a) there is an intention to liquidate the entity or to cease operating; or (b) that there is no realistic alternative but to do so.

5.218 If the assumption of continuity is not appropriate, the assumption will need to be disclosed in the accounting policies in the notes to the financial statements (additional disclosure are also required in the notes to the financial statements as referred in paragraph below). The entity would consider whether different specific accounting policies are more appropriate in these circumstances, for example valuing assets at fire sale value.

5.219 The impact of such changes will depend upon the entity's particular circumstances. For example, the effect on the recorded amounts of assets will depend upon whether operations are to be transferred to another entity, sold, or liquidated. Judgement will be required in determining whether a change in the carrying amount of assets and liabilities would be required. It will also be necessary to consider whether the change in circumstances leads to additional liabilities or triggers clauses in debt contracts which will lead to reclassifying those debts as current liabilities.

Offsetting

5.220 User of the financial statements should be given as much relevant information as possible about the entity. Therefore, the entity would be required to report gross amounts for transactions, and not offset (net-off) any associated transactions or balances. This means that:

(a) assets and liabilities shall not be offset against each other; and

(b) revenue/Income and expenses shall not be offset against each other.

5.221 Revaluation adjustments such as write-downs of inventory or property, plant and equipment provide for the change in value of an entity's assets. Measuring assets net of revaluation adjustments is not considered offsetting. Accounting for the net amount of GST owing to or from the taxation authority would not be considered offsetting.

Provisions, Contingent Liabilities and Contingent Assets

5.222 A provision is a liability of uncertain timing or amount. For example, an entity's office premises lease may contain conditions requiring the premises to be renovated at the end of the lease, resulting in establishing a provision.

5.223 A provision would be recorded as a liability when:

(a) the entity has a present obligation (legal or constructive) as a result of past events;

(b) it is probable that the entity will have to settle the obligation; and

(c) the entity can make a reliable estimate of the amount of the obligation.

5.224 The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability, especially in the case of provisions, which by their nature are more uncertain than most other liabilities. Except in extremely rare cases, an entity should be able to make an estimate of the obligation that is sufficiently reliable to use in recording a provision.

5.225 A contingent liability is a possible obligation that arises from past events that is contingent (dependent) on some future event. For example, a court case not yet settled, or a guarantee issued. Contingent liabilities would not be recorded in the statement of financial position but would be reported in the notes to the financial statements.

5.226 The New Zealand Tier 3 reporting requirements do not contain guidance on the reporting requirements for contingent assets. As such, the Board does not propose any simplifications beyond what is currently required in AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, that is, an entity would not be required to recognise a contingent asset.

Questions for respondents

Primary financial statements

Question 14

Paragraphs 5.14 to 5.20 discuss the Board's preliminary view that a Tier 3 general purpose financial statements comprise of a statement of profit and loss and other comprehensive income, statement of financial position, statement of cash flows and explanatory notes.

Do you agree? Why or why not? If you disagree with the Board's view, which financial statements to you think should not form part of the Tier 3 general purpose financial statements?

As noted in the paragraphs 5.21 - 5.23, the Board has not yet formed a view whether a statement of changes in equity should also form part of the Tier 3 general purpose financial statements.

Do you think the statement of changes in equity should also form part of the Tier 3 general purpose financial statements? If you do not agree, do you think the information that would be presented in the statement of changes in equity should be required as part of the notes to the financial statements?

Question 15

Paragraphs 5.24 to 5.31 discuss the Board's preliminary view that the information to be presented on the face of the statement of the financial position and statement of profit or loss and other comprehensive income should be consistent with those specified by AASB 1060 supplemented by explanatory guidance and/or education materials to support entities how information can be presented on the face of the financial statements.

Do you agree? Why or why not? If you disagree with the Board's view, do you prefer the alternative approaches in to presenting information on the face of the financial statements as specified in paragraph 5.25? If not, do you have other suggestion on how information should be presented on the face of the financial statements?

Question 16

Paragraph 5.32 to 5.40 discuss the Board's preliminary view to require the statement of cash flows to present:

(a) cash flows from operating activities separately from other cash flows;

(b) cash flows from operating activities using the direct method; and

(c) cash and cash equivalent as specified by AASB 101 and AASB 1060.

Do you agree? Why or why not? If you disagree with the Board's view, which presentation requirements from (a) to (c) above for the statement of cash flows concern you the most? Do you suggest any other simplification(s) to the statement of cash flows? Please explain why.

Consolidated financial statements

Question 17

Paragraph 5.41 to 5.54 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.

Separate financial statements of the parent

Question 18

Paragraph 5.55 to 5.61 discuss the Board's preliminary view on the accounting requirements for a parent that presents separate financial statements to measure its interest in subsidiaries at either:

(a) cost;

(b) at fair value through other comprehensive income; or

(c) applying the equity method of accounting.

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

Changes in accounting policies and correction of accounting errors

Question 19

Paragraph 5.62 to 5.67 discuss the Board's preliminary view to develop a requirement for a modified retrospective approach to apply to changes in accounting policies and correction of accounting errors.

Do you agree? Why or why not? If you disagree with the Board's view, do you prefer any other alternative requirements for changes in accounting policies and correction of accounting errors, for example Tier 3 accounting requirements should continue to require the accounting treatment specified by AASB 108 to retrospectively reflect voluntary changes in accounting policies and accounting errors? Please explain why.

Changes in accounting estimates

Question 20

Paragraph 5.68 discusses the Board's preliminary view to develop a requirement for changes in accounting estimates to be accounted for prospectively, consistent with AASB 108.

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

Financial instruments

Question 21

Paragraphs 5.69 to 5.83 discuss the Board's preliminary views with respect to the accounting for financial instruments, in particular to develop simpler reporting requirements only for the identified 'basic' financial instruments.

The Board intends to require certain 'more complex' financial instruments to be accounted for in accordance with AASB 9 (or other Australian Accounting Standard, as appropriate) if the financial instrument is not otherwise addressed by a topic-based Tier 3 requirement. In addition, the Board intends not to specifically highlight or address particular financial instruments or transactions considered in AASB 9, AASB 132 and AASB 139 where these items and transactions are not common to not-for-profit private sector entities.

Do you agree with the Board's approach to the identified basic financial instruments? Why or why not? If you disagree with the Board's view, do you suggest any other alternatives? Please specify and explain why.

Question 22

Paragraphs 5.84 to 5.87 discuss the accounting for derivatives. The Board has formed a preliminary view that a proportionate response for Tier 3 reporting requirements is not to require an entity to separately recognise certain derivative financial instruments that are not immediately obvious, including any embedded derivatives.

The Board is seeking to understand the extent to which a smaller not-for-profit private sector entity is likely to have derivatives embedded within its contracts, or enter into arrangements or contracts that may result in a derivative financial instrument. This will help inform the Board how it should approach these instruments in a future Tier 3 Standard.

Are you aware of any clauses in your contracts entered into that would give rise to a derivative? Have you provided an arrangement with another party or entered into a net-settled contract that would meet the definition of a derivative? Please explain.

Question 23

Paragraphs 5.88 to 5.89 discuss the Board's preliminary views that an entity preparing Tier 3 compliant financial statements will not have access to hedge accounting.

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

Question 24

Paragraphs 5.90 to 5.92 discuss the Board's preliminary view to develop a requirement for basic financial assets and financial liabilities to be initially measured at their fair value. Transaction costs and fees incurred by the entity to acquire a financial asset or assume a financial liability are to be immediately expensed.

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

Question 25

Paragraphs 5.93 to 5.111 discuss the Board's preliminary develop a requirement for basic financial assets and financial liabilities to be subsequently measured as follows:

(a) basic financial assets that are held to generate both income and a capital return – at fair value through other comprehensive income; and

(b) other basic financial assets and financial liabilities – at cost. Interest income and interest expense on these instruments are to be recognised as amounts are earnt or incurred, calculated by reference to the contractual interest rate. Any initial premium or discount on acquisition of the basic financial asset or financial liability is to be amortised on a straight-line basis over the life of the instrument, unless another systematic basis or shorter period is more reflective of the period to which the premiums or discounts relate.

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

Question 26

Paragraphs 5.112 to 5.115 discuss the Board's preliminary view to develop a requirement for impairment of basic financial assets measured at cost to be recognised when it is probable that some or all of the amount owed will not be collectible. The impairment loss is to be measured at the anticipated uncollectible amount.

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

Question 27

Paragraphs 5.116 to 5.121 discuss the Board's preliminary view to develop a requirement that a financial asset is derecognised only when either the contractual rights to the cash flows from the financial asset expire or are settled, or the entity otherwise loses control of the asset.

The Board also formed a preliminary view not to address instances of debt instrument exchanges or modification of the terms of a financial liability as part of its Tier 3 Standard. An entity treats a modification of the terms of a financial liability or an exchange of a debt instrument for a different debt instrument as an extinguishment of the original financial liability.

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

Fair value measurement

Question 28

Paragraphs 5.122 to 5.126 discuss the Board's preliminary view to not depart from the principles of AASB 13 *Fair Value* when develop reporting requirements for Tier 3 not-for-profit private sector entities as it thinks maintaining a consistent understanding of 'fair value' across the different reporting tiers is important.

Do you agree? Why or why not? If you disagree with the Board's view, do you prefer any other alternative requirements Tier 3 not-for-profit private sector entities? Please specify and explain why.

Question 29

Paragraphs 5.127 to 5.128 discuss the Board's preliminary view that cost may be an appropriate estimate for fair value when cost represents the best estimate of fair value within a wide range of possible fair value measurement for instances described in paragraph 5.127.

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

Question 30

Paragraphs 5.129 to 5.131 discuss the Board's preliminary view not to allow other current value measurement bases as appropriate estimates of fair value.

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

Inventory

Question 31

Paragraphs 5.132 to 5.134 discuss the Board's preliminary view to develop Tier 3 reporting requirements that are consistent with the requirements in AASB 102 *Inventories*.

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

Biological assets

Question 32

Paragraph 5.135 discusses the accounting for biological assets if not scoped out from a Tier 3 Standard. The Board's preliminary view is not to include biological assets, and agricultural produce at the point of harvest in a Tier 3 Standards as discussed in paragraphs 4.17 to 4.22.

Do you agree? Why or why not? If you disagree with the Board's view, do you prefer the accounting for biological asset should be included in a Tier 3 Standard and accounted for in accordance with the requirements for inventory? Please specify and explain why.

Investments in associates and joint arrangements

Question 33

Paragraphs 5.136 to 5.139 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 entity that is:

(a) a parent 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 interest in associates and joint ventures.

The Board has not yet discussed other exemptions and exceptions to applying the equity method as its only consultation 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.

Separate financial statements of the investor

Question 34

Paragraphs 5.140 to 5.141 discuss the Board's preliminary view is 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 interest in associates and joint ventures as 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.

Property, plant and equipment and investment property

Question 35

Paragraphs 5.142 to 5.151 discuss the Board's preliminary view to require property, plant and equipment and investment property, other than with respect to borrowing costs, to be recognised and measured in a consistent manner to Tier 2 Australian Accounting Standards.

Do you agree? Why or why not? If you disagree with the Board's view, do you prefer any other alternative requirements such as not to allow smaller not-for-profit private sector entities to revalue their non-current assets? Please specify and explain why.

Non-financial assets acquired for significantly less than fair value

Question 36

Paragraphs 5.152 to 5.156 discuss the Board's preliminary view to allow an entity following accounting policy choice for initial measurement of non-financial assets acquired for significantly less than fair value:

(a) inventory to be measured at cost or at current replacement cost; and

(b) other non-financial assets to be measured at cost or at fair value.

The Board also decided to propose retaining the option to permit, but not require, a smaller not-for-profit entity to recognise volunteer services received, or a class of volunteer services, if the fair value of those services can be measured reliably.

Do you agree? Why or why not? If you disagree with the Board's view, do you prefer any other alternative requirements discussed in paragraph 5.155? Please specify and explain why.

Borrowing costs

Question 37

Paragraph 5.157 to 5.159 discuss the Board's preliminary view to require all borrowing costs to be expensed in the period incurred for Tier 3 not-for-profit private sector entities.

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.

Impairment of non-financial assets

Question 38

Paragraphs 5.160 to 5.165 discuss the Board's preliminary view that the impairment model for non-financial assets of Tier 3 entities should:

(a) only require non-financial assets subsequently measured at cost or deemed cost to be subject to impairment testing.

(b) only require to consider whether non-financial assets are impaired when the asset has been physically damaged or when its service potential might have been adversely affected by a change in the entity's strategy or changes in external demand for the entity's services;

(c) recognise impairment of a non-financial asset if its carrying amount exceeds its recoverable amount being the higher of its fair value less costs of disposal and its value in use. Tier 3 reporting requirements will include a rebuttable presumption that fair value less costs of disposal is expected to be the most appropriate measure of a non-financial asset's recoverable amount because non-financial assets are generally not held by NFP entities to generate cash flows; and

(d) allow to group non-financial assets that do not generate cash flows that are largely independent of those from other assets into cash-generating units.

Do you agree? Why or why not? If you disagree with the Board's view, do you prefer any other alternative requirements discussed in paragraph 5.165? Please specify and explain why.

Assets held for sale

Question 39

Paragraph 5.166 discusses the Board's preliminary view not to propose introducing any specific requirement for property, plant and equipment or other non-current assets that an entity intends to sell rather than hold for its continuing use.

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.

Intangible assets

Question 40

Paragraph 5.167 to 5.170 discuss that the Board has not yet form a view to develop requirements for accounting of intangible assets in a Tier 3 Standard. The Board is seeking to understand the extent of use of intangible assets by smaller not-for-profit private sector entity including the typical forms of any intangible assets held. This will help inform the Board how it should address intangible assets in a future Tier 3 Standard.

Are you aware of any intangible assets and their type, either internally generated or externally acquired, commonly held and recognised by smaller not-for-profit private sector entities?

Leases

Question 41

Paragraphs 5.171 to 5.181 discuss the Board's preliminary view on accounting requirements for leases, including:

(a) require a lessee to recognise lease payments as an expense on a straight-line basis over the lease term, unless another systemic basis is more representative of the time pattern of the user's benefit. A similar requirement would apply for lessors;

(b) concessionary lease arrangement ('peppercorn' leases) would be accounted for in the same manner as other leases; and

(c) Tier 3 accounting requirements would not include specific requirements for sale and lease back transactions or manufacturer or dealer lessors.

Do you agree with the Board's preliminary view? Why or why not? If you disagree with the Board's view, which of the requirement(s) in (a) – (c) above concerns you the most? Do you prefer Tier 3 accounting requirements should be developed consistent with AASB 16 Leases? Please explain why.

To the best of your knowledge, are sale and lease back transactions or manufacturer or dealer lessors common for smaller not-for-profit private sector entities?

Income (including Revenue)

Question 42

Paragraphs 5.182 to 5.191 discuss the Board's preliminary view that income recognition for Tier 3 entities should require an entity to assess whether a transaction is based on a common understanding, evidenced by the transfer provider in writing or some other form, that the entity is expected to use the inflows of resources in a particular way or act or perform in a particular way that results in outflows of resources, including:

(a) transferring goods or services;

(b) performing a specified activity;

(c) incurring eligible expenditure for a specified purpose; and

(d) using the inflows of resources in respect of a specified period.

Income is recognised in the manner that most faithfully represents the amount and pattern of consumption by the entity of the resources received. For all other income transactions, income is recognised at the earlier of receiving cash or obtaining a right to receive cash (receivable).

Do you agree? Why or why not? If you disagree, do you prefer any other alternative approach as discussed in paragraph 5.189? Please specify and explain why.

Employee benefits

Question 43

Paragraphs 5.192 to 5.202 discuss the Board's preliminary view that employee benefits expense is measured at the undiscounted amount of the obligation to the employee for:

(a) non-accumulation paid absences and termination benefits when the event occurs; and

(b) all other employee benefits when an employee has rendered the services that entitles the employee to consideration.

A provision for employee benefits is measured at the undiscounted future outflow expected to be required (including consideration of future pay increases) to settle the present obligation.

The Board has not yet determined the form of guidance to be developed to support preparers in determining the likelihood that an outflow of economic benefits that will be required to settle these obligations.

Do you agree? Why or why not? If you disagree with the Board's view, do you prefer other alternatives, for example Tier 3 requirements should require future outflows of employee benefits expenses to be discounted? Please specify and explain why.

If you currently apply an industry-specific probability guidance that would apply to the employee benefits such as a long service leave, please specify the source of that guidance.

Question 44

Paragraphs 5.203 to 5.206 discuss the Board's preliminary view to provide clarity for employee on-cost such as:

(a) payroll tax and workers compensation insurance are not treated as part of the employee benefits expense or liability and should be recognised when the entity has a present obligation to make an outflow of resources to settle the obligation; and

(b) annual leave loading and superannuation guarantee levy payments are treated as part of employee benefits expense and should be recognised as employees render the service giving rise to the entitlement.

Where material to the financial statements, on-cost that are not employee benefits should not be described as part of the employee benefit expense or liability.

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 45

Paragraph 5.207 discusses that the Board has not developed any special requirements for accounting for termination benefits and defined benefit plans.

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.

Other topics to be included in Tier 3 reporting requirements

Question 46

Paragraphs 5.208 to 5.226 discuss the Board's preliminary view that Tier 3 reporting requirements would be similar to that specified be the New Zealand Tier 3 reporting requirements for the following topics:

(a) commitments;

(b) events after reporting period;

(c) expenses;

(d) foreign currency transactions;

(e) income tax;

(f) going concern;

(g) offsetting; and

(h) provisions, contingent liabilities and contingent assets.

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.

Section 6: Disclosure approach

6.1 Disclosure requirements play a complementary role to the recognition and measurement requirements, which are fundamental to providing useful financial information about the entity's operations. An item that possesses the essential characteristics of the element of a financial statement but fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes or other explanatory material. Such a consideration is appropriate when knowledge of the item is relevant to the users' evaluation of primary financial statements.

6.2 The Board also considered its approach to simplification in Appendix B, including the principle that consistency with Tier 2 accounting principles is desirable but might not always be warranted. This principle considers that Tier 3 requirements are being developed as a proportionate response to the costs incurred by certain entities whilst meeting the needs of users of the financial statements of smaller not-for-profit entities. For example, the Board noted that opportunities for deviation from Tier 2 accounting principles that could give a similar outcome to users while reflecting an appropriate cost/benefit balance could include disclosure requirements instead of a Tier 2 measurement requirement or an approach of specifying minimum 'prescriptive' disclosures.

6.3 Currently, not-for-profit entities are required to comply with Tier 2 reporting requirements, as a minimum, when preparing their general purpose financial statements. Tier 2 disclosure requirements are set out in AASB 1060, which was developed using a 'bottom up' approach based on the *IFRS for SMEs* Standard and adjusted as necessary based on the premise to align to *IFRS for SMEs* disclosures where the recognition and measurement requirements are the same or similar to full IFRS Standards. If the recognition and measurement principles in full IFRS Standards differ significantly from those in the *IFRS for SMEs* Standards, disclosures were either removed or added.

6.4 Consequently, the Board considered the need to propose an approach to developing disclosure requirements that appropriately complement the Board's preliminary views on Tier 3 recognition, measurement and presentation requirements. The Board also gave regard to the objective of the project being to develop a differential reporting framework that is simple, proportionate, transparent, and easy to understand and apply. The consideration of the approach to simplification provides the opportunity to obtain the feedback at this stage from stakeholders on the Board's preliminary view on the approach to disclosures illustrated on selected topics covered by this Discussion Paper.

6.5 Accordingly, the Board proposed to adopt the following disclosure approach to determine disclosure requirements for topics covered in Tier 3 requirements:

(a) for transactions and other events where there is a recognition and measurement difference between Tier 3 and Tier 2 reporting requirements, Tier 3 reporting requirements will:

i) adopt appropriate disclosure requirements from jurisdictions pronouncements or frameworks with comparable recognition and measurement requirements; or

ii) develop fit-for-purpose disclosure requirements (e.g. using the existing disclosure requirements for topics whose requirements could be analogised to the Tier 3 topics as the base to develop fit-for-purpose Tier 3 disclosures) if there are no comparable recognition and measurement requirements in other jurisdictions/frameworks.

(b) for transactions where the recognition and measurement requirements for Tier 3 reporting requirements are the same or similar to the corresponding Tier 2 recognition and measurement requirements – the disclosure requirements in AASB 1060 will be

Commented [A65]: **Note for Board members:** At the M188 (June 2022) Board meeting in Agenda Paper 12.3.2, staff informed the Board that staff will bring the draft disclosure requirements for other key topics to be included in the DP. Staff have since decided against including any further disclosure examples to be included as part of the DP as staff think there are already sufficient disclosure examples included in the DP to demonstrate how the Board's preliminary view of the approach to developing Tier 3 disclosure requirements will apply. Adding any further examples will also substantially increase the length of this DP.

Commented [A66]: **Note for Board members:** The text in this section has in part been informed by or drawn from M188 Agenda Paper 12.3.1 (June 2022) and the Board's discussion at its June 2022 meeting used as a starting point with further consideration of simplifications that may be appropriate.

6.6 The Board has not yet formed a view on whether simplifications to AASB 1060 disclosure requirements are needed for transactions where there are no differences in recognition and measurement requirements between Tier 2 general purpose financial statements or for topics covered in the Tier 3 reporting requirements but not discussed as part of this Discussion Paper, such as related party disclosures. The Board would be interested to understand what disclosure requirements required in AASB 1060 can be further simplified, if any, that would be required for Tier 3 reporting requirements in that regard.

6.7 As part of its deliberations when forming its view on developing the disclosure approach, the Board considered developing principles of the Tier 3 reporting requirements as referenced in Appendix B. The Board considered that disclosure requirements in AASB 1060 should act as 'the cap' for possible Tier 3 disclosure requirements, except as necessary to acknowledge differences between Tier 2 recognition and measurement requirements, to ensure internal integrity and consistency of Tier 3 requirements. The Board was persuaded to its views, noting:

(a) stakeholder feedback from its preliminary targeted outreach support that the proposed disclosure approach would enable appropriate disclosure requirements to be developed for Tier 3 reporting requirements; and

(b) the proposed approach complements the proposed Tier 3 recognition and measurement requirements. It accords the Board with the flexibility to develop fit-for-purpose disclosures requirements based on comparable international pronouncements or frameworks with comparable recognition and measurement requirements.

6.8 The Board acknowledged that its proposed approach would inevitably lead to some departure from the disclosure requirements of Tier 1 and Tier 2 general purpose financial statements. However, the Board considered that its decisions are made within the boundaries of the agreed Tier 3 objectives and will result in consistent Tier 3 requirements. The Board noted that its further deliberations on any final Tier 3 requirements, including simplifications to the Tier 2 disclosure requirements will be informed by common users' needs. These needs will be balanced with the cost to preparers. The Board seeks to obtain further information on these considerations through comments to this Discussion Paper and related outreach activities.

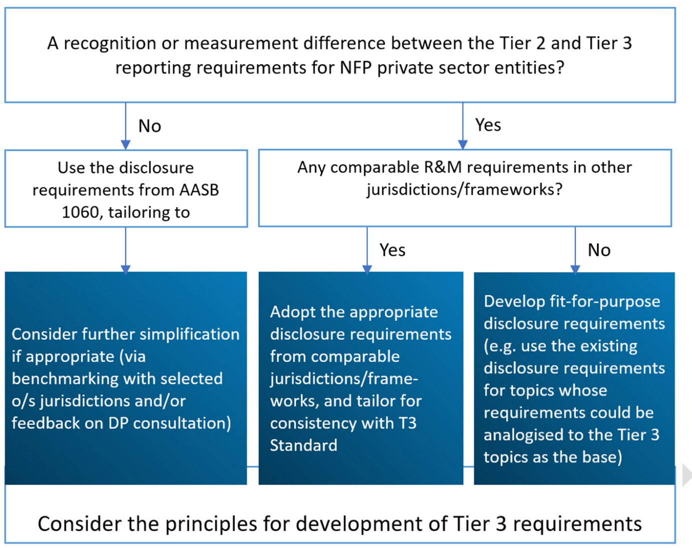
6.9 The Board also considered an alternative approach adopting the 'bottom up' approach similarly used to develop AASB 1060 as noted in paragraph 6.3 above. This would require the Board to identify the appropriate reporting framework as the base that is proportionate for entities within the size and nature of the Tier 3 reporting requirements. The Board did not pursue this approach, noting that:

(a) challenges in identifying an appropriate base from which to build the Tier 3 disclosure requirements given the proposed recognition and measurement of the Tier 3 reporting requirement were developed considering pronouncements of different jurisdictions; and

(b) it may present unnecessary complexity to apply disclosure requirements where practitioners may be unfamiliar with other international pronouncements.

6.10 Figure 6.1 presents the approach to developing Tier 3 disclosure requirements as described in paragraphs 6.5 – 6.6.

Figure 6.1: Approach to developing Tier 3 disclosure requirements



6.11 The following section presents the proposed disclosure approach applied to some of the Tier 3 reporting requirements, including Property, Plant and Equipment and Investment Property (referred to in paragraphs 5.142 – 5.151), Leases (referred to in paragraphs 5.171 – 5.181) and Changes in Accounting Policies and Accounting Errors (referred to in paragraphs 5.62 – 5.68) above.

Example of disclosures for property, plant and equipment and investment property

6.12 Table 6.1 below summarises the application of the Board's preliminary view on the disclosure approach to property, plant and equipment and investment property. The example below Table 6.1 illustrates disclosure requirements resulting from the respective approaches identified in Table 6.1.

Table 6.1: Evaluation of the proposed disclosures for property, plant and equipment and investment property

	Is there any recognition and measurement difference between Tier 3 and upper tiers?	Is there a jurisdiction or framework with comparable recognition or measurement requirements?	Approach to developing disclosure requirements
Initial measurement of non-financial assets acquired for significantly less than fair value	Yes – Tier 3 reporting requirements allow entities an accounting policy choice to apply either the cost model or the fair value model in accordance with AASB 13.	Unique to Tier 3, however, similar to the current requirement measuring right-of-use (ROU) assets arising under concessionary leases at cost in AASB 16.	Develop fit-for-purpose disclosures using the current disclosure requirements in AASB 1060 for right-of-use (ROU) assets arising under concessionary leases as the base.
Subsequent measurement requirements for investment	No recognition or measurement difference between Tier 3 and current requirements in	Not applicable	Adopt disclosure requirements in AASB 1060 as a starting point with minor tailoring to align terms and languages with Tier 3

	Is there any recognition and measurement difference between Tier 3 and upper tiers?	Is there a jurisdiction or framework with comparable recognition or measurement requirements?	Approach to developing disclosure requirements
property and property, plant and equipment other than the initial measurement of non-financial assets acquired for significantly less than fair value	AASB 140 and AASB 116		reporting requirements and update cross-reference with applicable paragraphs in the Tier 3 Standard. The Board will consider whether further simplification is required.
Borrowing costs	Yes – Tier 3 reporting requirements require all borrowing costs to be expensed in the period incurred.	Yes – IFRS for SMEs Standard	Adopting the applicable requirements in IFRS for SMEs Standard, which is not to have any specific disclosure requirements for borrowing costs.

Example – disclosure requirements for property, plant and equipment and investment property

Non-financial assets acquired for significantly less than fair value

1 When a not-for-profit entity elects to measure a class or classes of non-financial assets acquired for significantly less than fair value to further its objective at initial recognition at cost in accordance with paragraphs [X] of, the entity shall disclose information that helps users of financial statements to assess the entity's dependence on non-financial assets acquired for significantly less than fair value principally to enable the entity to further its objectives.

2 The disclosures provided by a not-for-profit entity in accordance with paragraph [X] shall be provided individually for each material non-financial assets acquired for significantly less than fair value principally to enable the entity to further its objectives or in aggregate for non-financial assets of a similar nature. An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics.

[Based on AASB 1060 paragraphs 151–152]

Property, Plant and Equipment and Investment Property at Cost

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

(a) the measurement bases used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the reporting period; and

(e) a reconciliation of the carrying amount at the beginning and end of the reporting period, showing separately:

- (i) additions;
- (ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with paragraph [X] and other disposals;
- (iii) acquisitions through business combinations;
- (iv) increases or decreases resulting from revaluations under paragraph XX and from impairment losses recognised or reversed in other comprehensive income in accordance with paragraph [X] *Impairment of Assets*;

(v) transfers to and from investment property carried at fair value through profit or loss (see paragraph [X] *Investment Property*);

(vi) impairment losses recognised or reversed in profit or loss in accordance with paragraph [X];

(vii) depreciation; and

(viii) other changes.

This reconciliation need not be presented for prior periods.

[*Based on AASB 1060 paragraph 134*]

2 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 liabilities;

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

(c) if an 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.

[*Based on AASB 1060 paragraph 135*]

3 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;

(b) whether an independent valuer was involved;

(c) the methods and significant assumptions applied in estimating the items' fair values; and

(d) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to owners/members (if any).

[*Based on AASB 1060 paragraph 136*]

Example of disclosures for leases

6.13 Table 6.2 below summarises the application of the Board's preliminary view on the disclosure approach to the leases. The example below Table 6.2 illustrates disclosure requirements resulting from the respective approaches identified in Table 6.2.

Table 6.2: Evaluation of the proposed disclosures for leases

	Is there any recognition and measurement difference between Tier 3 and upper tiers?	Is there a jurisdiction or framework with comparable recognition or measurement requirements	Approach to developing disclosure requirements
Lessee	Yes – Proposed Tier 3 R&M requirements are similar to reporting requirements for operating leases in AASB 117 Leases and lessees are not required to recognise ROU assets.	Recognition: NZ PBE SFR-A (NFP), where all leases are treated the same. Measurement: similar to accounting for operating leases in UK FRS 102, UK FRS 105, UK Charities SORP, Singapore CAS, HK SME-FRF & SME-FRS, Canada ASNPFO.	Adopt the disclosure requirements for operating leases in *IFRS for SMEs* Standard, which is same as the disclosure requirements in AASB 117 for operating leases. The Board considered that Tier 3 entities would be familiar with these pre-AASB 16 disclosure requirements, making the transition easier.
Lessor	All leases are treated in a similar manner to that currently required for leases classified as an 'operating lease'. No further classification (i.e.	N/A	Adopt the current disclosure requirements in AASB 1060 for operating leases and tailor to align terms and language with Tier 3 reporting requirements. No further simplification for disclosures from current AASB

	Is there any recognition and measurement difference between Tier 3 and upper tiers?	Is there a jurisdiction or framework with comparable recognition or measurement requirements	Approach to developing disclosure requirements
	operating versus finance leases) is required. There is no R&M difference between Tier 3 and current operating lease requirements in AASB 16 for lessors.		1060 requirements intended at this stage.

Example – disclosure requirements for leases

Leases – Lessees

1 Lessees shall make the following disclosures for leases:

(a) the total of future minimum lease payments under non-cancellable leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years

(b) lease payments recognised as an expense; and

(c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

[*Based on the IFRS for SMEs Standard paragraph 20.16*]

Leases – Lessors

1 A lessor shall disclose the following for operating leases:

(a) the future lease payments under non-cancellable leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years;

(b) total variable lease payments that do not depend on an index, or a rate, recognised as income; and

(c) a general description of the lessor's significant leasing arrangements, including, for example, information about variable lease payments, renewal or purchase options and escalation clauses and restrictions imposed by lease arrangements.

[*Based on AASB 1060 paragraph 148*]

2 In addition, the requirements for disclosure about assets in accordance with the sections covering of Property, Plant and Equipment and Investment Property at Cost, Intangible Assets other than Goodwill, and Impairment of Assets apply to lessors for assets provided under leases.

[*Based on AASB 1060 paragraph 149*]

Example of disclosures for changes in accounting policies and correction of errors

6.14 Table 6.3 below summarises the application of the Board's preliminary view on the disclosure approach to changes in accounting policies and correction of errors, and the example below Table 6.3 presents the illustration of disclosure requirements resulting from the respective approaches identified in the Table 6.3.

Table 6.3: Evaluation of the proposed disclosures for changes in accounting policies and correction of errors

	Is there any recognition and measurement difference between Tier 3 and upper tiers?	Is there a jurisdiction or framework with comparable recognition or measurement requirements	Approach to developing disclosure requirements
Changes in Accounting policies	Yes – simplification provided to Tier 3. However, the simplification is similar to AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors “impracticable out” from restating comparatives.	None	Develop fit-for-purpose disclosure requirements starting with the current Tier 2 requirements in AASB 1060 and removing non-applicable disclosure requirements. The Board will consider disclosures related to transitional provisions, to be developed after considering stakeholder feedback of its preliminary views.
Correction of errors	Yes – simplification provided to Tier 3.	NZ PBE SFR-A(NFP)	Adopt the applicable disclosure requirements in NZ PBE SFR-A(NFP) (paragraph 212) and adjust for Australian Tier 3-specific circumstances.

Example – disclosure requirements for changes in accounting policies and correction of errors

Disclosure of a change in accounting policy

1 When a voluntary change in accounting policy has an effect on the current period or any prior period, an entity shall disclose the following:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) to the extent practicable, the amount of the adjustment for each financial statement line item affected, shown separately:

(i) for the current period; and

(d) in the aggregate for all affected prior periods.

Financial statements of subsequent periods need not repeat these disclosures.

[*Based on AASB 1060 paragraph 108*]

Disclosure of prior period errors

1 An entity shall disclose the following about prior period errors:

(a) a description of the error, including how the error occurred, and how it was corrected; and

(b) the line items and amounts that have been corrected.

Financial statements of subsequent periods need not repeat these disclosures.

[*Based on NZ PBE SFR-A (NFP) paragraph 212 and AASB 1060 paragraph 110*]

Questions for respondents

Question 47
Paragraphs 6.1 to 6.11 discuss the Board's preliminary view that disclosure requirements for Tier 3 not-for-profit private sector entities should be developed based on the following principle: (a) for transactions where there is a recognition and measurement difference between Tier 3 reporting requirements and Tier 2 general purpose financial statement, Tier 3 reporting requirements will: (i) adopt appropriate disclosure requirements from comparable jurisdictions pronouncements or frameworks if available; or (ii) develop fit-for-purpose disclosure requirements if there are no comparable recognition and measurement requirements from other jurisdictions pronouncements or frameworks. Fit-for-purpose disclosure requirements could be developed based on the disclosure requirements in AASB 1060 where the recognition and measurement requirements could be analogised to the Tier 3 reporting requirements. (b) for transactions where the recognition and measurement requirements for Tier 3 reporting requirements are the same or similar to the corresponding recognition and measurement requirements for Tier 2 general purpose financial statements, the disclosure requirements in AASB 1060 will be used as a starting point with further consideration on simplifications that may be appropriate Do you agree? Why or why not? If you disagree, what alternative approach do you suggest? Please specify and explain why.

Question 48
Paragraph 6.12 discusses the Board's preliminary view on the disclosure requirements for property, plant and equipment including investment property. Do you agree with the Board's preliminary view? Why or why not? If you disagree, do you suggest any alternative disclosure requirements? Please specify and explain why.

Question 49
Paragraphs 6.13 discuss the Board's preliminary view on the disclosure requirements for leases. Do you agree with the Board's preliminary view? Why or why not? If you disagree, do you suggest any alternative disclosure requirements? Please specify and explain why.

Question 50
Paragraph 6.14 discusses the Board's preliminary view on the disclosure requirements for changes in accounting policies and correction of errors. Do you agree with the Board's preliminary view? Why or why not? If you disagree, do you suggest any alternative disclosure requirements? Please specify and explain why.

Appendix A: Comparison of the Board's preliminary views against other reporting requirements

Appendix A provides an overview of the Board's preliminary views for Tier 3 general purpose financial statements compared to the corresponding Tier 2: Australian Accounting Standards – Simplified Disclosures requirements and the New Zealand NZ Accounting Standard *Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)*.

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
Service performance information	N/A	N/A	A statement of service performance must be presented.
Hierarchy approach to the accounting requirements for topics specifically scoped out from Tier 3 Standard (i.e. omitted topics)	The following hierarchy applies to developing an accounting policy for transactions and other events and conditions specifically scoped out of Tier 3 Standard to: • first apply accounting specified by Tier 2: Australian Accounting Standards – Simplified Disclosures; • otherwise, in descending order ○ by reference to the Tier 3 accounting applicable to similar and related transactions or events; and ○ consistency with the Australian conceptual framework to the extent it does not conflict with Tier 3 reporting requirements. In forming an appropriate accounting policy, an entity may also consider Tier 1 or Tier 2 requirements or the most recent pronouncements, of other standard-setting bodies that use a similar conceptual framework, other accounting literature and accepted industry practices, to the extent these do not conflict with Australian Accounting Standards.	The following hierarchy applies to developing an accounting policy, in descending order: • by reference to the [Tier 2] accounting applicable to similar and related issues; and • consistency with the Australian conceptual framework. An entity may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework, other accounting literature and accepted industry practices, to the extent these do not conflict with Australian Accounting Standards.	The following hierarchy applies to developing an accounting policy, in descending order: • by reference to the NZ Tier 3 accounting applicable to similar and related transactions or events; and • consistency with the NZ Public Benefit Entity Conceptual Framework to the extent it does not conflict with NZ Accounting Standard *Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)*. In developing an accounting policy, consideration may be given to relevant NZ Tier 2 accounting requirements dealing with the same, similar, or related transactions or events.
Ability to "opt up" to an alternative accounting policy	The Board has not yet formed a view whether to develop a requirement that would allow entities to "opt up" to an accounting policy permitted by Tier 1 or Tier 2 Australian Accounting Standards for topics addressed in Tier 3 reporting requirements	Not applicable	An entity is allowed to apply an accounting policy specified by a 'higher' reporting Tier, rather than that specified by the NZ Accounting Standard *Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)*

Commented [A67]: Question 20 to Board members
This appendix provides a summary of the Board's preliminary views of the Tier 3 reporting requirements compared to Tier 2 reporting requirements and the New Zealand Tier 3 reporting requirements proposed in its ED as staff think it may enable stakeholders to understand the proposed Tier 3 simplifications without the detail accorded to in Section 5 for each topic. However, the result for inclusion in the DP is duplication of the information and adding length to the DP.
Staff have only provided a comparison to New Zealand Tier 3 reporting requirements has been presented here for Board member consideration, having regard to initial project proposals to align the reporting requirements with the New Zealand accounting standard and the AASB's policy in the harmonisation of Trans-Tasman standard-setting. However, the Board may also wish to consider including a comparison against the reporting requirements for IFRS for SMEs Standards to evaluate the extent of simplification proposed for Tier 3 reporting requirements.

Do Board members want to include a comparison of the IFRS for SMEs Standards in this Appendix?

Do Board members wish to retain Appendix A in the final version of the DP?

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
Primary financial statements	The following financial statements form part of the general purpose financial statements: • statement of financial position • statement of profit or loss and other comprehensive income • statement of cash flows. • Notes to the financial statements The Board has not yet formed a view on whether to require a statement of changes in equity to be presented.	The following financial statements form part of the general purpose financial statements: • statement of financial position • statement of profit or loss and other comprehensive income • statement of changes in equity • statement of cash flows • notes to the financial statements A statement of retained earnings and income may be presented instead of a separate statement of profit or loss and other comprehensive income and statement of changes in equity (conditions apply).	The following financial statements form part of the general purpose financial statements: • statement of financial position • statement of financial performance • statement of cash flows • notes to the financial statements
Presentation of statement of cash flows	Cash flows from operating activities are presented: • using the direct method • separately from other cash flows Investing cash flows do not need to be separately distinguished from financing activity cash flows. The statement of cash flows is otherwise consistent with AASB 107 requirements for this statement.	Cash flows are presented in the statement of cash flows classified as either operating, investing or financing cash flows. Cash flows from operating activities may be presented using either the direct method or the indirect method (reconciliation from net profit).	Cash flows from operating activities are presented: • using the direct method • separately from other cash flows (investing cash flows do not need to be separately distinguished from financing activity cash flows).
Presentation of the statement of financial position and statement of profit or loss and other comprehensive income	As per Tier 2 presentation requirements accompany with guidance.	Tier 2 specifies minimum financial information to be presented on the face of the statement of financial position and statement of profit or loss and other comprehensive income with flexibility to present further information (either in the notes or on the face of the financial statements)	A specify list of line items to be presented on the face of the financial statements with further disaggregation to be made only in the notes to the financial statements.
Consolidation of subsidiaries	An entity can choose whether to prepare only separate financial statements (no subsidiaries are consolidated) or consolidated financial statements (all subsidiaries are consolidated – except if the parent entity is controlled by another Australian entity or an investment entity). Disclosures will be required for entities preparing separate financial statement that would provide users of the financial statements with information about the parent entity's significant relationships.	Consolidated financial statements must be presented. All subsidiaries must be consolidated – except if the parent entity is controlled by another Australian entity (ultimate or any intermediate parent entity) or an investment entity.	Consolidated financial statements must be presented. All subsidiaries must be consolidated – except if the developing parent entity is controlled by another New Zealand entity or an investment entity.

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
Separate financial statements	A parent entity that presents separate financial statements can measure its interest in subsidiaries at either: • cost; or • at fair value through other comprehensive income (FVTOCI); or • using the equity method of accounting	An entity can measure its interest in subsidiaries, joint ventures and associates at either: • cost, • in accordance with IFRS 9 (at fair value through profit or loss (FVTPL) unless it makes an irrevocable election to measure at FVTOCI); or • using the equity method of accounting.	An entity can measure its interest in subsidiaries, joint ventures and associates at either: • cost, • in accordance with IFRS 9 (at fair value through profit or loss (FVTPL) unless it makes an irrevocable election to measure at FVTOCI); or • using the equity method of accounting.
Voluntary changes in accounting policies	Voluntary changes in accounting policies are applied following modified retrospective approach by adjusting the opening balances of the current reporting period for the cumulative effect of the change without amending comparative information.	Voluntary changes in accounting policies are applied retrospectively by adjusting the opening balances of the earliest reporting period unless impracticable, and the comparative period(s), presented in the financial statements for the cumulative effect of the change.	Voluntary changes in accounting policies are applied prospectively from the date of the accounting policy change.
Accounting errors	Material prior period errors are corrected in the period in which they are identified by adjusting opening balances of the financial year without amending comparative information	Material prior period errors are corrected for retrospectively by adjusting the opening balances of the earliest reporting period when the error occurred if practicable, and the comparative period(s), presented in the financial statements.	Material prior period errors are corrected in the period in which they are identified by adjusting opening balances of the financial year.
Basic financial instruments	<u>Initial measurement</u> Basic financial instruments are initially measured at fair value. Transaction costs are expensed immediately. <u>Basic financial assets – subsequent measurement</u> Basic financial assets are measured at cost except for financial assets that are held to generate both income and capital return for the entity. These are measured at FVTOCI. <u>Basic financial liabilities – subsequent measurement</u> Basic financial liabilities are measured at cost. <u>Interest income/expense</u> Interest income and interest expense is calculated by reference to the instrument's contractual interest rate. Any initial premium or discounted is amortised over the expected life of the instrument. <u>Impairment</u> Impairment is recognised when it is probable that the carrying amount will not be collectible. <u>Derecognition</u>	<u>Initial measurement</u> Under AASB 9 all financial instruments are initially measured at fair value adjusted for, in the case of a financial asset or financial liability not at FVTPL, transaction cost. <u>Classification</u> Financial assets and financial liabilities are classified into specified categories. Some financial instruments that meet the definition of a financial liability are classified as equity. The component parts of a compound financial instrument are separately recognised and measured. <u>Financial assets – subsequent measurement</u> Financial assets meeting both a business model test and solely payments of principal and interest ('SPPI') test are subsequently measured at amortised cost using the effective interest method. A financial asset that meets both a business model test (including selling financial assets) and SPPI test or is a qualifying equity	<u>Option to opt up</u> An entity is allowed to apply an accounting policy specified by a 'higher' reporting Tier, rather than that specified by the NZ Accounting Standard *Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)* <u>Initial measurement</u> Financial instruments are initially measured at transaction price. <u>Classification</u> N/A <u>Financial assets – subsequent measurement</u> A specified list of financial assets including debtors and investments are subsequently measured at original carrying amount less impairment. <u>Financial liabilities – subsequent measurement</u> A specified list of financial liabilities is subsequently measured as follows: for bank overdraft – at the drawn amount; creditors – at initial amount owing less amounts paid/not

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
	For basic financial assets – when either the contractual rights to the cash flows from the financial asset expire or the entity otherwise loss control of the asset For basic financial liabilities – when the obligation is discharged. A modification of the terms of a financial liability or an exchange of financial liabilities is treated as an extinguishment of the original financial liability and recognition of a new financial liability. Hedge accounting Hedge accounting is not permitted.	instrument may be measured at FVTOCI. Other financial assets, including derivatives, are measured at FVTPL. Financial liabilities – subsequent measurement Financial liabilities that are held for trading (including derivatives), or are designated into the category, are measured at FVTPL. In general, other financial liabilities are measured at amortised cost using the effective interest method. Specific requirements apply to financial instruments such as financial guarantee contracts. Financial guarantee contracts are measured at higher of the expected credit loss allowance and the instrument's fair value less any income subsequently recognised. Interest income/expense Interest income and expenses are calculated based on the effective interest method. Impairment Impairment is recognised based on an expected credit loss model that requires impairment loss to be calculated using a probability-weighted estimate of credit losses over the expected life of the financial instrument. Derecognition A financial asset is derecognised when either the contractual rights to the cash flows from the financial asset expire or the financial asset is transferred. Criteria applies to determining when a financial asset is transferred in a manner that qualifies for derecognition; including whether the entity has any continuing involvement in the transferred financial asset. A financial liability is derecognised when the obligation is discharged, cancelled or expires. Some modifications or exchanges of financial liabilities are not treated as a derecognition of the original financial liability. Hedge accounting Hedge accounting is permitted. Conditions apply. Embedded derivative	owed; loans – at outstanding principal plus unpaid interest. Interest income/expense Interest income and interest expense is calculated by reference to the contractual interest rate. Impairment If it appears that the carrying amount of a debtor or an investment will not be recovered, the financial asset is written down to the amount collectible/ current market price. Derecognition Financial assets are derecognised when the asset has been sold/amounts have been collected or written off. Hedge accounting Hedge accounting is not permitted (unless the entity opts-up).
Other financial instruments	In general, an entity is required to apply AASB 9 to other (more complex) financial instruments. Hedge accounting Hedge accounting is not permitted. Embedded derivatives An embedded derivative is not separately recognised.		

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
		Certain embedded derivatives must be separately recognised and measured.	
Fair value measurement	As per Tier 2	Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. AASB 13 establishes a fair value hierarchy categorising into three levels the inputs to valuation techniques to allow an entity to measure fair value that is appropriate in the circumstances by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.	Fair value is the amount for an arm's length transaction if it takes place between two willing parties in the market. An entity can elect to measure assets based on the current value rather than applying Tier 1 and Tier 2 PBE requirements to determine fair value, unless an entity opts up. Based on the proposals in ED 2022-5 – *Tier 3 (NFP) Standard Exposure Draft Reporting Requirements for Tier 3 Not-for-profit Entities* for classes of property, plant and equipment, current value is based on a valuation by a suitably qualified independent valuer, or for land and buildings, a local council rateable value. For publicly traded investments, its current value is current market price.
Inventory	As per the AASB Tier 2 requirement except Tier 3 will not address how to account for the reversal of any previously recognised write-downs of inventories to net-realisable value or for a loss of service potential.	Inventory is measured at the lower of cost and net realisable value and inventories held for distribution is measured at cost, adjusted for impairment where applicable for any loss of service potential. An entity is required to assess whether there is any indication of an impairment loss that no longer exist. A reversal of impairment loss is recognised immediately in profit or loss unless the asset is carried at a revalued amount in accordance with another Standard in which the reversal is treated as a revaluation increase.	Inventory is recorded at the lower of cost and selling price for goods for sale, and goods for use or distribution is measured at cost, adjusted where applicable for any impairment charges such as when inventory ages, future customer would not pay as much for the inventory, stock obsolescence and inventory is less valuable to service recipients. An entity is required to reverse an impairment charge when there is an indication that an impairment charge recorded in the prior period may no longer exist or may have decreased.
Investment in associates and joint arrangements	A parent entity that presents consolidated financial statements or an entity that is not a parent entity applies the equity method of accounting as per Tier 2 recognition and measurement requirements. An entity that is a parent entity that presents separate financial statements as its only financial statements does not apply the equity method of accounting to measure its associates and joint ventures. An entity can only apply cost or FVTOCI for the accounting for interest in associates and joint ventures.	Unless the investor presents separate financial statements as its only set of financial statements, then interests in associates and joint ventures are measured using the equity method of accounting in an investor's financial statements. Investor. An Investor that presents separate financial statements as its only set of financial statements may apply the accounting policy described under Separate Financial Statements	Unless the investor presents separate financial statements as its only set of financial statements, then interests in associates and joint ventures are measured using the equity method of accounting in an investor's financial statements. Investor. An Investor that presents separate financial statements as its only set of financial statements may apply the accounting policy described under Separate Financial Statements

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
Property, plant and equipment	Same as Tier 2 recognition and measurement requirements, however the directly attributable costs of acquiring or constructing property, plant and equipment do not include any borrowing costs. Borrowing costs that are a directly attributable cost of a qualifying asset are expensed as incurred.	Property, plant and equipment is measured at cost or on the revaluation basis, less any accumulated depreciation and accumulated impairment (discussed later in this table). 'Cost' includes the directly attributable costs of bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.	Property, plant and equipment is measured at cost, less any accumulated depreciation and accumulated impairment.
Investment property	Same as Tier 2 recognition and measurement requirements, however the directly attributable costs of acquiring or constructing investment property do not include any borrowing costs. Borrowing costs that are a directly attributable cost of a qualifying asset are expensed as incurred.	Investment property is measured at cost (less any accumulated depreciation and accumulated impairment) or on the fair value basis.	Investment property is treated the same as requirements for property, plant and equipment.
Borrowing costs	Borrowing costs are expensed in the period incurred.	Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of the asset. Other borrowing costs are expensed in the period incurred.	Interest charged on borrowings is expensed in the period incurred.
Non-financial assets acquired at significantly less than fair value (donated non-financial assets)	An entity can choose to initially measure: • inventory at cost or current replacement cost; and • other non-financial assets at cost or at fair value in accordance with AASB 13 Income is recognised at the amount the asset was initially measured (i.e. either at cost or fair value of the asset).	Non-financial assets acquired at significantly less than fair value is initially measured at fair value in accordance with AASB 13. Income is recognised at the amount the asset was initially measured (i.e. at fair value of the asset).	Significant donated assets including inventory with useful lives of 12 months or more are measured at readily obtainable current value such as rateable or government valuations. Significant donated assets that are difficult to value (such as intangible assets, highly specialised assets and heritage assets) and other asset with useful life of less than 12 months are not recognised.
Impairment of non-financial assets	Same as AASB 136 requirement regarding the impairment of inventory. For other non-financial assets - only assets subsequently measured at cost or deemed cost are subject to impairment testing. Assets are only impaired when: 1) physically damaged; or 2) service potential might have been adversely affected by a change in the entity's strategy or changes in external demands of the entity's services. Measurement of impairment as per AASB 136 except Tier 3 reporting requirements will	An entity is required to determine whether there is an indication that an asset is impaired, or the asset is one that is required to be tested for impairment annually. The asset is impaired if its carrying amount exceeds the recoverable amount (i.e. the higher of its fair value less cost of disposals and its value in use), with the difference recognised as an impairment loss. If the impairment loss no longer exists, a reversal of impairment loss is recognised immediately in profit or loss unless the asset is carried at a revalued amount in accordance with another	Specific examples of when to record impairment are provided, including: • debtors – when it is likely that the amount owed (or some portion) will not be collected. The loss is recorded as a bad debt. • prepayments – if the entity is unlikely to get the service it has paid for. • Inventories: goods for sale – write-down to lower of cost and selling price. Goods for use or distribution – write-down if the value to the entity decrease; • Property, plant and equipment: assets to be

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
	include a rebuttable presumption that fair value less costs of disposal is expected to be the most appropriate measure of an asset's recoverable amount. Tier 3 will not address how to account for the reversal of any previously recognised impairment losses.	Standard in which the reversal is treated as a revaluation increase.	sold – if the market price for an equivalent asset falls below the carrying amount of the asset. Assets to be used - if the value to the entity in using the asset falls below the carrying amount of the asset. • Investments – if it appears that the carrying amount of the investment will not be recovered, it shall be written down to the current market price; • Other assets – if it appears that the asset will not be recovered. Limited guidance is provided to determine recoverable amount. An impairment charge shall be reverse for all or part of that impairment charge if there is any indication that the impairment charge no longer exists or may have decreased.
Leases	A lessee (lessor) recognises the lease payments (receipts) associated with the leasing arrangement as an expense (income) on a straight-line basis over the term of the agreement, unless another systematic basis is representative of the time pattern of the consumption by the entity of the asset's benefit	A lessee recognises a right-of-use asset and lease liability for leases other than for short-term leases and leases of low-value assets. For short-term leases and leases of low-value assets, the lease payments associated with the leasing arrangement are recognised as an expense on a straight-line basis over the lease term (or another systematic basis – conditions apply). A lessor classifies a lease as either a finance lease or operating lease. The lessor in a finance lease derecognises the underlying asset and recognises in its place a lease receivable measured at its net investment in the lease. The lessor in an operating lease recognises lease payments as income on a straight-line basis (or another systematic basis – conditions apply).	A lessee recognises an expense when the cost is incurred. A lessor recognises lease receipts as income on a straight-line basis over the term of the agreement unless another systematic basis is representative of the time pattern of the user's benefit.
Revenue/ Income	Income is deferred when there is a common understanding, evidenced by the transfer provider in writing or some other form, that the entity is expected to use the inflows of resources in a particular way or act or perform in a particular way that results in outflows of resources. Income is recognised in a manner that most faithfully represents the amount and	NFP entities are required to comply with AASB 15 and AASB 1058 when accounting for revenue and income. An entity is required to identify and assess the performance obligation for the goods or services promised to transfer to the customer, and recognises revenue when (or as) the entity satisfies the performance obligation when the promised goods or services is transferred. For transactions where the consideration to	Based on the proposals in ED 2022-5 – *Tier 3 (NFP) Standard Exposure Draft Reporting Requirements for Tier 3 Not-for-profit Entities*, revenue from significant donations, grants bequest and pledges are deferred when there are documented expectations that is specific enough, and agreed upon by both parties about how or when the funds received will be used. Revenue is recognised when the expectation over use is

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
	pattern of consumption by the entity of the resources received. For all other income transactions, income to be recognised at the earlier of receiving cash or cash receivable.	acquire an asset is significantly less than fair value, principally to enable an entity to further its objects, income (except for those scoped out of AASB 1058 such as share-based payments) would be recognised immediately upon recognising an inflow of an asset except to the extent that the entity has an enforceable obligation to use a transferred financial asset to acquire or construct a recognisable non-financial asset to be controlled by the entity.	satisfied, either at a point in time or over a period of time. Revenue from commercial activities such as sales of goods or provision of services are recognised when the goods are sold or by reference to the stage of completion of the services provided at balance date
Volunteer service	Same as Tier 2 requirement	An entity can elect to recognise volunteer service, or a class therefore of, at fair value provided that fair value of those service can be measured reliably	Donated volunteer services are not recognised.
Employee benefits	Employee benefits are recognised as an expense when the employee has rendered the services entitling them to compensation. Outstanding employee benefit obligations are recognised as a current liability, measured at the undiscounted amount of the expected future outflow required to settle the obligation.	Employee benefits are categorised as short-term, post-employment, other long-term and termination benefits. They may also be share-based payments. Different accounting requirements apply to each category. However, in general: • an expense is recognised when the employee has rendered the services entitling them to compensation; • amounts not expected to be settled within 12 months are discounted, even if the obligation is classified as a current liability; and • the probability that an outflow of economic resources is required must be considered in measuring an employee benefit liability.	Wages, salaries and superannuation contributions are recognised as an expense as staff provide the services that give rise to the entitlement. Bonuses are recognised as an expense when the employee is notified that the bonus has been granted. Employee costs payable (e.g. leave entitlements) are recognised as a liability, measured at the amount to be paid.
Approach to disclosure requirements	For transactions with the same or similar recognition and measurement requirements to Tier 2, disclosure requirements to be based on the corresponding requirements in AASB 1060. For transactions with different recognition and measurement requirements to Tier 2, disclosure requirements will adopt appropriate disclosure requirements from other jurisdictions that are comparable to Tier 3 recognition and measurement requirements or develop specific disclosure requirements in the absence of appropriate international precedents	Disclosure requirements were developed based on a bottom-up approach starting from the *IFRS for SMEs* Standard where disclosures in *IFRS for SMEs* Standards are retained for transactions with the same or similar recognition and measurement requirements to IFRS Standards. Disclosures in *IFRS for SMEs* Standards were removed where the recognition and measurement requirements or options in the *IFRS for SMEs* Standard are not available in full IFRS Standards. Where the recognition and measurement in full IFRS Standards were significantly different from those in *IFRS for SMEs* Standards or certain topics are not addressed	Disclosure requirements were developed based on a top-down approach where new disclosures are developed starting from public benefit entity standards and removing or simplifying the disclosure requirements not applicable to New Zealand Tier 3 entities.

Topic	AASB Tier 3 preliminary views	AASB Tier 2 requirement	Reporting requirements for New Zealand Tier 3 not-for-profit entities
		in the IFRS for SMEs Standards, disclosure may be added.	

Appendix B: Framework for developing Tier 3 reporting requirements

Commented [A68]: **Note for Board members:** The text in this section has been largely drawn from M180 Agenda Paper 3.3, M180 Agenda Paper 3.3.1 and AASB Action Alert No.207, and the Board's discussions at its 20-21 April 2021 meeting.

Principles for the Board's decision-making

B1 In developing AASB 1053 *Application of Tiers of Australian Accounting Standards* (which introduced Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements), the Board applied 'user needs' and 'cost/benefit' considerations to identify the extent to which disclosure requirements applicable to Tier 1 entities should be relaxed for Tier 2. 'User needs' and 'cost/benefit' considerations were also implicit in the development of the simplified disclosures in AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*. Similarly, such considerations were also applied by the IASB to determine the less onerous recognition and measurement requirements of the IASB's *IFRS for SMEs*. Accordingly, the Board similarly decided its proposals on Tier 3 accounting requirements should be developed, considering 'user needs' and 'cost/benefit' as overarching principles.

B2 The Board observed that developing reporting requirements considering a set of principles will provide robustness to its decision-making on this project. As part of its consideration of user needs and cost/benefit considerations, the Board decided to consider the following principles:

(a) the development of Tier 3 reporting requirements is subject to the AASB's *Not-for-Profit Entity Standard-Setting Framework*;

(b) Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of the financial statements;

(c) consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable, but might not always be warranted, since Tier 3 requirements are being developed as a proportionate response to the costs incurred by certain entities whilst still meeting the needs of users of the financial statements for this cohort of entities. For example, opportunities for deviation from Tier 2 accounting principles that could give a similar outcome to users while reflecting an appropriate cost/benefit balance could include disclosure requirements instead of a Tier 2 measurement requirement or an approach of specifying minimum 'prescriptive' disclosures;

(d) where possible within the context of its conceptual framework and user needs and cost/benefit considerations, in developing accounting requirements the aim is to maximise leveraging information that management uses to make decisions about the entity's operations; and

(e) the accounting requirement does not impose disproportionate costs to preparers, when compared to benefits of that information.

B3 The Board has also formed a preliminary view that its work on the extent of Tier 3 reporting requirements will consider balances and transactions commonly undertaken by not-for-profit private sector entities with revenues between $500,000 and $3 million. Such size indication, adopted only for practicality reasons on consideration of the wide breadth in possible boundaries, provides the Board with an indicative boundary for identifying common transactions and forming views on requirements applying to Tier 3 financial statements. Consistent with the Board's preliminary view described in Section 1, it is not intended to identify or limit the entities that might prepare Tier 3 general purpose financial statements in the future.

AASB Not-for-Profit Entity Standard-Setting Framework

B4 The AASB Not-for-Profit Entity Standard-Setting Framework is predicated on two assumptions:

(a) that IFRS Standards are appropriate as a base for developing Australian accounting standards; and

(b) that like transactions and events should be accounted for in a like manner by all types of entities, reflecting their economic substance, unless there is a justifiable reason not to do.

B5 Consequently, the *Not-for-Profit Entity Standard-Setting Framework* states that modifications to IFRS requirements are justified only where necessary to address:

(a) Australian-specific legislation, user needs or public interest issues relevant to financial reporting or other external reporting;

(b) issues specific to the not-for-profit sector of such prevalence and magnitude that the objectives and qualitative characteristics of financial reporting as set out in the Australian conceptual framework would not be met; or

(c) undue cost or effort considerations.

B6 The Board considers that its preliminary views resulting in modifications to IFRS requirements set out in this Discussion Paper are consistent with its *Not-for-Profit Entity Standard-Setting Framework* because:

(a) existing requirements impose costs or require effort by preparers that might not be proportionate to the entity's significance and extent of operation;

(b) the user needs of unsophisticated users may be better met by accounting requirements that may not depict economic reality as closely as Tier 1 accounting requirements, but still provide a relevant and faithfully representative depiction of the entity that is easier for these users to understand; and/or

(c) the Board's actions are consistent with other government red tape reduction initiatives to reduce the financial reporting burden for entities.

Tier 3 general purpose financial statements

B7 The decision that the financial statements presented in accordance with Tier 3 reporting requirements are general purpose financial statements has the following implications:

(a) as the role of general purpose financial statements is to provide both information about an entity's past performance as well as information that allows users to assess the entity's prospects for future cash flows, 'Tier 3 general purpose financial statements' should provide information to users beyond that offered by a strict historical cost/cash bookkeeping exercise. That is, an entity preparing financial statements that comply with Tier 3 reporting requirements will be required to present financial information that goes beyond a simple record of transactions offered by, for example, a statement of cash flows or listing of payables and receivables;

(b) information that is arguably necessary to demonstrate discharge of management's stewardship of an entity may be excluded from Tier 3 general purpose financial statements where such information is not used by users for making resource allocation decisions. Such information may be regarded as not being useful financial information, as the Conceptual Framework links useful information about management's stewardship of the entity to its ability to help users in making decisions relating to providing resources to the entity.

B8 The Board observes that its preliminary views are formed considering the resultant financial statements being sufficient to satisfy the needs of users of the financial statements of the entity. However, those needs may be satisfied in potentially a different manner to general purpose financial statements complying with Tier 1 or Tier 2 reporting requirements.

Consistency with Tier 2 accounting principles

B9 The Board decided to maximise consistency with Tier 2 accounting principles where possible, bearing in mind its objectives in developing a further differential reporting tier. Maintaining consistency across reporting Tiers of classification, recognition and measurement requirements to the extent possible is important:

(a) because various articles of legislation classify entities into groupings based on financial thresholds calculated in accordance with accounting standards. The Board observed it would be undesirable if the requirements resulted in an outcome where an entity would be classified into a grouping (e.g. ‘large’) based on compliance with Tier 1 reporting requirements, but a different grouping (e.g. ‘small’) based on compliance with Tier 3 reporting requirements, as this introduces uncertainty for preparers, auditors and regulators;

(b) to facilitate the preparation of financial statements of mixed groups (e.g. not-for-profit groups where which the parent entity prepares consolidated Tier 1 or Tier 2 financial statements or for-profit consolidated entities that include a not-for-profit private sector entity subsidiary); and

(c) to limit education and knowledge transfer costs.

Appendix C: Alternative accounting policies considered and rejected

The table below summarises accounting policies considered and rejected by the Board, and the Board's rationale for doing so.

Topic	Accounting policy considered but rejected	Rationale
Consolidation of subsidiaries	The Board considered whether an entity should be permitted to consolidate some, but not all, its subsidiaries.	The Board recognised that part of the hesitation to consolidate is because some not-for-profit entities consider that they do not have 'real' control over another entity. Consequently, the parent entity is concerned that the resultant consolidated financial statements may provide a "misleading" view of its performance and financial position. However, the Board considers that it is conceptually inappropriate for an entity to be able to 'pick and choose' subsidiaries to consolidate. The Board was also not inclined to depart from the concept of control as widely understood under existing Australian Accounting Standards. The Board observed that the concerns expressed by stakeholders are general to the not-for-profit sector. Consequently, the Board noted that the avenue for raising, and any address of, these concerns is as part of its Post-Implementation Review of Appendix E of AASB 10 *Consolidated Financial Statements*. For the reasons above, the Board rejected this possible accounting policy.
Accounting policies	The Board considered whether to require a voluntary change in accounting policies to be accounted for prospectively.	The Board acknowledged that accounting for a voluntary change in accounting policy on a prospective basis is likely to more closely reflect that users and preparers may not "use" adjusted prior year amounts for their resource allocation decisions. However, the Board was concerned that accounting for a change in accounting policy prospectively would misrepresent the current period's results. This could impact financing, or inadvertently change the extent of the entity's reporting obligations through a once-off change to the entity's revenues or expenses. For this reason, the Board rejected this possible accounting policy.
Accounting errors	The Board considered whether to require an accounting error to be accounted for prospectively.	The Board acknowledged that accounting for the error retrospectively may hide the error from users of the financial statements. However, the Board was concerned that accounting for the error prospectively could misrepresent the current period's results, in addition to the misrepresentation in the period of the error. For this reason, the Board rejected this possible accounting policy.
Leases	The Board considered whether to require a lessee and lessor to measure the lease expense or lease income at the amount of the periodic payment made.	The Board observed that this approach is straightforward to apply, and arguably also provides users with relevant information as the benefits of a rental holiday or other lease incentive is reflected in the period the benefit is provided. However, lease incentives and variable lease payments are unlikely to be common in shorter term lease arrangements, and consequently, the result is likely to be the same as measurement on a straight-line basis. Noting the above, the Board thinks that the cost saving between the two approaches considered is unlikely to be of such significance that it should adopt an approach where the timing of lease payments may not necessarily represent the time pattern of the lessee's consumption of the value of the leased asset.

Commented [A69]: Question 21 to the Board members:
Appendix C summaries the alternative accounting policies considered and rejected, including the Board's rationale for doing so. Staff have not yet finalised this Appendix. The remaining topics for this Appendix will be completed subject to the Board's feedback on whether to retain Appendix C as part of the DP bearing in mind the alternative approaches would also be documented in each topic in Section 5. As such, the result for inclusion in the DP is duplicating the information and adding length to the DP.

Do Board members wish to retain Appendix C in a final version of the draft DP?

Topic	Accounting policy considered but rejected	Rationale
		For this reason, the Board rejected this possible accounting policy.

[This table will be added to following discussions on a topic, subject to Board feedback about the section]

Page 6: [1] Commented [A5] **Author**

Question 4 to Board members:

Do Board members agree with the staff recommendation to describe Tier 3 reporting requirements in the Discussion Paper as Tier 3: Australian Accounting Standards – Simplified Accounting?

Background, staff analysis and recommendation

Staff presented several options for identifying the Tier 3 reporting requirements at the February 2022 AASB meeting (refer to M185 Agenda Paper 11.1). The Board did not decide on the name of Tier 3 Standard in that meeting. The options were:

Option A: Tier 3 Australian Accounting Standards – Simplified Accounting. This description is consistent with describing Tier 2 – reporting requirements as 'Simplified Disclosures'.

Option B: Tier 3 Australian Accounting Standards – Simplified Accounting (Not-for-Profit Private Sector Entities). This identifies the entities the Standard is intended for and will help distinguish from any future development of possible Tier 3 reporting requirements for public sector entities. However, such labelling is inconsistent with existing Australian Accounting Standards that do not include their limited application in their titles, such as AASB 8 *Operating Segments* and 1004 *Contributions*.

Option C: Tier 3 Australian Accounting Standards – Less Complex Entities. This corresponds to the description given by the International Auditing and Assurance Standards Board in respect of its proposed auditing standard.

Option D: Tier 3 Australian Accounting Standards – Small and Medium-Sized Entities. This acknowledges the size of the entities for which the reporting Tier is being developed and provides a 'link' to IFRS as the basis for Australian accounting standard-setting.

However, the reference to "small" entities may be confusing for some stakeholders. As such, an alternative is for this descriptor to omit the term 'small' to convey that Tier 1 and Tier 2 general purpose financial statements may be more appropriate for larger NFP private sector entities.

Option E: Tier 3 Australian Accounting Standards – Simplified Accounting for Smaller Not-for-Profit Entities. This maintains consistency with the Tier 2 descriptor as well as identifies the intended user group.

Staff recommended identifying the Tier 3 reporting requirements as Tier 3 Australian Accounting Standards – Simplified Accounting (**Option A**), as reflected in the present DP drafting. At the February 2022 meeting, the Board did not vote on an agreed descriptor, but made the following comments:

1. That the length of the descriptor should be shorter, if possible.

Staff response, August 2022: The proposed title is consistent with the description given to Tier 1: Australian Accounting Standards and Tier 2: Australian Accounting Standards – Simplified Disclosures in AASB 1053. Staff think it is to further shorten the Tier 3 descriptor without changing the naming convention applied to the other reporting tiers. For this reason, staff propose no change to the suggested descriptor in this regard.

2. That the descriptor should, for preference, include a NFP identifier.

Staff response, August 2022: Having regard to the Board comment about minimising the descriptor length, staff propose that the Tier 3 descriptor continue to exclude a reference to the entities it would apply to. This would also retain consistency with the naming convention applied to other AASB pronouncements (e.g. *Conceptual Framework for Financial Reporting*).

Staff note that the identification of the reporting tier as Tier 3: Australian Accounting Standards – Simplified Accounting is different to the title that might be given to the proposed stand-alone Tier 3 pronouncement.

For example, to be consistent with AASB 1060, if Tier 3 reporting requirements were contained in an AASB 10XX accounting standard, it might be titled AASB 10XX *General Purpose Financial Statements – Simplified Accounting for Not-for-Profit Private Sector Entities*. Alternatively, if it were issued as a separate pronouncement in the style of the *IFRS for SMEs* or NZ Tier 3 reporting requirements, it might be simply titled *Simplified Accounting for Not-for-Profit Private Sector Entities*, even if the reporting Tier 3 were described in AASB 1053 as 'Tier 3: Australian Accounting Standards – Simplified Accounting'.

This Discussion Paper does not suggest a title for the proposed stand-alone Tier 3 pronouncement. This is because the Board is, as part of this DP, seeking feedback on its proposal to develop Tier 3 accounting requirements in this form. Consequently, staff have not sought a Board view in this regard.

Page 74: [2] Commented [A57] Author

<u>Question 17 to Board members:</u>

NFP panel members provided feedback at the May 2022 NFP Panel meeting that the Board's proposals for the initial recognition and subsequent measurement requirements of non-financial assets acquired for significantly less than fair value could result in an accounting arbitrage (refer to panel meeting minutes in Agenda Paper 12.4 at the June 2022 Board meeting). This accounting arbitrage could occur where an entity elects to initially measure donated non-financial assets at cost with no impact to the profit or loss for the period and elect to subsequently measure the donated non-financial asset under the revaluation model with the revaluation difference recognised in other comprehensive income and accumulated equity under the revaluation reserve.
This could result in:

(a) the accounting policy choices accorded to initial measurement and subsequent measurement may result in the arbitrage when the difference is recognised:
   i) in profit or loss at fair value on initial measurement; or
   ii) as other comprehensive income at fair value on subsequent measurement. Additionally, the potential to record the initial measurement of donated assets at cost and subsequently elect to fair value the donated assets allow the entity to not recognise the income of the donated assets and ultimately not impact the size of the entity for reporting purposes;

(b) different accounting outcomes depend on whether the asset's carrying amount is measured at the revaluation difference between the asset's fair value or at cost at initial measurement, and its fair value at subsequent measurement. The latter approach appears to undervalue the asset on the balance sheet substantially; and

(c) where an entity is required to measure revaluation differences between the asset's fair value at initial and subsequent measurement, it may be impracticable to obtain the fair value of the donated assets retrospectively in determining the revaluation difference if an entity elects to measure the asset at cost initially.

Staff consider it necessary to clarify circumstances when an entity can elect to measure donated assets initially at cost and subsequently to revalue the asset.

Option A) Not permitting entities that initially measure donated assets at cost, to elect the revaluation/fair value model for subsequent measurement [staff preferred option]. Whilst this option may appear to limit the accounting policy option for subsequent measurement for entities that elect the cost model for initial measurement. However, staff think that smaller entities will unlikely apply the revaluation model for subsequent measurement, therefore the impact of not permitting revaluation should be minimal, and eliminates the potential accounting arbitrage noted above.

Option B) Requiring an entity to obtain the fair value of the donated asset on initial measurement if the entity elects to measure the asset at cost initially. This will enable the entity to determine the revaluation difference if an entity elects to subsequently revalue the donated asset. If the entity subsequently revalues the donated asset the revaluation difference should be determined based on the difference between the asset's fair value on initial measurement and its fair value on subsequent measurement. This option will still result in the accounting arbitrage as noted above and may not be considered to simplify the accounting requirements given entities are required to obtain the fair value of the asset on initial measurement. The carrying amount of the asset would substantially be undervalued.

Option C) Not requiring an entity to obtain the fair value of the donated asset on initial measurement If an entity elects to measure an asset at cost initially. If the entity subsequently revalues the donated asset, the revaluation difference should be determined based on the cost of the asset on initial measurement and its fair value on subsequent measurement. This option will still result in the potential accounting arbitrage noted above. However, it enables management to continue to apply an accounting policy choice that leverages information management uses and the carrying amount of the donated asset would not be substantially undervalued compared to Option B.

Staff view is Option A, to not permit an entity to apply the revaluation/fair value model for subsequent measurement if an entity initially elects to measure donated assets at cost.

Do Board members support the staff view (i.e. Option A)? If not, which approach do Board members support?