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Dr Keith Kendall
Chair
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Our ref Submission - Tier 3 Discussion Paper
Contact Heng, Kim (+61 2 9455 9120)

31 March 2023

Dear Dr Kendall

Discussion Paper – Development of Simplified Accounting Requirements (Tier 3 Not-For-Profit Private Sector Entities)

KPMG Australia (KPMG) is pleased to have the opportunity to comment on *Discussion Paper – Development of Simplified Accounting Requirements (Tier 3 Not-for-Profit Private Sector Entities)* (the "Discussion Paper"). We recognise many smaller not-for-profit (NFP) entities have limited resources and the compliance costs are relatively high given their sizes and nature. Therefore, we welcome the AASB's efforts to develop a differential reporting tier for use by smaller NFP entities that improves the balance of cost-benefit, and meets the needs of the users of their financial statements.

We broadly support the proposals, as set out in the Discussion Paper. We support the objective of reducing the financial reporting burden for smaller NFP entities. We do, however, have some concerns about the AASB's approach to recognition, measurement and disclosures as they could require this sector to develop new accounting policies.

We have set out our detailed comments to select questions in the Appendix to this letter. Where we have no response to specific questions they have not been reproduced in the Appendix.

We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact Julie Locke on (02) 6248 1190, or myself on (02) 9455 9120.

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Yours sincerely

Kim Heng
Partner
KPMG Australia

KPMG

Appendix

Part A: Extending the differential reporting framework

We support the AASB's extension of the *Conceptual Framework for Financial Reporting* to all NFP private sector entities, the resulting alignment of the use of the term "reporting entity" with its use internationally, and consequent superseding of the definition of "reporting entity" in SAC 1 *Definition of the Reporting Entity*.

Whilst the extension of Australian Accounting Standards (AAS) to a broader set of NFP private sector entities will remove their ability to prepare special purpose financial statements ("SPFS"), the new Tier 3 reporting requirements with its simplified reporting requirements is a further differential reporting tier which could alleviate much of the burden of not being able to prepare SPFS. We therefore agree with the Board's view to align the timing of any new Tier 3 reporting requirements with the timing of such extension.

We agree with the Board's proposal to introduce a new third simpler reporting tier for NFP private sector entities that are required to prepare financial statements complying with AAS. We support the proposal to specify Tier 3 reporting requirements in a single stand-alone accounting standard.

We agree with the Board's view to not develop a fourth tier of accounting for NFP private sector entities. Including our proposals in the remainder of this Appendix, the proposed Tier 3 reporting requirements appear to adequately deal with simplifications for the cohort proposed. We are of the view that any cost would outweigh the benefit of developing or maintaining a fourth tier of accounting.

1. ***Paragraphs 1.3 to 1.8 discuss the Board's view that it should not develop 'reporting thresholds' to specify which reporting Tier that a not-for-profit private sector entity must, at a minimum, comply with in preparing financial statements.***

   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?

   We agree with the Board's view that it should not develop "reporting thresholds" to specify which reporting Tier to apply. We agree the AASB's remit is to develop standards for the application of Tiers of Australian Accounting Standards to different categories of entities preparing financial statements, while legislative or regulatory authorities set out the requirements for whether entities need to prepare financial statements that comply with AAS.

   We understand 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 the

Invitation to Comment – Discussion Paper – Development of Simplified Accounting Requirements (Tier 3 Not-For-Profit Private Sector Entities)

purpose of the Discussion Paper. Without advocating a particular threshold, we received feedback from stakeholders suggesting the proposed simplifications under Tier 3 would provide significant relief for entities with similar less complex transactions and events but with an even higher revenue threshold should the regulator resolve to specify thresholds higher than those the AASB used as a reference point

2. ***Paragraphs 1.9 to 1.11 discuss the Board's view that it does not intend to develop proposals for reporting service performance information as part of this project.***

   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?

   We agree that service performance reporting information proposals should not be developed as part of this project. We are pleased the AASB is reactivating its project on service performance reporting and encourage the AASB to progress this project as a priority given the benefits to users of reporting service performance in the NFP sector.

Part B: Proposed Tier 3 reporting requirements

10. ***As discussed in paragraphs 4.10 to 4.14, Tier 3 not-for-profit private sector entities can opt-up to Tier 1 or Tier 2 reporting requirement in its entirety. However, the Board has not yet formed a view on whether it should restrict the range of accounting policies available to an entity preparing Tier-3-compliant financial statements.***

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

    (a) transactions, events and circumstances covered in the Tier 3 reporting requirements that are specifically permitted by the Board only; or

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

    Do you agree? Why or why not? Please explain your answer.

    We agree with the Board's view in (b) that an entity preparing Tier-3-compliant financial statements should have the ability to opt up to an accounting policy permitted or required by Tier 1 or Tier 2 for all transactions, events and circumstances covered by a particular AAS (e.g. opt up for *all* financial instruments rather than for different types financial instruments or for elements of the financial instruments standards), regardless of whether they are covered in the Tier 3 reporting requirements.

We believe flexibility to opt up to Tier 1 or Tier 2 should be provided to entities provided that an accounting policy is applied on a consistent basis for all transactions, events and circumstances in the same class and clear disclosure of the accounting policy applied. We have heard from stakeholders that consistency and comparability among this cohort of NFP entities is less relevant.

11. Paragraphs 4.15 to 4.20 discuss the Board's preliminary view on the transactions and other events and conditions that may not be covered in a Tier 3 Standard. The types of items the Board intends to scope out from the Tier 3 Standard include:

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

(b) insurance contracts issued, reinsurance contracts held, 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.

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?

We strongly recommend business combinations be included in the scope of the Tier 3 Standard. In our experience, it is not uncommon for the NFP entities to engage in business combinations – often amalgamating or merging. We believe that specific guidance on how to account for such arrangements could result in more consistent accounting for these types of arrangements. Given the challenges of measuring fair value in the NFP sector, we would recommend the AASB propose a simplified approach to that required by AASB 3 *Business Combinations.*

17. Paragraph 5.34 to 5.47 discusses the Board's preliminary view to allow an entity to present either:

(a) separate financial statements as its only financial statements, even if it has subsidiaries, however, require information on the parent's significant relationships; or

(b) consolidated financial statements consolidating all its controlled entities.

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

We agree with the Board's view to allow an entity the choice of presenting consolidated financial statements or separate financial statements with information on the parent's significant relationships.

Should this approach be proposed, we urge the AASB to clearly define what is meant by "significant relationship" and to provide guidance on how to assess what is a significant relationship.

23. Paragraphs 5.81 to 5.82 discuss the Board's preliminary view that an entity preparing Tier 3-compliant financial statements will not have access to hedge accounting.

Do you agree? Why or why not? Please specify and explain why. Are you aware if smaller not-for-profit private sector entities use hedge accounting?

Whilst under current requirements hedge accounting by smaller NFP entities is not common we do not agree with the Board's view that an entity preparing Tier 3-compliant financial statements should not have access to hedge accounting.

Hedge accounting under Tier 1 and Tier 2 is an accounting policy choice. We recommend the Board allow smaller NFP entities the same an accounting choice, albeit we expect this will not be a common circumstance. Continuing to allow smaller NFPs this accounting policy choice is consistent with the objective of simplifying financial statement preparations as smaller NFP entities can choose to not apply hedge accounting. Given as an accounting community we have accepted inconsistency in regard to hedge accounting more generally, we do not consider a lack of consistency amongst smaller NFP entities to be a persuasive rationale for disallowing the application of hedge accounting among this cohort.

24. Paragraphs 5.83 to 5.85 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 prefer other alternatives? Please specify and explain why.

The Board's preliminary view on immediate expensing of transaction costs and fee incurred by smaller NFP entities to acquire a financial asset or assume a financial liability is different from the current Tier 1 and Tier 2 reporting requirements. We have no comment from an application perspective. Whilst simplifying recognition and measurement, we are uncertain if smaller NFP entities will welcome this proposal as it will negatively impact the net result of the year of acquisition. In this regard, we re-iterate our view in Part B Question 10 of the importance of allowing smaller NFP entities to opt up to higher Tiers for all transactions, events and circumstances, regardless of whether they are covered in the Tier 3 reporting requirements.

26. ***Paragraphs 5.105 to 5.108 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 prefer other alternatives? Please specify and explain why.

We agree with the Board's preliminary view to develop a requirement for an impairment loss on basic financial assets measured at cost to be measured at the anticipated uncollectible amount.

We are aware that some NFP entities currently account for the impairment loss for financial assets based on the incurred loss model for management reporting purposes. The expected credit loss model comes with a level of complexity relative to the simple nature and smaller size of such NFP's operations. In our experience. the incurred loss model is more relatable to NFP business models with less judgement involved and achieves an appropriate cost-benefit.

41. ***Paragraphs 5.168 to 5.178 discuss the Board's preliminary view on accounting requirements for leases, including:***

(a) requiring 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 similar requirement would apply for lessors;

(b) concessionary lease arrangements ('peppercorn' leases) would be accounted for in the same manner as other leases; and

(c) not including specific requirements for sale and lease back transactions, or for 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) concerns you the most? Do you prefer that Tier 3 accounting requirements should be consistent with AASB 16 Leases? Please explain why.

To the best of your knowledge, are sale and lease back transactions common for smaller not-for-profit private sector entities?

We agree with the Board's preliminary view on requiring a lessee/lessor to recognise lease payments/receipts as an expense/income 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.

We understand that some NFP entities account for leases using the old leases standard, AASB 117 *Leases*, for management reporting purposes and adjust for AASB 16 *Leases* when preparing statutory financial statements. This would indicate the proposed method of accounting for leases reflects what information is important to the decision makers of the entity. We agree the disclosures of an entity's lease commitments will provide necessary information to compensate the needs of the users of the financial statements.

In our experience, sale and lease back transactions are not common for smaller NFP private sector entities.

42. Paragraphs 5.179 to 5.188 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 5.186? Please specify and explain why.

We agree with the Board's view to develop a simpler approach to income recognition for smaller NFP entities. We agree with the approach that income is recognised in the manner that most faithfully represents the amount and pattern of consumption by the entity of the resources received and for all other income transactions, income is recognised at the earlier of receiving cash or obtaining a right to receive cash.

We have heard concerns on the "mismatch" of income and expenses in which income is recognised in one financial year and expenses incurred in subsequent financial years under the requirements of AASB 1058. The proposed income recognition for Tier 3 reporting requirements would provide a more "matching" view of an entity's financial performance and reflect the actual operation of an entity – which provides useful information to the users of the financial statements of smaller NFP entities, e.g. management and the grantor and achieves an appropriate cost-benefit.

However, we do have concerns regarding what is meant by the words "some other form" ("*evidenced by the transfer provider in writing or* ***some other form***"). Should this approach be proposed, we strongly recommend the AASB provide further guidance and examples to clarify what this means in practice.