Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Private Sector Financial Reporting Framework**	**Meeting:**	M181
Topic:	**Setting of Tier 3 reporting requirements in the context of Australian Accounting Standards**	**Agenda Item:**	3.2
		Date:	7 June 2021
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		Decision-Making:	High
		Project Status:	Initial deliberations

Objective of this paper

1 The objective of this staff paper is for the Board to decide its views in respect of Tier 3 reporting requirements for not-for-profit (NFP) private sector entities for the purposes of the NFP Financial Reporting Framework (NFP FRF) discussion paper (DP) on:

(a) the setting of the Tier 3 reporting requirements in the context of Australian Accounting Standards (AASB Standards; AAS) to provide indication of the approach to related aspects such as:

- terminology and definitions;
- extent of cross references to other AASB Standards;
- application guidance and template financial statements; and
- maintenance policy.

(b) application of accounting policies on topics omitted in Tier 3 requirements and ability to apply requirements of other standards for a class of transactions and to the financial statements in their entirety.

Background

2 At its 20-21 February 2021 meeting, the Board agreed to develop a further reporting Tier (Tier 3) for application by not-for-profit (NFP) private sector entities. Tier 3 is intended to be a proportionate response for application by certain (but not all) NFP private sector entities that are currently preparing special purpose financial statements (SPFS) on the basis that the entity is not a reporting entity as defined in SAC 1 *Definition of the Reporting Entity*. In addition, this reporting Tier might be applied by some (but not all) NFP private sector entities that are currently preparing Tier 1 or Tier 2 general purpose financial statements.

3 At its 20-21 April 2021 meeting, the Board decided on the principles against which it will form its views on Tier 3 accounting requirements, for inclusion in a DP. *The Not-for-Profit Private Sector Financial Reporting Framework Project Summary* provides the details of those agreed principles.

4 This staff paper is one of a series of staff papers to assist the Board in forming its preliminary views on detailed aspects of the Tier 3 reporting requirements outlined in paragraph 1 above, for inclusion in the DP. Developing preliminary views on these matters will enable the Board to

obtain useful feedback to inform the Board as to whether the proposed approach is supported and should be further developed into an Exposure Draft.

Reasons for bringing this paper to the Board

5 Staff consider it is important for the Board to form a view on the overarching approach to the design of Tier 3 reporting requirements to support the development of the proposals for the DP including consideration of the setting of the Tier 3 possible future requirements within the context of AAS, based on the feedback from the targeted staff outreach conducted between August – October 2020 and from a recent AASB NFP Project Advisory Panel meeting, with stakeholders putting emphasis on the user-friendliness of the possible future requirements, as well as having regard to the importance of the overarching approach to the setting of the Tier 3 reporting requirements on the direction for the staff when developing future staff papers for the Board's considerations on the topics to be included in the DP (outlined in Agenda item 3.1).

6 This staff paper summarises aspects of the pronouncements (see paragraph 14) applied by selected other jurisdictions that as useful reference points to assist the Board based on the feedback from stakeholders to assist the Board in assessing the proposals for the DP:

(a) whether Tier 3 requirements should be presented as a stand-alone accounting pronouncement or in some other format and to consider other aspects such as the inclusion of cross-references to other AASB Standards and the approach to the maintenance of the Tier 3 requirements; and

(b) how Tier 3 requirements will be applied, including the ability of the entities in scope to apply the requirements of other AASB Standards.

Structure of this paper

7 This staff paper is set out as follows:

(a) Summary of staff recommendations (paragraph 8)

(b) Overview of reviewed aspects of the pronouncements adopted in selected other jurisdictions (paragraph 9 – 14)

(c) Setting of Tier 3 in the context of Australian Accounting Standards (paragraph 15 – 24)

(d) Application of accounting policies for omitted topics and ability to apply requirements of other standards for a class of transactions (paragraphs 25 – 43)

(e) Appendix A: Summary of reviewed aspects of the pronouncements for smaller/NFP entities in selected other jurisdictions.

Summary of staff recommendations

8 Staff recommend proposing the following in respect of Tier 3 reporting requirements in a DP for public comment:

(a) Tier 3 requirements will be developed as a single stand-alone pronouncement.

(b) Tier 3 single stand-alone pronouncements will include:

- simplified language with terminology tailored to NFP entities. It would also have its own glossary (if required);

- minimal cross-references to requirements of an existing AASB standards;

- maintenance cycle in accordance with the AASB Due Process Framework and post-implementation review requirements, i.e. Tier 3 would only need to be updated periodically or when the requirements of the NFP Standard Setting Framework are met such as evidence of undue widespread and significant diversity in accounting practices;

- a separate basis of conclusion setting how the Board reached its conclusion in developing the Tier 3 reporting requirements;

- application guidance and template financial statements.

(c) Following hierarchy approach will apply for entities when determining an appropriate method of accounting for the topic or transaction where Tier 3 requirements do not provide guidance:

- Apply the Tier 3 principles and requirements dealing with similar and related transactions or events;

- Have regards to the definitions and concepts in the applicable conceptual framework to the extent that they do not conflict with Tier 3 requirements;

- Permit (but not require) entities to elect to use the requirements of a higher tier for a specific type of transaction as long as the entity applies that same requirement to all transactions of that type.

(d) Entities applying Tier 3 requirements will be able to adopt AASB Tier 1/Tier 2 requirements for a class of transactions as long as that option is applied consistently to the class of transaction (in addition to any specific permissions to apply Tier 1/Tier 2 requirements for accounting topics the Board will deliberate at future meetings).

(e) Entities applying Tier 3 requirements will be allowed to apply the requirements of Tier 1/Tier 2 in full when preparing the general purpose financial statements.

Overview of reviewed aspects of the pronouncements adopted in selected other jurisdictions

9 For the purposes of assessing how Tier 3 requirements may fit within the context of AASB Standards (i.e. whether it is a stand-alone accounting pronouncement or some other format), staff considered the following aspects and how they are applied in the pronouncements of selected other jurisdictions that were identified as suitable reference points by staff (see Agenda paper 3.1). Table 1 *Comparison of the selected aspects of pronouncements for smaller/NFP entities by jurisdiction* below provides a high-level overview of the following aspects by jurisdiction:

(a) Stand-alone pronouncement – whether a pronouncement is a stand-alone standard or single document applicable to smaller entities or presented in other form.

(b) Cross-references - whether the pronouncement contains cross-references to the requirements of a higher tier(s). Cross-references could be necessary if the standard does not provide enough guidance (or omits particular topic) and requires or allows application of requirements of a higher tier instead.

(c) Conceptual framework – whether the pronouncement includes its own conceptual framework that is different to one applied by a higher reporting tier.

(d) Application of pronouncement including the ability to apply the requirements of a higher tier – the approach applied for transactions or other events that are not addressed within the pronouncement ('omitted topics') or for an accounting policy that is not presented in the topic included in the pronouncement, including:

(i) whether entities are able to make an accounting policy choice to adopt the requirements of a higher tier for a class of transactions; or

(ii) whether entities are able to adopt the requirements of a higher tier in respective of their standards/pronouncements only if they step up to the requirements of the higher tier in their entirety (i.e. apply the higher tier requirements in full).

(e) Maintenance – the frequency of the pronouncement's review and update and any linkage to the amendments to higher tier of the financial reporting requirements.

(f) Glossary of terms and terminology – whether the pronouncement uses simplified language when compared to a higher tier and whether terminology used in the pronouncement were adapted for NFP sector.

(g) Application guidance – whether the pronouncement contains mandatory application guidance that has the same authority as the standard or whether the guidance is voluntary.

(h) Template financial statements – whether the pronouncement provides example template financial statements within the pronouncement.

(i) Basis for conclusion – whether the pronouncement contains its own basis of conclusion outlining matters considered in developing the standard/pronouncement.

10 AASB Staff Paper: *Comparison of Standards for Smaller Entities* (Small Entities Comparison Paper) considered the requirements of a number of pronouncements across various jurisdictions applicable to smaller entities and NFP entities. AASB Research Report 5: *Financial Reporting Requirements Applicable to Charities* also made comparisons of the several selected international jurisdictions financial reporting requirements to those applicable to charities in Australia.

11 Appendix A Summary of reviewed aspects of the pronouncements for smaller/NFP entities in selected other jurisdictions. The following pronouncements are considered in this paper (following the approach outlined in Agenda paper 3.1, Appendix B).:

(a) *IFRS for SMEs*, United Kingdom's Financial Reporting Standards FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* (FRS 102), *Accounting and Reporting by Charities: Statement of Recommended Practice* (Charities SORP) and New Zealand's *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)* (NZ Tier 3) - these standards/pronouncements were previously considered in the Small Entities Comparison Paper by the AASB staff due to their applicability to smaller entities or NFP entities.

(b) Canada's *Part III Accounting Standards for Not-for-profit Organisations* (Canada ASNFPO), Singapore's *Charities Accounting Standard* (Singapore CAS), Hong Kong's *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standards* (HK SME-FRF & SME-FRS) - these standards/pronouncements were previously considered in Research Report 5 due to their applicability to charities.

(c) United States *Accounting Standards Codification Not-for-Profit Topic 958* (US ASC NFP 958). This standard has not been included in the AASB literature mentioned above, however staff consider it a relevant reference source as it contains NFP specific accounting standards that non-governmental organisations are required to apply in the United States (US). US has been one of the jurisdictions used as a comparison with Australia in terms of financial reporting issues in the past AASB research and therefore staff have included their NFP requirements to ensure a more comprehensive view is provided to the Board.

Staff also note that some standards/pronouncements referred above do not contain NFP-specific guidance (e.g., *HK SME-FRF* & *HK SME-FRS* and *IFRS for SMEs*) and the scope is not directly comparable to expected application scope of Tier 3 (e.g. size of the entities in the scope may not be comparable to the one the Board indicated at its Board meeting for the purposes of the development of Tier 3 requirements).

12 Staff have also considered whether the jurisdictions noted in paragraph 11 contain any aspects in regard to a standardised chart of accounts (i.e. similar to the National Standard Chart of Accounts (NSCOA) designed for charities and not-for profit organisations in Australia containing a data dictionary for charities and other NFP entities which all Australian governments (Commonwealth, state and territory) have agreed to accept requesting information from NFP). Staff noted that some jurisdictions provide template financial statements or a glossary. As such staff did not include analysis of this aspect in this staff paper, however will consider the definitions provided in the NSCOA when analysing possible Tier 3 requirements further, for example, when considering disclosure principles.

13 In addition, staff have considered the following information when assessing possible setting of Tier 3 requirements in the context of the AASB standards:

(a) information from other research papers including AASB Research Report 16 *Financial Reporting By Non-Corporate or Small Entities*, AASB Research Report 10 *Legislative and Regulatory Financial Reporting Requirements*, University of Adelaide research on '*Are Accounting Standards Understandable*' presented at the 2020 AASB Research Forum;

(b) the manner in which the NFP modifications to AAS are made currently under AASB's *Not-for-Profit Entity Standard-setting Framework;*

(c) feedback received from the members of Not-for-Profit Project Advisory Panel meeting held in May 2021 (Agenda paper 3.4 in supplementary folder); and

(d) feedback from preliminary targeted outreach presented to the Board at the September 2020 Board meeting. [1]

1 Agenda paper 5.1 *Summary of initial targeted consultation and key matters identified* (AASB Board meeting, September 2020)

Table 1 Comparison of the selected aspects of pronouncements for smaller/NFP entities by jurisdiction

Aspects		IFRS for SMES	FRS 102	Charities SORP	NZ Tier 3	Canada ASNFPO	Singapore CAS	Hong Kong SME FRF and FRS[2]	United States ASC NFP 958
Stand-alone pronouncement		✓	✓	✓	✓	×	✓	✓	× [3]
Cross-referencing		Minimal	✓	✓(to FRS 102)	Some	✓	×	×	✓
Conceptual framework within pronouncement		✓	✓	×	×	×	×	✓	×
Ability to apply requirements of other standards	For a class of transactions	✓(only for omitted topics)	✓(or where specified)	✓(for omitted topics and where permitted)	✓	✓(only for omitted topics)	✓(only for omitted topics)	×	✓(only for omitted topics)
	Whole of F/S	✓	✓	×	✓	✓	✓	not stated	×(NFP must apply this standard and other codification but not GASB or FASB in full)
Maintenance cycle		No more frequently than 3 years	Every 3 years	Annual review	Post Implementation Review	Annual or Biennial basis	Not specified (not updated since introduction in 2011)	Not specified but revisions made with updates to legislation	Amendments or annual review for urgent matters
Glossary of terms/Simplified or NFP-specific terminology		✓	✓	✓	✓	✓	✓	×	✓(for NFP topics only)
Application guidance		✓	✓	✓	✓(some)	✓(some)	×	×	✓
Template financial statements		×	×	✓(mandatory)	✓(optional)	×	✓(mandatory)	✓(optional)	✓(optional)
Basis of conclusion		✓	✓	✓	✓	✓	×	×	✓

2 The Hong Kong Company Ordinance (CO) permits private companies and companies limited by guarantee to take advantage of a "reporting exemption" if they meet certain qualifying criteria in section 359 of the CO, which includes the exemption from the requirement for the financial statements to give a true and fair view. Instead the financial statements prepared by entities can be prepared in accordance with the SME-FRF and SME-FRS. SME-FRF and SME-FRS require consistency with historical cost convention.

3 This standard contains some NFP topics in a single standard but NFP entities will also need to apply topics and subtopics outside of the FASB ASC NFP 958 unless the exemptions are provided within those topics/subtopics.

14 Table 1 considers how each of the aspects outlined in paragraph 9 are applied by each of the pronouncements listed in paragraph 11 above. Staff noted the following:

(a) The majority of pronouncements examined are contained in a separate standard or document with minimal cross-references to other/full suite of standards. Requirements in Canada and the US were the exceptions as neither are stand-alone standards. Instead, they contain only some NFP topics and NFP entities are required to apply standards applicable to for-profit entities for the topics not covered.

(b) Both Canada and the US pronouncements include the most cross-references to other standards to address relevant topics not considered within their respective pronouncements. This is not surprising as mentioned above, neither Canada and US are stand-alone standards and they do not contain all NFP requirements within their standards. The Singapore and Hong Kong pronouncements do not include any cross-references to other standards, while *IFRS for SMEs* and NZ Tier 3 contained minimal cross-references. Staff noted that although FRS 102 is originally based on *IFRSs for SMEs* it includes cross-references to full IFRS for some topics such as IFRS 8 *Operating Segments,* IFRS 9 *Financial Instruments* and IFRS 2 *Share-based payments* rather than including the relevant requirements directly in FRS 102. Similarly, the Charities SORP includes cross-references to FRS 102. Based on the jurisdictional analysis, staff identified the following circumstances where cross-references may apply:

(i) a section of the pronouncement does not provide enough guidance on the topic (or topic is explicitly omitted);
(ii) the pronouncement requires application of the requirements of the higher tier; or
(iii) the definition or term is already used or defined in another higher tier standard.

(c) Several pronouncements do not have their own conceptual framework but a number of them have, such as HK *SME-FRF* and *SME-FRS*, *IFRS for SMEs* and FRS 102 (and consequently Charities SORP which supplements FRS 102). These pronouncements were developed to reflect the differences in the types of entities and the needs of the users of SME entities' financial statements, [4] as well as limitations in, and the cost of, the accounting expertise available to these entities. Although NZ Tier 3 and Singapore CAS are both stand-alone standards, they make references to the conceptual framework which the standards are derived from (i.e. NZ *Public Benefit Entities' Conceptual Framework* and Singapore's *Financial Reporting Standards*). In summary, in surveyed jurisdictions a stand-alone standard either applies its own conceptual framework or it refers to an existing conceptual framework.

(d) The majority of jurisdictions allowed entities to apply the requirements of a higher tier either for a class of transaction or in its entirety, with three pronouncements (i.e. FRS 102, Canada ASNFPO and NZ Tier 3) permitting entities to apply the requirements of a higher tier by a class of transactions and/or in its entirety, recognising the diversity within the sector in which the requirements were developed for. *IFRS for SMEs*, Singapore CAS and HK SME-FRF and SME-FRS do not permit entities to apply the requirements of a higher tier for a class of transactions for topics included in their pronouncement on the basis that it will hinder comparability between entities. FRS 102 specifies when an entity must adopt the requirements of a higher tier for certain topics. UK Charities SORP provides guidance on how to apply FRS 102 to charities' financial statements and it should be noted that in the hierarchy approach established in accounting standards, FRS

4 The *IFRS for SMEs* was developed for small and medium sized entities and non-publicly accountable entities. SMEs do not have public accountability and publish general purpose financial statements (GPFS) for external users, e.g. users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

102 requirements and legal requirements take precedence over the SORP (para.3 of Charities SORP). While US NFP entities must only apply the US ASC NFP 958 standard for the topics included and for topics not covered to follow the Codification, they cannot apply the Governmental Accounting Standards Board or Financial Accounting Standards Board Standards in full. Staff noted that both Charities SORP and US ASC NFP 958 are agnostic of tiers of reporting and provide the mandatory reporting requirements/guidance for NFPs. Based on the above, staff consider the following circumstances could give rise to the application of the requirements of a higher tier (further discussed in paragraph 25-43):

(i) Omitted topics – if requiring entities to apply the requirements of a higher tier for a class of transactions following a hierarchy approach
(ii) Topics included in Tier 3:
  - Permitting to apply requirements of a higher tier for a class of transactions
  - Permitting to apply requirements of a higher tier only for specified topics covered by Tier 3 (i.e. not omitted) but not allowing for others
  - Not permitting to apply higher tier for any of the topics covered
(iii) Permitting or not to apply higher tier requirements in their entirety

(e) Four of the five stand-alone standard/pronouncements (*IFRS for SMEs*, FRS 102, Charity SORP and NZ Tier 3) have a specified timeframe for when the pronouncement is reviewed. This is either at its post implementation review or not more frequently than three years, whereas the UK Charities SORP is reviewed annually. Staff noted that some small changes have been made to NZ Tier 3 since its issue, however the NZASB has not made significant changes to allow time for entities to become familiar with the requirements and reduce the cost of compliance for smaller entities. The Singapore CAS and HK SME-FRF and SME-FRS do not specify the frequency, however the HK SME-FRF and SME-FRS is revised with changes to legislation. In contrast Canada ASNFPO[5] and US ASC NFP 958 are generally updated on an annual basis given both standards only provide some NFP reporting requirements within the existing suite of standards. Based on this review, it appears a stand-alone standard would generally have a specified time frame on which it is reviewed, and this would be a longer period compared to if the standard was not a stand-alone pronouncement and/or contained significant extent of cross-references to existing standards.

(f) The majority of jurisdictions have developed simplified terminology for use in the requirements. In addition NZ Tier 3, UK Charities SORP, Singapore CAS, Canada ASNFPO and the US ASC NFP 958 have developed specific NFP requirements and guidance, definitions and terminology tailored to the NFP sector. Staff noted that Canada CAS and the US ASC NFP 985 also use consistent terminology to other GAAP standards as NFP entities are also required to apply those standards for topics not included in the NFP sections. Only HK SME-FRF and SME-FRS doesn't appear to have simplified language and terminology and its glossary of terms is consistent with the definitions provided in the full suite of Hong Kong accounting standards (HKFRS). However, there are some departures from HKFRS, most notably inclusions in the smaller entity standard such as

5 BC paragraph 29 of Canada ASNFPO noted that accounting standards for not-for-profit organisations will not be static. The AcSB co-ordinates changes to accounting standards for private enterprises and not-for-profit standards, and plans to update the accounting standards for private enterprises on an annual or biennial basis, with each update potentially consisting of changes to several standards that would all be effective at the same time. The AcSB believes that this bundling of changes will be sensitive to the needs of both private enterprises and not-for-profit organizations.

application of the historical cost convention. Based on the above, there appear to be two options to consider when applying this aspect:

(i) Simplified terminology in the stand-alone pronouncement compared to the one used in existing higher-tier requirements (this is consistent with the *IFRS for SMEs*, NZ Tier 3, UK Charities SORP and Singapore CAS approach)

(ii) Terminology consistent with existing standards adapted to NFP circumstances (this is consistent with the Canada CAS and US ASC 958 approach)

(g) The majority of pronouncements provide mandatory application guidance as well as non-mandatory guidance in form of illustrative examples and template financial statements. Staff noted that Singapore CAS mandates the format of primary financial statements and similarly, UK Charities SORP mandates the structure, format and headings of the Statement of Financial Activity. Based on this analysis, staff identified that most of the compared pronouncements contain application guidance and template financial statements were provided within or accompanying the pronouncements either on a mandatory basis or for illustrative purposes.

(h) The majority of the reviewed pronouncements provide a basis for conclusion documenting the rationale applied in their development. Only HK SME-FRF and SME-FRS does not appear to have a basis of conclusion. Singapore CAS also does not provide a basis for conclusions, however instead it includes the Financial Reporting Framework for Charities Statement of Applicability which provides some information about the implementation of the standard and a Q&A section on the application of the Financial Reporting Standards or Singapore CAS. Staff observed that a basis for conclusion would generally be included within the pronouncement regardless of whether a stand-alone standard or not.

Setting of Tier 3 in the context of Australian Accounting Standards

15 Based on the analysis above and considering how the modifications to for-profit accounting standards are made currently under AASB's *Not-for-Profit Entity Standard-setting Framework* via 'Aus' paragraphs as well as Australian-specific guidance in additional appendices or accompanying materials or via Australian-specific standards, staff have identified two main possible options for a form and setting of Australia Tier 3 requirements for NFP private sector entities in the context of AAS:

(a) Option 1: Single stand-alone pronouncement (see paragraphs 16-19); or

(b) Option 2: 'Aus Tier 3' paragraphs within existing AASB Standards (see paragraphs 20-23).

Further analysis of each option is included in paragraphs 16 to 24. When considering the advantages and disadvantages of each option, staff considered whether it was necessary to discuss possible options for each of the aspects outlined in paragraph 9 above separately. However, the application of some of these aspects are interlinked and some aspects may not be relevant to an option. As such, each option will consider the aspects that staff consider are appropriate to operationalise each of the options, including how they are applied by relevant jurisdiction. Staff observe that similar options have been also identified by IFR4NPO when considering the format of the future guidance while staff acknowledge that the considerations may be different for IFR4NPO being an international guidance.

Option 1: Single stand-alone pronouncement

16 Based on the review of surveyed accounting requirements in **Table 1**, staff developed this option to have the following aspects:

- simplified language with terminology tailored to NFP entities. It would also have its own glossary (if required);
- minimal to no cross-references to requirements of an existing AASB standard;
- maintenance cycle in accordance with the AASB Due Process Framework and post-implementation review requirements, i.e. Tier 3 would only need to be updated periodically or when the requirements of the NFP Standard Setting Framework are met; such as evidence of undue widespread and significant diversity in accounting practices;
- a separate basis of conclusion setting how the Board reached its conclusions in developing the Tier 3 reporting requirements;
- application guidance including illustrative examples and template financial statements.

This approach would achieve that all common NFP topics for Tier 3 entities will be included within the single stand-alone pronouncement with aim to achieve Tier 3 reporting that satisfy needs of the users with balancing of the cost to the preparers.[6] Staff noted that some stand-alone pronouncements (i.e. *IFRS for SMEs* and HK SME-FRF and SME FRSs) contains their own conceptual framework. This Paper does not discuss whether the development of a new conceptual framework[7] is required as this is subject to the outcome of the consultation on any further NFP amendments potentially needed to the Conceptual Framework such as primary users of GPFS and objective of GPFS as decided by the Board at its April meeting for inclusion into the DP. Another consideration then follows whether such amendments (if any) would be incorporated into NFP CF applicable across all reporting tiers or would result in a stand-alone CF included in Tier 3. Staff also noted that the Board adopted approach of a stand-alone pronouncement when developing AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities.*

17 Staff have identified the following advantages of the Tier 3 requirements being a single stand-alone pronouncement with the above aspects:

(a) It facilitates easier application and could result in a more user-friendly document by centralising all the requirements in one location without the need to access separate sections in each or majority of AASB standards. If Tier 3 only addresses the transactions, other events and conditions that are expected to be common for a Tier 3 entity, it could be reduced and simplified without including Tier 1 and 2 requirements that are not expected to be applicable for Tier 3 entities.[8] This would still provide useful information for resource allocation decisions as only transactions that are common to a Tier 3 entity is included and users may not necessarily have the same interest in the information based on Tier 1 or Tier 2 requirements. This option is also more likely to leveraging information that management uses in a more effective way through a more user-friendly

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6 Research Report 16 *Financial Reporting By Non-Corporate or Small Entities* noted in 2008, an Australian Senate Economics Standing Committee inquiry was conducted into the disclosure regimes of charities and NFP entities. A content analysis of the submissions by Palmer (2013) highlighted the importance but also the deficiencies in current NFP reporting, in terms of consistency, efficiency and transparency. There was support for a sector-specific standard, with some relief for smaller NFPs that would find the costs of compliance too high.

7 Research Report 16 *Financial Reporting By Non-Corporate or Small Entities* concluded that there were some consensus in the academic literature about the difficulties applying a conceptual framework targeted at for-profit entities to the reporting of not-for-profit entities.

8 Summary of the feedback from the post-implementation review of the NZ Tier 3 and 4 standards shows that respondents overall found the NZ Tier 3 standard is working well and provides the necessary information for Tier 3 entities to meet their transparency and accountability requirements at the cost they expected. Refer to Agenda item 5 Post-implementation Review of Tier 3 and 4 Standards

document for preparers. It may also benefit auditors, advisors and software companies that develop Tier 3 accounting system packages as they would generally only need to reference single source of the requirements.

(b) It allows simplification of language and terminology including definitions better suited for Tier 3 entities recognising that NFP entities applying Tier 3 may have limited resources or accounting knowledge compared to preparers of Tier 1 or 2 standards. In most jurisdictions (*IFRS for SMEs*, FRS 102, Charities SORP, NZ Tier 3, Canada ASNFPO and Singapore CAS) a glossary of terms provides definitions that are generally simplified and/or contains terminology tailored to NFP entities. Some of the principles agreed by the Board is consistency with Tier 2 principles being desirable but not warranted and not to impose disproportionate costs to preparers, when compared to benefits to users. Simplifying the language and providing terminologies tailored to NFP Tier 3 entities, resulting in relevant and reliable information for Tier 3 users is in line with this principle.

(c) For Tier 3 to be a stand-alone pronouncement, it is desirable to keep cross-references to a minimum. However, staff have identified two circumstances where cross-references may be necessary:

(i) If the Tier 3 standard does not provide sufficient guidance on a particular topic – for example, where it is not possible to develop/include sufficient proportionate guidance on a particular topic that is common for Tier 3 entities. In this case, the Board could instead provide a cross-reference to relevant AASB Standard, if such guidance is determined to be useful to the preparation of the Tier 3 financial statements.[9]

One of the benefits of cross-referencing is that it can minimise the length of a section/topic especially if there is a significant amount of guidance already available in an AASB Standard (e.g. the *Australian Implementation Guidance for not-for-profit entities* in AASB 10 *Consolidated Financial Statements* contains 12 pages of guidance).[10] However, the trade-off is that this will impact the standard being considered a 'stand-alone' pronouncement. This approach also presumes that the language and content in the existing guidance is suitable for Tier 3 entities. Cross-references may also require preparers that have previously prepared SPFS to be familiar with the requirements of a higher tier as well as the requirements in Tier 3 which would be more burdensome.[11] This is further discussed in paragraph 18 below.

(ii) For topics that are omitted from Tier 3 because it was determined to be uncommon, the entity may be required to refer to and apply the requirements of a higher tier. The Board could instead provide cross-references to the accounting policy options of the corresponding AASB Standards instead of providing all accounting policy choices within Tier 3. This will require the Board to determine a

9 In NZ Tier 3 an example of cross-references used is the requirement to apply consolidation which cross-references the requirement to applying PBE IPSAS 35 *Consolidated Financial Statements*.

10 Preliminary feedback from Panel members at the Not-for-profit Project Advisory Panel held in May 2021 considered that one of the objectives of a stand-alone pronouncement should aim for as simple and user-friendly (from a preparer perspective) as possible – for example including definitions within the Tier 3 standard may add to the length of the standard so directing preparers to existing definitions or using technology such as hyperlinks to the definition within the existing AASB standard could be an alternative to including a definition within Tier 3.

11 In the ACNC review of charities' 2019 annual financial information and annual financial reports which reviewed 274 annual financial reports, 81% of medium-sized charities prepared SPFS and 45% of large charities prepared SPFS, (although it acknowledges that only 66% of the sampled charities selected the correct type of financial statements).

hierarchical approach when an entity will look to guidance and apply the requirements of a higher tier. This is discussed in paragraphs 25 to 43 of this staff paper.

(d) This option enables Tier 3 requirements can be maintained (updated) less frequently and therefore would reduce the need for preparers to devote significant resources to understand any new accounting requirements for changes/amendments compared to existing AASB Standards (such as when changes or updates are introduced to IFRS standards). However, as noted in paragraph 17(c), it is necessary to be mindful of the effect of any cross-references may have on a stand-alone Tier 3 standard.

(e) Majority of the members of the NFP Project Advisory Panel supported the option of setting Tier 3 as a separate stand-alone pronouncement noting possible difficulties some preparers may have currently with locating existing 'Aus' paragraphs within AAS. Feedback from previous outreach also indicated general support for stand-alone pronouncement when the initial design proposals were using NZ Tier 3 as a starting point for discussion purposes.[12]

(f) This approach is likely to better enable aspects that are relevant to a stand-alone pronouncement including application guidance, illustrative examples and template financial statements,[13] i.e. if Tier 3 application and guidance were included within the body of an existing AASB Standard, it will increase the length of that standard and may cause confusion to preparers especially if there is already existing application guidance for Tier 1 or Tier 2. Based on the staff analysis of the feedback received from NZ post-implementation review for NZ Tier 3, the overall feedback was that NZ Tier 3 was working well with some of the attributes as "the tier 3 standards covers everything it needs to", "preparing our performance report helps others to better understand our organisations", "the Tier 3 standard is easy to understand and use", "the Tier 3 template is easy to understand and use" and "the cost of using the Tier 3 standards are about what we expected".

18 Staff have identified the following disadvantages of setting Tier 3 as a stand-alone pronouncement:

(a) Subject to how frequent the amendments to existing or new AASB Standards are made, Tier 3 entities may not benefit from applying those changes. For example, the revenue section of *IFRS for SMEs* is based on the old revenue and lease standard (IAS 18 *Revenue* and IAS 17 *Leases*) rather than IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* respectively. Until the *IFRS for SMEs* is amended,[14] any changes that the IASB

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12 See Agenda item 5.1 *Summary of initial targeted consultation and key matters identified* for September 2020 Board meeting

13 Are accounting standards understandable? research presented at the AASB 2020 Research Forum confirmed desire for simplicity from stakeholders and suggested providing of more advance illustrative examples and increased use of flowcharts and other visual aids/templates.

14 The IASB issued a Request for Information for its second comprehensive review of the *IFRS for SMEs* standard in January 2020 to consider how the *IFRS for SMEs* Standard should be updated to take account of full IFRS Standards and amendments not currently incorporated into the *IFRSs for SME* Standards. The IASB tentatively decided at its Board meeting on 24 March 2021 to work towards publishing an exposure draft, proposing amendments to *IFRS for SMEs* Standard for new requirements that are in scope of the Review. Link to current work status: https://www.ifrs.org/projects/work-plan/2019-comprehensive-review-of-the-ifrs-for-smes-standard/#current-stage

may make or propose with respect to full IFRS do not apply to entities applying *IFRS for SMEs*.[15]

(b) Any cross-references to Tier 1/Tier 2, whilst mitigating the disadvantage discussed in (a) directly above, may cause 'version control' issues and can give rise to confusion whether an amendment to a cross-referenced AAS results in automatic change for the entities applying Tier 3 requirements including such cross-reference and even minimal extent of cross-referencing will require Tier 3 preparers (and possibly users) to be familiar with the referenced Tier 1/Tier 2 requirements. [16] This increases complexity of the AAS framework and its maintenance by the AASB.

(c) On the other hand, having simplified language and a NFP glossary of terms may cause inconsistency e.g. if a Tier 2 entity has a definition and a Tier 3 entity has a simplified definition referring to the same element of financial statements or economic phenomena. It may cause complexity should an entity need (e.g. those that are close to a size threshold) or want to move depending on the extent of simplification or differences in terminologies to existing AASB standards. However, given the simplification of the existing standards is implicit with developing Tier 3,[17] this risk can be mitigated through clear delineation of the terms defined in Tier 3 or other tiers as well as possible ability to adopt higher tier's requirements in their entirety (discussed in paragraphs 25 – 43).

19 Tier 3 requirements will form part of the AAS in line with the principles the Board agree that the development of Tier 3 requirements is subject to the *AASB Not-for-Profit Entity Standard-Setting Framework*.

Option 2: Modification of existing AASB Standards via 'Tier 3 Aus Paragraphs'

20 This approach would propose to include 'Tier 3 Aus paragraphs' in existing AASB standards.[18] This approach would not be a separate stand-alone pronouncement. Instead Tier 3 entities would apply the requirements of:

(a) specific Tier 3 modifications (e.g. recognition, measurement, presentation and disclosure reductions, simplifications or other amendments) which would be made by 'Aus Tier 3' paragraphs. In this case, Tier 3 entities would apply the requirements of the 'Aus Tier 3' paragraphs, and

(b) any requirements of Tier 1 or Tier 2 not amended by the 'Aus Tier 3' paragraphs; unless a particular standard or section thereof is excluded (scoped-out) for Tier 3 entities through application paragraphs in existing AAS if not deemed proportionate for Tier 3 entities to

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15 BC 152-154 of IFRS for SMEs states that an entity to choose only either the complete set of full IFRSs or the complete IFRS for SMEs and not to permit SMEs to revert to full IFRSs principle by principle.

16 BC 82 of *IFRS for SMES* noted some of the principal reasons for recommending a stand-alone IFRS standards included the issue of cross-references causing version control issues, causing confusion to which version of pronouncement it applies where changes to full IFRSs are made and the burden it would place on SMEs to continuously monitoring of full IFRS. In BC 34, the IASB concluded to make the final IFRSs for SMEs a stand-alone document (eliminating all but one of the 23 cross-references to full IFRS that was originally proposed in the exposure draft), eliminating most of the complex options and adding guidance on the remaining ones and omitting topics that typical SMEs are not likely to encounter, thereby removing the requirement to cross references to full IFRSs.

17 *"Are accounting standards understandable?"* research concluded that accounting standards are perceived as complex documents that are not easy to read or understand, increasingly too long to navigate especially to those with highly limited resources.

18 This approach is consistent with the approach currently adopted in AASB Standards as Australian-specific paragraphs which are not included in IFRS Standards are identified with the prefix 'Aus' in accordance with AASB standard-setting frameworks.

apply such requirements. Possible approaches for permitting or requiring an entity to apply the requirements of an existing AASB standards is discussed in paragraphs 25-43.

Staff noted that no other reviewed jurisdiction has applied this approach. Staff consider that the analysis below also applies to a variation of this approach where the Tier 3 requirements could be affected through appendices to the relevant Tier 1 and Tier 2 accounting standards and therefore did not analyse such approach separately.

21 This approach will also likely; maintain the same amount of cross-references as currently provided in existing AASB Standards unless Tier 3 modifications exclude sections/paragraphs containing those cross-references, consistent language and terminology used in existing Standards of any Tier 3 modification, and enable better alignment of Tier 3 requirements to amendments made to existing AASB Standards. Application guidance and template financial statements could be provided but will add to the length of each existing AASB Standards. Alternatively, non-mandatory guidance such as illustrative examples and template financial statements could be contained in a separate document(s) to the requirements contained in the standards. This option would most likely apply the Conceptual Framework applicable to Tier 1 and Tier 2 not-for-profit entities (regardless of any specific Tier 3 amendments if applicable).

22 Staff have identified the following advantages to develop 'Aus Tier 3' paragraphs within existing AASB Standards:

(a) If 'Aus Tier 3' paragraphs were not included in a AASB Standard (i.e. because a topic that is common for both NFP and for-profit entities may not necessarily require amendment through 'Aus Tier 3'paragraphs and complies with principles the Board agreed for Tier 3 requirements), the entity would apply the full requirements of the relevant AASB Standard if applicable. This could benefit entities that may be already applying Tier 1 or Tier 2 requirements, however this may hinder the aim for simpler language as noted further in paragraph 23.

(b) Some could argue that this approach supports the transaction neutrality approach in to treat like transactions and events in a like manner for all types of entities. As noted by the Canadian Accounting Standards Board, they decided a stand-alone standard should not be developed for NFP organisations because of the diversity of Canadian NFP organisations and the resultant diversity of users' needs. [19] This approach also reflects the AcSB's position that "…*there should be no differences in accounting between profit-oriented enterprise and not-for-profit organizations when the circumstances and transactions are the same. Other matter that are unique to not-for-profit organizations are included in Part III of the Handbook*."

(c) This option provides the most desirable alignment to Tier 2 principles given the likely increased need for language and terminology to remain consistent with existing AASB Standards to avoid confusion that could arise, for example if the same element of financial statements or economic phenomena is defined differently in the same AASB standard.

(d) This option may make it less complex for amendments to be applied by Tier 3 entities if any changes or updates are introduced to IFRS standards. It will also avoid time lags between possible changes made to Tier 1 and 2 standards with Tier 3, in addition to allowing NFP entities to benefit from those updates.

(e) It may allow a Tier 3 entity for easier transition to a higher tier and enable the transfer of skills between and within the for-profit and NFP sector for preparers/advisors/auditors if

19 Para 11 -17 Basis for Conclusion to Canadian ASNFPO

the language and terminologies remain consistent with existing AASB Standards. NFP Standard Setting Framework (par. 19) aims (amongst other) to obtain the benefits of comparability within and across sectors and facilitate movement of professionals across sectors, and ensure the cost of complying with AAS does not outweigh the benefits.

(f) If a Tier 3 entity prefers to the large extent to apply the requirements of a higher tier, 'Aus Tier 3' paragraphs within existing AASB standards may be more user-friendly approach for such entity.

23 Staff have identified the following disadvantages for developing 'Aus Tier 3' paragraphs within existing AASB Standards:

(a) Tier 3 entities may also need to apply the full AASB standards unless there are specific Tier 3 scope modifications made to the relevant AASB Standard or its sections – which will be more cumbersome as preparers will need to refer to the application of the relevant AASB standard (even if through referring to AASB 1053 *Application of Tiers of Australian Accounting Standards* and AASB 1057 *Application of Australian Accounting Standards*) and apply any 'Aus Tier 3' paragraphs appropriately (similar to current NFP modifications). This approach would also increase the length of existing AASB standards which may create additional undue cost/effort to preparers, outweighing the benefit of the NFP modification made under this option. Adding another series of Tier 3 NFP modifications to existing AASB Standards may also create confusion for all preparers to determine which sections within the AASB Standards are applicable to them, noting that extent of the Tier 3 amendments may be much more prevalent compared to existing NFP modifications and entities currently preparing SPFS (and therefore not necessarily referring to the whole suite of AAS) would need to apply these requirements.

(b) It is expected that preparers of Tier 3 financial statements generally have less resources than preparers of Tier 1 and Tier 2 standards and are unlikely to have staff with in-depth familiarity to consider and apply any changes to Tier 1 and Tier 2 standards that would in turn impact Tier 3 requirements. For this reason, an approach that is not updated too frequently is likely to be preferred for Tier 3 entities to give them period on period consistency and also give them sufficient time to plan for any significant changes.[20] If, as the result, the 'Aus Tier 3' paragraphs within existing standards are not amended, it would result in unnecessary internal inconsistency within AAS.

(c) There may be constraints on the extent of simplifications to the language and terminology that can be made to avoid confusion if the Tier 1 and Tier 2 AASB standards also have different definitions for similar transactions/other events applying to other (non-Tier 3 entities). This approach may also cause confusion to all preparers including those applying Tier 1 and 2 reporting requirements if different terminologies for the same transaction/other event are contained within the same AASB standards. This does not support previous feedback and the Board's intention to develop a simplified standard.

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20 BC 163 of *IFRS for SMEs* noted the feedback to their discussion paper that SMEs do not have internal accounting resources or ability to hire accounting advisers on an ongoing basis, the *IFRS for SMEs* should be updated only periodically, perhaps only once in two or three years. They also noted that not every new IFRS or Interpretation or amendment to an IFRS or Interpretation will affect the *IFRS for SMEs*. On the basis of users' needs or cost-benefit considerations, some of those changes may be relevant only for full IFRSs. Furthermore, there may be some changes to the *IFRS for SMEs* that are appropriate even if full IFRSs are not changed.

Table 2 Applying Tier 3 principles to options for setting Tier 3 reporting standards

In the table below staff have assessed the options discussed above against principles the Board agreed at its April meeting against which it will form its views on Tier 3 accounting requirements, for inclusion in a discussion paper.

Tier 3 Principles	Option 1: stand-alone pronouncement (see paragraph 16-19)	Option 2: 'Aus Tier 3' paragraphs or appendices within existing AASB Standards (see paragraph 20-23)
(a) Compatible with AASB NFP SSF, focusing on whether Tier 3 requirements would create undue cost/effort[21]	• Allows NFP application issues to be considered and not creating undue cost/effort – enabling a separate stand-alone pronouncement that is consistent, efficient and transparent with all Tier 3 requirements contained within. • Par. 8 of the NFP Standard Setting Framework refers to ASIC Act "to consider the suitability of a proposed standard for different types of entities and to ensure there are appropriate accounting standards for each type of entity that must comply with Australian Accounting Standard" which supports the Boards approach to develop a Tier 3 reporting requirements that is suitable to the scope of entities which will apply this standard. • Paragraph 23(d) of the NFP SSF refers NFP entities can only apply Tier 1 or Tier 2 standards, as such it will need to include Tier 3 to be applicable to the entities in scope.	• May create undue cost/effort for preparers (noting that cost may be relatively higher for Tier 3 entities compared to Tier 1 or Tier 2 entities) to locate 'Aus Tier 3' paragraphs (or amendments in appendices) and to determine application of a Tier 1 or Tier 2 standard, limited opportunities for simplified language and terminology and likely need to consider updates more frequently. • Paragraph 23(d) of NFP SSF will also need to be amended as discussed in option 1.

21 Overlaps Principles (b) and (e)

Tier 3 Principles	Option 1: stand-alone pronouncement (see paragraph 16-19)	Option 2: 'Aus Tier 3' paragraphs or appendices within existing AASB Standards (see paragraph 20-23)
(b) Provides useful information for resource allocation decisions	• Tier 3 financial statements will be GPFS. This option will include topics that are considered common for Tier 3 entities. For omitted topics transactions that will be mechanisms to achieve relevant and reliable information that is useful to users. • This approach also recognises the differences in the types and needs of users of Tier 3 financial statements, as well as limitations in, and the cost of, the accounting expertise available to the users of Tier 3 suggests that separate standard could include constraints such as consistent definitions of elements of financial statements and focus on the needs of users of Tier 3 financial statements.	• Tier 3 financial statements under this option will still be GPFS but it will include all topics compare to both options 1 and 2 (unless specifically scoped out for Tier 3 entities), achieving the same results as option 1. However it will be more cumbersome for preparers to use and apply as they will need to determine application of relevant AASB standard and apply any 'Aus Tier 3' paragraphs or appendix.
(c) Consistent with principles for Tier 2 is desirable but not always warranted	• Whilst this option will provide least consistency with AASB standards through simplified language adapted to NFP needs and possibly different recognition and measurement requirements to Tier 2 requirements, but departure from principles of Tier 2 may be warranted to achieve a relevant and reliable information for users without undue cost to preparers.	• This option provides the most desirable alignment to Tier 2 principles likely due to limited opportunities in simplifying the language and the extent of NFP language that can be adapted to existing AASB Standards and increased need for cross-references to existing AASB standard within the 'Aus Tier 3' paragraphs. However this option will likely result in increased complexity of AASB standards and in turn increased preparers' cost.
(d) Leverages information that management uses	• This option will focus on transactions typically encountered by a Tier 3 entity including the ease of use for those seeking to apply this option of Tier 3 where much of the material in Tier 1 and Tier 2 would not normally have application for a Tier 3 entity and if relevant, would need to be tailored to enable application of this principle.	• This option provides better linkage to existing standards to ensure all topics are covered and in one place via 'Aus Tier 3' paragraphs/appendix within the existing AASB standards and reduce the likelihood of unintended difference arising between a Tier 1 or Tier 2 standards and the related requirements in Tier 3. However it will include information that is not necessarily used by management of a Tier 3 entity, unless specifically excluded from scope of Tier 3 requirements in relevant AASB standards.

Tier 3 Principles	Option 1: stand-alone pronouncement (see paragraph 16-19)	Option 2: 'Aus Tier 3' paragraphs or appendices within existing AASB Standards (see paragraph 20-23)
(e) Benefits exceed costs	• Preparers can locate the Tier 3 requirements in one document with less frequent updates than Tier 1 and 2 standards, making it simpler to use and reduce preparation cost. It may also benefit auditors/advisors/software providers where Tier 3 standards are in a single document. However it may hinder transition between tiers for entities that may need/want to move to a higher tier as well as mobility of accounting professionals and increase cost of training.	• May increase preparation cost and not perceived as user friendly if preparers are required to locate 'Aus Tier 3' paragraphs/appendices within each AASB standard and determine the applicability of relevant AAS to them. • With the constraint of language and simplification, will add to the cost to preparers and does not align with the project objective to simplify Tier 3 standards. However it may allow entities'/mobility of accounting professionals to transition between tiers as Tier 3 will not be separated from Tier 1 and Tier 2 standards.

24 **Staff view**: Staff recommend that the Board to propose Tier 3 for NFP private entities to be developed as a single stand-alone pronouncement (i.e. Option 1), because of the reasons outline in paragraphs 16 – 23. Staff consider this option will be a more user-friendly document compared to Option 2 and better supports the Board's objective to develop proportionate reporting requirements for the NFP private sector entities having regard to 'user needs' and 'cost/benefit' as overarching principles.

Questions to Board members

Question 1: Do Board members agree with the staff recommendation, for the purposes of the discussion paper, to propose that Tier 3 should be developed as a single stand-alone pronouncement?

Question 2: If Board members agree with question 1, do Board members agree with the staff recommendation, for the purposes of the discussion paper, to apply the following aspects of Tier 3 requirements?

- simplified language with terminology tailored to NFP entities including its own glossary (if required);
- minimal cross-references to requirements of an existing AASB standards;
- maintenance cycle in accordance with the AASB Due Process Framework and post-implementation review requirements, i.e. Tier 3 would only need to be updated periodically or when the requirements of the NFP Standard Setting Framework are met such as evidence of undue widespread and significant diversity in accounting practices;
- a separate basis of conclusion setting how the Board reached its conclusion in developing the Tier 3 reporting requirements;
- application guidance and template financial statements.

Application of accounting policies for omitted topics and ability to apply requirements of other Australian Accounting Standards

25 Staff consider it is necessary for the Board to decide for the purposes of the DP whether an entity that would apply Tier 3 requirements will be permitted to apply the requirements of a higher tier (i.e. Tiers 1 or Tier 2 requirements) and if so, in what circumstances. In the analysis below, staff did not distinguish between requirements of Tier 1 and Tier 2, noting that this distinction is related to further deliberation by the Board on the disclosure principles of Tier 3 requirements at a future meeting.

26 The decision of the Board on the staff recommendations in Question 1 and 2 above will have impact on the mechanics how the approach to the application of accounting policies and ability to apply requirements of other AAS is implemented:

(a) If Tier 3 requirements are implemented as specific amendments to existing AAS through "Tier 3 Aus paragraphs", any application of Tier 1 or Tier 2 requirements would be implemented through "scope exclusion" paragraphs for Tier 3 entities as discussed in paragraph 20.

(b) On the other hand, if Tier is a stand-alone standard, the ability to apply requirements of Tier 1 or Tier 2 will need to be affected through cross-references as discussed in paragraph 16 above.

27 Whilst the consideration in paragraph 25 would be relevant under both approaches outlined in paragraph 26, for simplicity, staff have considered following occasions where an entity Tier 3 requirements could refer entities to other AASB standards from the perspective of a stand-alone Tier 3 standard:

(a) Omitted accounting topics[22] – as discussed in paragraph 17(c)(ii), Tier 3 as a stand-alone pronouncement only include topics that are common to Tier 3 entities. In absence of a requirement in Tier 3 (including cross-reference to Tier 1 or Tier 2 requirements) that applies to a transaction or other event or condition ("omitted topics"), the Board will need to determine the approach (i.e. hierarchy approach) a Tier 3 entity should adopt when deciding on the appropriate accounting policy in the circumstances.

AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a hierarchy approach which states:

"AusCF11 "…management shall refer to, and consider the applicability of, the following sources in descending order:

a) The requirement in Australian Accounting Standards dealing with similar and relate issues; and

b) The definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework [AusCF2]

12. In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop an accounting standard, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11."

22 Staff have not identified any specific Australian research that specifically identifies transactions or events that are common among the scope of entities that could apply Tier 3 and staff will leverage off feedback from outreach to date and existing sources including Australian and overseas research and academic evidence, noting that the consultation process is expected to assist in identifying any omitted transactions or topics that would be relevant and common for Tier 3 entities.

(b) In regard to topics included in Tier 3, the Board will need to determine whether to allow an entity to adopt an accounting policy choice available in a higher tier, either by:
   i. Permitting to apply requirements of a higher tier for a class of transactions;
   ii. Permitting to apply higher tier only for specified topics covered by Tier 3 (i.e. not omitted) but not allowing for others;
   iii. Not permitting to apply higher tier for any of the topics covered.

(c) The Board will also need to decide whether to permit an entity to 'step-up' to the requirements of a higher tier in its entirety and if so, in what circumstances.

28 Staff have identified four possible options which could give rise to the application of the requirements of a higher tier:

(a) Option 1: a Tier 3 entity prohibited from adopting the requirements of other AASB standards either in full or by class of transactions for both omitted topics and the topics included in Tier 3 (see paragraphs 31 – 33);

(b) Option 2: a Tier 3 entity permitted to elect to apply the requirements of a higher tier in its entirety, i.e. for topics included, entities must apply the reporting requirements in Tier 3. For omitted topics, an entity may refer (but not required) to the requirements of a higher tier to develop an appropriate accounting policy after the entity considered Tier 3 requirements dealing with similar issue first and then applicable Conceptual Framework (paragraph 34 – 36);

(c) Option 3: for topics included in Tier 3 – an entity would be permitted to apply the requirements of a higher tier for specific topics allowed by Tier 3 requirements. For omitted topics not covered in Tier 3 – an entity may apply the requirements in the higher tier for a class of transactions following the approach in Option 2. A Tier 3 entity may elect to apply the requirements of a higher tier in its entirety (paragraph 37 – 38);

(d) Option 4: Permitting an entity to adopt a higher tier requirements for any accounting topic and to apply such accounting policy consistently for the same class of transaction. For omitted topics an entity would apply the approach outlined in Option 2 and also a Tier 3 entity would be able to apply the requirements of a higher tier in its entirety (see paragraph 39 – 41).

29 Staff have presented possible combinations of the considerations noted in paragraph 27 forming Options discussed in paragraph 28 in the table below:

	Omitted topics - hierarchy		**Included topics**			**Step up in its entirety**		
	1. Tier 3 analogy 2. CF 3. Higher tier	**1. Tier 3 analogy 2. CF**	**by class for any topic**	**by class where allowed**	**not allowed by class**	**not allowed**	**permitted**	**mandatory**
Option 1		X			X	X		
Option 2	X				X		X	
Option 3	X			X			X	
Option 4	X		X				X	

30 Staff observed that other combinations can exist resulting in different options, for example:

(a) for topics that are omitted from Tier 3, an entity could be prohibited to adopt the requirements of a higher tier, but for topics that are included they can apply the requirements of a higher tier for a class of transactions but not in its entirety. However staff consider that this would be unreasonable where an entity has the choice to adopt a higher tier requirements for topics included but not for omitted topics.

(b) an entity could be required to step up to the requirements of a higher tier in full in some specific cases, for example where the nature of an entity would warrant it or when an omitted accounting topic would be pervasive to the financial statements of the entity as a whole. Staff consider that the first instance would be a case for a regulator or respective legislation rather than the accounting standards to specify the financial reporting requirements and the latter instance would involve significant judgement while the same outcome can be achieved to provide Tier 3 entities an option to apply a higher tier requirements in their entirety. As such staff did not explore these options further and have restricted the options as presented in paragraphs 31 to 41.

***Option 1**:* <u>A Tier 3 entity prohibited from adopting the requirements of other AASB standards either in full or by class of transactions for both omitted topics or the topics included in Tier 3.</u>

31 If this approach were adopted, where a transaction or other event was not specifically addressed by the Tier 3 requirements, entities would be limited to consider the applicability of the requirements and guidance within Tier 3 dealing with similar and related issues and management would apply judgement to determine an appropriate accounting policy having regard to concepts and principles in the conceptual framework. Entities would not be permitted to refer to the requirements of other AASB standards for either omitted topis or topics addressed by Tier 3 requirements. Staff noted that no reviewed pronouncement from other selected jurisdictions takes this approach.[23] Staff also noted that it would not be practical to limit entities to apply principles in the conceptual framework without potentially applying implicitly requirements of other AAS at least in some cases.

32 Staff have identified the following advantages:

(a) It ensures Tier 3 entities only apply the applicable Tier 3 requirements which are considered appropriate for the needs of users of Tier 3 GPFS as preparing financial statements using the requirements permitted in a higher tier may not be considered useful for those users.

(b) It could result in relatively more comparable financial statements across Tier 3 entities and improve consistency, depending on how entities would apply the requirements to the omitted topics where application of Tier 3 requirements in analogy or application of the conceptual framework itself could arise in the inconsistent application of the accounting policies to the same transactions amongst Tier 3 entities.

33 Staff have identified the following disadvantages:

(a) Almost all of pronouncements for the jurisdictions examined permitted entities to elect to either adopt the requirements of a higher tier by a class of transactions or in its entirety, recognising the diversity within the sector in which the requirements were developed for. Not allowing the flexibility for preparers to adopt the requirements of a higher tier would prohibit accounting policy choices that management considers most appropriate to their circumstances, aligning with the principal of leveraging information that management uses.

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23 HK SME-FRF and SME-FRS does not permit an entity to adopt the requirements of a higher tier on a class of transaction, but it was silent on whether an entity can adopt the requirements of a higher tier in its entirety. Some reviewed NFP-specific pronouncements (such as UK Charities SORP) understandably do not allow application of a higher tier requirements in its entirety as the for-profit oriented requirements of higher tier would not be appropriate for the transactions specific to NFP entities.

(b) Not allowing application of the higher tier in its entirety may further increase complexity of interaction of AAS with relevant legislation and regulations, if for example a legislation would require specific type of NFP entities (that would otherwise be required to apply Tier 3 requirements) to apply Tier 1 or 2 AAS.

(c) It is inconsistent with the requirement as set out in paragraph 12 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors,* where in the absence of an AAS that specifically applies to a transaction, other event or condition, management may consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards – in which case for a Tier 3, would be the Tier 1 and Tier 2 requirements in the AAS and therefore this option could be considered as inconsistent with the approach taken for other AAS.

(d) This option does not support the transaction neutrality approach - if a transaction is not addressed by the Tier 3 standard, and the entity cannot refer to other existing AASB Standards this goes against the principle of like events being accounted for in the same way (unless there is a specific reason to do so).

Option 2: A Tier 3 entity permitted to elect to apply the requirements of a higher tier in its entirety, i.e. for topics included, entities must apply the reporting requirements in Tier 3. For omitted topics, an entity may refer (but not required) to the requirements of a higher tier to develop an appropriate accounting policy, after it considered Tier 3 requirements dealing with similar issue first and then applicable Conceptual Framework.

34 This option follows the approach adopted by the *IFRS for SMEs* would not allow (through cross-referencing or otherwise) to apply accounting requirements by class of transaction if the topic is included in the Tier 3 requirements (with notable exception of the option to use IAS 39 instead of Section 11 and 12 of *IFRS for SMEs*). For the omitted topics, the hierarchical approach (as adopted by *IFRS for SMEs*, NZ Tier 3 and other reviewed selected pronouncement) would require first to consider the applicability of the requirements and guidance within Tier 3 dealing with similar and related issues and management would apply judgement to determine an appropriate accounting policy having regard to concepts and principles in the conceptual framework. In making the judgements, management may also consider the requirements and guidance in a higher tier dealing with similar and related issues.

35 Staff have identified the following advantages:

(a) It ensures consistency in the accounting policies adopted by Tier 3 entities and ensure comparability of the information in their financial statements. When developing *IFRS for SMEs*, the IASB was of the view that an SME entity should be required to choose only either the complete set of full IFRSs or the complete *IFRS for SMEs* and not to permit SMEs to revert to full IFRSs principle by principle.[24] It can also be argued that entities with complex transactions, or preferring applying one or more of the accounting policy options available in a higher tier for another reason such as for consolidation purposes where an entity elects to opt up because they are a controlled entity of a Tier 1 or Tier 2 parent entity, it would be appropriate to allow a Tier 3 entity to adopt Tier 1 or 2 requirements in full.

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24 Paragraphs BC 152-BC154 of *IFRS for SMEs* notes that the IASB was of the view that "*allowing SMEs optionally to revert to full IFRSs either principle by principle or standard by standard, while continuing to follow the* IFRS for SMEs *for other transactions and circumstances, would result in significant non-comparability. Undesirably, SMEs would have almost an infinite array of combinations of accounting policies from which to choose".*

(b) Also, in BC 154 of *IFRSs for SMEs*, some respondents view that the recognition and measurement principles in a full IFRS are so interrelated that they should be regarded as an integrated package and should not allow the permission to apply the higher tier requirement principle by principle which could hinder consistency of financial information within the financial statements of a Tier 3 entity.

(c) In comparison with Option 1, this option provides additional source of guidance for omitted topics, being the guidance in Tier 1 or 2. On the other hand, for the topics included in Tier 3 requirements may result in simpler application compared to other options as would result in less management judgement involved as no assessment would be required whether to apply requirements of higher tier or not, which can benefit especially smaller entities within those that will apply Tier 3 requirements.

36 Staff have identified the following disadvantages:

(a) It may unnecessarily prohibit entities to elect to provide more sophisticated information to the users if entity has resources to do so which may be the case for larger entities within the indicative size range of the entities the Board intends to develop Tier 3 requirements for.

(b) This option may also make transition between Tiers (for those entities that want or need to change reporting Tiers, (e.g. due to increase in size) more complex as all Tier 3 requirements are contained within the topics included and entities will be less likely to look/required to look into Tier 1 or 2 standards.

(c) This option can result in less concise Tier 3 requirements due to possibly increased need to provide more accounting policy choices within Tier 3 than otherwise could be provided through option of applying higher tier requirements. This may also result in more time and effort to develop Tier 3 requirement proposals by the AASB. Alternatively, this could result in insufficient range of accounting policies available for what could be relatively wide range of entities applying Tier 3.

Option 3: <u>For topics included in Tier 3 – an entity is permitted to apply the requirements of a higher tier only for specific topics were allowed by Tier 3 requirements. For omitted topics that are not covered in Tier 3 – an entity may apply the requirements in a higher tier for a class of transactions following the approach in Option 2. A Tier 3 entity may elect to apply the requirements of a higher tier in its entirety.</u>

37 In regard to the topics included in Tier 3 requirements, this option adopts the approach in UK Charities SORP and US ASC NFP 958 and would allow for application of Tier 1 or 2 requirements in those specified instances when allowed by Tier 3 requirements.

38 Staff have identified the following advantages of this option:

(a) This approach could enhance consistency of the accounting policies applied by Tier 3 entities while providing flexibility to apply higher tier requirements for those topics where allowed (through cross-referencing) for those entities that will choose to do so.

(b) Subject to the extent of Tier 1 or 2 accounting requirements made available in Tier 3, it may facilitate easier transition for entities from Tier 3 if needed or required.

(c) This option can result in more concise Tier 3 compared to Option 2 given the lesser need to include the accounting policy choices provided by higher tiers (in simplified form) in Tier 3 requirements if it is determined that could be of benefit to the users of the financial statements of some entities. As a result, this Option could require less time and effort to develop specific Tier 3 requirements for cases where cross-reference to higher tier can satisfy needs of the users of Tier 3 entities' financial statements.

Staff have identified the following disadvantages:

(a) The Board will need to determine which section/topic should be permitted to apply higher tier requirements. This may increase the complexity of the Tier 3 standard for preparers that do not have complex transactions, as while they may not need to apply the requirements of a higher tier, they may need to consider whether it is permitted/appropriate for them and would also introduce the need to understand higher tier requirements in this respect.

(b) It could also increase complexity of Tier 3 requirements compared to Option 2 due to increase use of cross-referencing (if an option of stand-alone standard is the one that the Board prefers).

(c) Despite the option to apply a higher tier requirements would be limited to specific topics, this may result in decreased consistency and comparability across the Tier 3 entities.

(d) Ability to apply requirements of a higher tier may result in further complexity for the maintenance of the Standard and consideration will have to be given how to deal with scenarios when a referred Tier 1 or 2 is amended or replaced.

Option 4: Permitting an entity to adopt the requirements of a higher tier for any topics (applied consistently for a class of transaction) or in its entirety and for omitted topics to follow the approach in Option 2.

39 In regards to topics included in Tier 3 requirements, this option follows the approach adopted by NZ Tier 3 and FRS 102, and permits (but does not require) entities to elect to use the requirements of a higher tier for a specific type of transaction (but not limited to those specified by Tier 3 requirements) as long as the entity applies that same requirement to all transactions of that type. For omitted topics, this option adopts the approach outlined in Option 2, i.e. the hierarchy approach first applying the principles and requirements in the Tier 3 dealing with similar and related transactions or events; secondly the definitions and concepts in the Conceptual Framework to the extent that they do not conflict with Tier 3 and in making that judgement the entity may consider (but is not required to apply) the relevant requirements of Tier 1 or 2.

40 Staff have identified the following benefits:

(a) It will enable preparers to refer to and adopt the requirements of a higher tier if they prefer, for example if they do not want to apply simplification in Tier 3 or wish to use an option that is available in a higher tier, for example if management determines that requirements of the higher tier are appropriate in the circumstances. This is also in-line with one of the overarching principles for developing Tier 3 requirements the Board decided to adopt, that is, to maximise the information that management uses to make decision about the entity's operations.

(b) The option allows for NFP entities to apply appropriate recognition and measurement criteria given the NFP modifications made to AAS where deemed appropriate by the AASB in accordance with its Not-for-Profit Standard Setting Framework.

(c) The option does not require the Board to specify which topics should or should not be permitted to adopt the requirements of a higher tier, minimising the risk that a topic may not be captured. This approach may also limit the length of the particular topic compared to Option 3 which may require for the topic to include all accounting policy choices to be provided that are deemed necessary, or otherwise cross-reference to the requirements of that existing AAS.

(d) Preliminary feedback from members of the NFP Project Advisory Panel (those that expressed an opinion) as well as from initial outreach[25] supported this option, as it provides the flexibility to permit an entity to apply the requirements of a higher tier with disclosures of the accounting policy option applied. They observed that an entity's decision to apply the requirements of a higher tier should not be regarded as hindering comparability, especially as any accounting policy choices are within the requirements of AAS (that already allow for accounting policy choice in many cases). Based on the staff review of the feedback publicly available from NZ post-implementation review of Tier 3 and Tier 4, this option was considered helpful by the stakeholders (also see paragraph 41(b) for further comments).

41 Staff have identified the following disadvantage:

(a) Establishing an overarching policy to allow entities to use options that are available in a higher tier may cause inconsistent accounting policies being adopted which may hinder comparability,[26] as otherwise comparable Tier 3 entities may make different choices when considering accounting policy for any class of transactions presented in their financial statements. Some of the stakeholders during the targeted outreach were concerned with the implication on comparability of the financial statements potentially resulting in similar comparability and consistency issues currently identified for special purpose financial statements.

(b) Preparers may also be required to have the knowledge to apply the requirements of a higher tier and more importantly, this may not benefit the users of the financial statements who need to make comparisons between smaller entities and would need to obtain understanding of Tier 1 or 2 requirements first and then to examine which accounting requirements the particular entity applied.

(c) Additional guidance may be needed on how to apply requirements of a higher tier, and may introduce further complexity in the application of the Tier 3 given the interaction of many AAS requirements leading to increased cost to preparers.[27]

42 **Staff view**: Staff had mixed views in respect of permitting an entity to adopt the requirements of a higher tier for topics that are included in Tier 3. Those staff that support Option 3 to only permit the requirements of a higher tier for specific Tier 3 topics argue that this option provides balance between consistency and comparability of the financial reporting of Tier 3 entities that is important to users of the financial statements, relative simplicity of Tier 3

25 Summary of feedback from initial outreach indicated broad agreement that the option for middle tier entities to opt up on the type of transaction basis will ensure that accounting reflects the nature and complexity of the transaction. Entities' ability to opt up to a higher reporting tier in its entirety appears to be able to alleviate concerns, to certain extent, that some regulators' staff have over what the interaction of the thresholds defined in AAS with the respective regulatory requirements.

26 BC 89 – 94 of *IFRS for SMEs* presented disadvantages of providing accounting policy choice option is inconsistent with the IASB's objective of a simplified standard for smaller entities and would hinder comparability and noted that most SMEs would choose to follow the simpler options as they will generally be less costly. In BC 158, the IASB noted that undesirably, the preparers would have almost infinite array of combinations of accounting policies from which to choose.

27 From the staff analysis of the available feedback from post implementation review of NZ Tier 3 and 4 standards, respondents thought allowing the option to opt-up was useful but did not consider the standards were clear about how this was done. A specific area where this presented challenge was for Tier 3 entities wanting to opt up to specific Tier 2 standards to fair value their investment assets.

requirements and effort and time required for their development, while providing preparers opportunity to apply higher tier requirements where deemed appropriate noting that this option provides ability to apply higher tier requirements in its entirety. The staff supporting Option 4 consider it supports stakeholders view to provide flexibility to preparers of Tier 3 and the Board will not be required to determine which Tier 3 specific topic should provide option to apply a higher tier requirements while restricting/simplifying the accounting requirements for other topics. They also consider that Tier 3 entities are more likely adopt the simpler accounting policy option and including further accounting requirements and choices for the topics that would not have option to apply higher tier requirements (similarly to the approach *IFRS for SMEs* took when finalising the proposals) may add to the complexity and length of the Tier 3. They also noted that such approach has also worked well in NZ as indicated in the feedback from the Post Implementation Review of NZ Tier 3 and Tier 4.

43 For omitted topics, staff recommend first applying the principles and requirements in the Tier 3 dealing with similar and related transactions or events; secondly the definitions and concepts in the applicable Conceptual Framework to the extent that they do not conflict with Tier 3 and in making that judgement the entity may consider (but is not required to apply) the relevant requirements of Tier 1 or 2 for the reasons outlined in paragraph 35(c). Staff also recommend that Tier 3 should allow an entity to apply the requirements of Tier 1 or 2 in its entirety for the reasons in paragraphs 35(a) and 35(b). Both Options 3 and 4 are consistent in these aspects.

Questions to Board members

Question 3a Do Board members agree with the staff recommendation, for the purposes of the discussion paper, to propose the following hierarchy approach for entities when determining an appropriate method of accounting for the topic or transaction where Tier 3 requirements do not provide guidance?

1. Apply the Tier 3 principles and requirements dealing with similar and related transactions or events;
2. Have regards to the definitions and concepts in the applicable Conceptual Framework to the extent that they do not conflict with Tier 3 requirements;
3. Permit (but not require) entities to elect to use the requirements of a higher tier for a specific type of transaction as long as the entity applies that same requirement to all transactions of that type.

Question 3b Do Board members agree with the staff recommendation, for the purposes of the discussion paper, to propose that entities can adopt AASB Tier 1/Tier 2 requirements for a class of transactions as long as that option is applied consistently to the class of transaction (in addition to any specific permissions to apply Tier 1/Tier 2 requirements for accounting topics the Board will deliberate at future meetings)?

Question 3c Do Board members agree with the staff recommendation, for the purposes of the discussion paper, to propose that entities applying Tier 3 requirements should be allowed to apply the requirements of Tier 1/Tier 2 in their entirety when preparing the general purpose financial statements?

Appendix A Summary of reviewed aspects of the pronouncements for smaller/NFP entities in selected other jurisdictions

A. Accounting requirements and guidance as stand-alone pronouncement

1 *IFRSs for SMEs* is a stand-alone standard providing simplified reporting requirements for small to medium for-profit entities (SMEs). It is derived from full International Financial Reporting Standards (IFRS) with modifications to reflect the needs of users of SMEs' financial statements and cost-benefit considerations. Staff also noted that on-going project to review IFRS for SMEs may change the current status and content of the standard.

2 FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* (FRS 102) is a stand-alone standard originally based on the International Accounting Standards Board's (IASB) *IFRS for SMEs*. The FRC has modified the IFRS for SMEs substantially, both in terms of the scope of entities eligible to apply it and in terms of the accounting treatments provided. FRS 102 is designed to apply to the general purpose financial statements and financial reporting of entities including those that are not constituted as companies and those that are not profit-oriented.

3 The *UK Charities SORP* (FRS 102) *Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland* (SORP) is a single document but is not stand-alone standard itself as it does not contain all the requirements that may be applicable under FRS 102. The provisions of a SORP cannot override provisions of the law, regulatory requirements or FRC standards. The Charities SORP includes charity-specific requirements that are additional to those of FRS 102 (e.g. fund accounting) and requires additional disclosures which are not specifically required by FRS 102. The SORP is developed primarily to assist those involved in the preparation of the accounts and trustees' annual report of a charity.

4 The New Zealand *Tier 3: Public Benefit Entity Simplified Formal Reporting – Accrual (Not-For-Profit)* (NZ Tier 3) is a single stand-alone standard that applies to NFP public benefit entities that are eligible for, and elect to apply, the NZ Tier 3, being entities without public accountability and with expenses not more than NZ$2 million.

5 The Canadian *Accounting Standards for Not-for-profit Organisations* (ASNFPO) are standards applicable to NFP organisations. These standards are located in Part III of the CPA Canada Handbook ("the Handbook") and are mandatory for NFP organisations. NFP organisations that apply Part III of the Handbook also apply the *Accounting Standards for Private Enterprise*s as its supplementary framework addressing relevant topics not covered in the ASNFPO or IFRS standards (BC6 for ASNFPO). As such the accounting standards are not a stand-alone set of standards as it requires reference to another set of standards (i.e., those in Part II of the Handbook) to address some issues or for additional guidance on others (BC 25 of ASNFPO).

6 The *Charities Accounting Standard* (Singapore CAS) is a set of accounting standards developed by The Accounting Standards Council for charities in Singapore. The definitions and accounting treatments presented in the Singapore CAS are developed based on the requirements of the Financial Reporting Standards (FRS), taking into account the context and circumstances relevant to the charity sector. FRS is a set of accounting standards and interpretations that are based on IFRS Standards with some local amendments. The CAS excludes a number of FRS requirements that are largely not applicable to the charity sector.

7 The *Small and Medium-sized Entity Financial Reporting Framework* and *Financial Reporting Standard* (HK SME-FRF and SME-FRS) which are the accounting standards issued by the Hong Kong Institute of Certified Public Accountants (HKICPA), are to be followed in accordance with section 380(4) by those Hong Kong incorporated companies which are entitled to, and decide

to, take advantage of the reporting exemption in the Hong Kong Companies Ordinance. At a minimum, in accordance with section 359 of the CO these companies (or groups) must be private companies (or groups), or companies (or a group of companies) limited by guarantee. There are size tests to determine this reporting exemption eligibility, i.e. a small private company, a small guarantee company, larger eligible private companies or mixed group (comprising one or more small and/or eligible private companies and one or more small guarantee companies). For example a small private company does not exceed any two of the following:[28]

(a) Total annual revenue of HK$100 million
(b) Total assets of HK$100 million at the end of the reporting period
(c) 100 employees

8 In the US, the Accounting Standards Codification (ASC) contains NFP-specific accounting and reporting guidance ASC 958 *Not-for-Profit Entities*, and certain subsections of ASC 954 *Health care entities*. All non-governmental NFP organisations that meets the GAAP definition of an NFP must apply this standard. In addition, NFPs must apply guidance in all other FASB Codification Topics and subtopics unless the scope of any individual section explicitly excludes NFPs, or the nature of the subject matter would not apply to NFPs (for example payment of dividends). As such it is not considered a fully stand-alone standard in the staff analysis.

B. Cross-references

9 The *IFRS for SMEs* incorporates one cross-reference providing an option, but not a requirement, to follow IAS 39 *Financial Instruments*: *Recognition and Measurement* instead of the financial instruments sections of the *IFRS for SMEs.*

10 FRS 102 includes cross-referencing to EU-adopted IFRS in FRS 102 rather than setting out the requirements in the FRS 102 itself. Similarly, the Charities SORP makes cross references to FRS 102.

11 In NZ Tier 3, the topics containing cross references include consolidation, separate financial statements, interest in associates and joint ventures, joint arrangements, disclosures of interest in other entities, financial instruments, property, plant and equipment.

12 Canada ASNFPO requires NFP that apply Part III of the Handbook also apply the Accounting Standards for Private Enterprise as its supplementary framework addressing relevant topics not covered in the ASNFPO or IFRS standards (BC6 for Canada ASNFPO). Each NFP section makes cross references to the requirement in Part II of the Handbook except as otherwise provided in the NFP section.

13 Both Singapore CAS and HK SME-FRF and SME-FRS do not make any cross references to another standard.

14 The US guidance developed for NFPs is based on the guidance applied by business entities unless departures are justified by characteristics or transactions unique to NFPs. As such there are cross references to other FASB Codification Topics.

C. Conceptual Framework within the pronouncement

15 The *IFRS for SMEs* is organised by topic, with each topic presented in a separate numbered section with its own concepts and principles underlying the financial statements of SMEs, extracting the fundamental concepts from the IASB's *Framework for the Preparation and Presentation of Financial l Statements* and the principles and related mandatory guidance from

28 Para 24 – 40 of HK SME-FRF and SME-FRS

IFRSs (including Interpretations).[29] The IASB acknowledged that differences in the types and needs of users of SMEs' financial statements, as well as limitations in, and the cost of, the accounting expertise available to SMEs, suggested that a separate standard for SMEs is appropriate so it could include constraints such as consistent definitions of elements of financial statements and focus on the needs of users of financial statements of SMEs.[30] However, the IASB noted that the IASB's *Framework* provides the foundation for the IFRS for SMEs Standard. It should be also noted that the concepts incorporated in the IFRS for SMEs have authority of a standard whereas the *Framework* does not. The IASB at its May 2021 meeting decided that the status of Section 2 of the IFRS for SMEs Standard will remain unchanged but that it be aligned with the 2018 Conceptual Framework and to assess any potential inconsistencies between a revised Section 2 and any other section of the IFRS for SMEs Standard. The IASB also decided to retain the concept of 'undue cost or effort'.

16 HK SME-FRF and SME-FRS refer to its conceptual basis for the preparation of financial statements in accordance with the SME-FRS. The HKICPA decided to develop reporting requirements for SMEs that would better meet the needs of users of SME financial statements.[31] They were also aware that many smaller entities do not perceive benefits in the convergence of HKFRSs with IFRSs.[32]

17 FRS 102 concepts and pervasive principles is based on *IFRS for SMEs* but made a number of amendments including various entities that are outside the scope of the *IFRS for SMEs* are within the scope of FRS 102, including financial institutions and Public benefit entities. Also, FRS 102 includes an override paragraph emphasising that the specific requirements of the other Sections of the *IFRS for SMEs* Standard take precedence over the requirements of Section 2 *Concepts and Pervasive Principles*.

18 UK Charities SORP, NZ Tier 3, Singapore CAS, Canada ANSFPO and US ASC NFP 958 all do not have conceptual framework incorporated within. For example NZ Tier 3 refers to the IPSASB Conceptual Framework rather than its own. Singapore CAS is derived from the Financial Reporting Standards, and Canada ASNFPO and US ASC NFP 958 do not have its own NFP conceptual framework given they are not stand-alone standards.

D. Approach to selection of accounting policies for omitted topics and ability to apply for a class of transactions/events

19 For *IFRS for SMEs*, an entity's management is required to use its judgement in developing and applying an accounting policy and establishes a hierarchy for an entity to follow in deciding on the appropriate accounting policy in the circumstances. Firstly, management is to consider the applicability of the requirement and guidance within the standard dealing with similar and related issues. Then, the standard requires an entity to refer to the definitions, recognition and criteria and measurement concepts for assets, liabilities, income and expenses principles set out in the section 2 *Concepts and Pervasive Principles*. In making the judgements, management may also consider the requirements and guidance in full IFRS dealing with similar and related issues (para 10.5-10.6 of *IFRS for SMEs).* However, BC 152-154 of *IFRS for SMEs* states that an entity can choose only either the complete set of full IFRSs or the complete *IFRS for SMEs* and not to permit SMEs to revert to full IFRSs principle by principle.

20 FRS 102 provides guidance for making a judgement and establishes a hierarchy for an entity to follow in deciding on the appropriate accounting policy in the circumstances. It firstly requires an entity to look at the requirements and guidance in an FRS or FRC dealing with similar and related issues. Where the entity is in scope of a SORP, the requirements and guidance in that

29 BC 95 of *IFRS for SMEs*
30 BC 47 of *IFRS for SMEs*
31 Para 3 of Preface to Hong Kong Financial Reporting Standards
32 Para 31 of Preface to Hong Kong Financial Reporting Standards

SORP dealing with similar and related issues; and the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles set out within FRS 102 (Para 10.5 of FRS 102). It may also look to IFRS to consider the requirements and guidance with similar and related issues. Within FRS 102 for some specific topics such as Financial Instruments, Operating Segments or Exploration for and Evaluation of Mineral Resource allows entities to elect (or specifically requires) to apply the requirements to the IFRS equivalent standards. FRS 102 allows to apply an FRS or FRC Abstract if they specifically address a transaction, other even or condition.

21 Charities applying the Charities SORP need to refer to FRS 102 where certain situations are not covered or if extra disclosures are needed to provide a true and fair view. If FRS 102 does not address the matter, then charities adopting FRS 102 should refer to the hierarchy of sources set out in section 10 of FRS 102 which applies the same approach to that adopted by *IFRS for SMEs.* Para 3.24 of Charities SORP requires charities to refer to FRS 102 and modules within the Charities SORP when selecting their accounting policies for the treatment of a particular, transaction or events in the accounts. Where FRS 102 allows an accounting policy choice, the Charities SORP will identify whether a particular treatment is required or whether charities can exercise a choice (para 4 of Charities SORP).

22 Applying NZ Tier 3, the entity shall use its judgement to determine an appropriateness of accounting for that transaction type that results in the performance report providing relevant and faithfully representative information by, firstly applying the principles and requirements in the standard dealing with similar and related transactions or event; secondly the definitions and concepts in the PBE Conceptual Framework to the extent that they do not conflict with the standard. In making these judgements, the entity might also consider (but is not required to apply) the relevant requirements in the Tier 2 dealing with the same, similar or related transactions or events. The NZ Tier 3 permits entities to elect to use the recognition and measurement of a Tier 2 PBE Accounting Standard for a specific type of transaction as long as the entity applies that same requirement to all transactions of that type and discloses this in the statement of accounting policies (para 7-9 and BC 13 of NZ Tier 3). For some of the classes of transactions, the standard allows application of a higher tier, e.g. it specifies for revaluation of property, plant and equipment that entities may elect to revalue a class of property, plant and equipment to apply the requirement of PBE IPSAS 17 *Property, Plant and Equipment.* Similar approach is applied to the financial instruments.

23 Canada ASNFPO refer firstly to sections 1401 – 4470, including appendices (i.e.. Part III of Handbook), then sections 1505-3780 in Part II of the Handbook to the extent that the topics are not specifically discussed in Part III of Handbook; and accounting guidelines in Part II of Handbook (para 1101.02 to 1101.05 Part III of ASNFPO). Entities applying the Canada ASNFPO are required to reference standards in Part II of the Handbook to address some issues or for additional guidance on other topics (BC 25 of Canada ASNFPO).

24 Singapore CAS require to firstly refer to the requirements and guidance in the Singapore CAS dealing with similar and related issues, then the definition, recognition criteria and measurement concepts for assets/liabilities/income/expenditure and the accounting principles and policies set out in the respective sections of the CAS and thirdly the requirement and guidance in the FRS dealing with similar and related issues. The CAS must be adopted in its entirety and partial adoption or mixed adoption of the FRS or the CAS is not allowed (Q5 of the Q&A in Financial Reporting framework For Charities Statement of Applicability).

25 HK SME-FRF and SME-FRS states that in the event the SME-FRS does not cover an event, or a transaction undertaken by an entity, management may consider the SME-FRF for guidance on developing an appropriate accounting policy, consistent with the historical cost convention (para 1.2 of HK SME-FRF and SME-FRS) so there is no requirement or permission for entities to refer to a higher tier. Paragraph 1.5 stipulates that it is an extremely rare circumstance when

an entity has to depart from requirements of SME-FRS and in doing so, make appropriate disclosure and not to depart from historical cost convention.

26 US ASC NFP 958 does not have a hierarchical approach as NFP applies the other topics that are not within the ASC NFP 958. For topics that are not included in US ASC NFP 958, the entities are required to refer to the sections and topics in the other ASC. However NFP must apply the requirements within NFP 958 for the topics that are provided for not-for-profit entities.

E. Permission to apply the requirements of a higher tier in its entirety

27 Both *IFRS for SMEs* and FRS 102 permit entities to opt up to the requirements of a higher tier in its entirety, i.e. full IFRS, and NZ Tier 3 can opt up to the requirements in PBE 2.

28 The AcSB adopted a free choice of the accounting standards for not-for-profit organizations in Part III of the Handbook, or IFRSs in Part I of the Handbook (i.e. equivalent to full IFRS). In deciding on the approach, the AcSB noted that IFRSs do not, and it is expected will not, contain an "add on" equivalent to the existing 4400 series in the Handbook.

29 In accordance with Singapore CAS, once a charity has adopted an applicable financial reporting framework, it is strongly discouraged from changing to another financial reporting framework (i.e. from the CAS to the FRS or vice-versa), unless there is compelling reason to do so. This is to ensure the comparability of the charity's financial statements across periods. (par. 4 of the Financial Reporting Framework For Charities Statement of Applicability). However, as mentioned in section D above, the adoption of the higher tier (i.e. FRS) in its entirety is allowed.

30 Under US GAAP, an NFP cannot opt to follow either Governmental Accounting Standards Board or Financial Accounting Standards Board standards, or to report as a commercial entity rather than as an NFP and has to apply ASC Topic 958 (or ASC Topic 954 Health Care Entities) to the relevant transactions and events.

31 For charities applying Charities SORP, they must follow the Charities SORP requirements where is has mandatory requirements being supplementary to FRS 102. For charities that are companies however, they can apply IFRS Standards, FRS 101 or FRS 102.

32 Other than requirements outlined in paragraph 25 of Appendix A above, HK SME-FRF and SME-FRS does not specify whether entities are allowed to apply the Hong Kong Financial Reporting Standards (HK FRS). However it does contain a guidance on transitioning from a different GAAP (for example the transition from reporting in accordance with HK FRS) to the HK SME-FRF and SME-FRS.

F. Maintenance

33 After its initial review, the IASB is expected to consider amendments to the *IFRS for SMEs* approximately once every three years (para 16-17 of *IFRS for SMEs*) The *IFRS for SMEs* was last amended in October 2015 and it is currently undergoing its second Comprehensive Review.

34 When FRS 102 was issued, the Financial Reporting Council (FRC) indicated that it would be reviewed every three years. The rationale for a triennial review process was to provide opportunity to review the implementation of FRS 102. FRS 102 will also consider any major changes in IFRS on a case-by-case basis, and preferably to learn from IFRS implementation experiences to determine whether and how FRS 102 should be amended. FRS 102 will be subject to periodic review in 2021/22.

35 Paragraph B.2 of the Charities SORP states that Charities SORP are reviewed on an annual basis for changes in accounting standards and new developments.

36 Review of the NZ Tier 3 (together with NZ Tier 4 PBE SFR – C (NFP)) is carried out as part of a post-implementation review (PIR) which commenced in September 2020.

37 AcSB updates the accounting standards for private enterprises on an annual or biennial basis, with each update potentially consisting of changes to several standards that would all be effective at the same time to accommodate the needs of both private enterprises and not-for-profit organizations (BC 28-30 of Canada ASNPO). Changes to IFRSs are considered to determine the extent that they are appropriate for Canadian private enterprises and not-for-profit organisations.

38 Staff did not identify whether there is any policy in regard to the review of Singapore CAS, however noted that it was updated since the introduction in June 2011 and have not been updated since. Similarly, HK SME-FRF and SME-FRS does not specify a timeframe, but revisions were made along with updates to HK Companies Ordinance.

39 FASB ASC NFP 958 is maintained through post-implementation reviews, or emerging issues affecting financial accounting and reporting and problems with implementing standards of accounting and reporting for non-governmental entities. If needed, as a result an Accounting Standard is issued to amend the Accounting Standards Codification to reflect consensus guidance of the Emerging Issues Task Force (FASB's Rules of Procedures).

G. Glossary of terms and simplified or NFP-specific terminology

40 The glossary of terms in *IFRS for SMEs* contains a mix of consistent terms to IFRS and simplified definitions, e.g. business combination is defined as 'the brining together of separate entities or businesses into one reporting entity compared to the definition in IFRS refers to a transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in IFRS 13.

41 Similar to *IFRS for SMEs*, FRS 102 contains a mix of terms consistent with IFRS and simplified terms. It also contains some definitions not included in IFRS or *IFRS for SMEs*, such as the definition of an agent.

42 NFP Terminologies are used in the Charities SORP, as well as simplifying the definitions (taking some from FRS 102), are tailored to the charity sector, e.g. 'assets are defined as resources controlled by the charity as a result of past events and from which future economic benefits are expected to enable the charity to further its charitable aim'.

43 NZ Tier 3 terminology and language is simplified and tailored to the NFP entities and contains glossary with the terms defined in the standard.

44 Canada ASNFPO does not have specific glossary of terms, but definitions are contained under each topic in Part III of Handbook. Some definitions are consistent with Part II of the Handbook, but some are specific to the NFP sector such as the definition for contribution refers to restricted contribution, endowment contribution and unrestricted contribution (par. 4410.02 of Part III Handbook).

45 The definitions and accounting treatments presented in the Singapore CAS are developed based on the requirements of the Financial Reporting Standards (FRS), taking into account the context and circumstances relevant to the charity sector.

46 In HK SME-FRF and SME-FRS the glossary of terms is consistent with the definitions provided in the HKFRS, with some minor inclusions such as definition for historical cost convention which is not included in the HKFRS, however, is default measurement basis in HK SME-FRF.

47 There is no separate glossary for US ASC NFP 958 but within the NFP topics, there are some NFP definitions provided.

H. Application guidance

48 All paragraphs in the *IFRS for SMEs* have equal authority and some sections include appendices of implementation guidance that are not part of the standard but, rather, are guidance for applying it.

49 All the paragraphs of FRS 102 have equal authority. Some sections include appendices of implementation guidance or examples. Education Notes are also prepared by UK FRC staff for users of FRS 102 which aim to illustrate certain requirements of FRS 102 but are not part of FRS 102 and do not have authoritative status.

50 UK Charities SORP contains mandatory application guidance that charities must adhere to when applying the guidance.

51 NZ Tier 3 contains illustrative examples in Section 10 that forms an integral part of the standard. Explanatory guides to the standard (such as EG A5 that provides a template and guidance notes) is an explanatory document and that provides optional guidance.

52 Canada ASNFPO provides application guidance (e.g. for disclosure of allocated expenses) which forms an integral part of the standard, but the majority of illustrative examples contained in each section are provided as examples only.

53 Singapore CAS and HK SME-FRF and SME-FRS provide illustrative examples/guidance without mandatory application guidance.

54 For US ASC NFP 958, the Subtopics contain illustrations section with implementation guidance and illustrations that are an integral part of the Subtopic.

I. Template financial statements

55 For the Charities SORP, a set of templates are provided to assist charities to prepare their accounts and it is required under SORP to follow the structure, format and headings of these templates (e.g. par 4.8 of Charity SORP for Statement of Financial Activities). The Charity Commission for England and Wales provides a pro forma charitable company account designed to help small company charities prepare and present accruals accounts. They provide a format for such accounts and set out the key disclosures contained in the Charities SORP (FRS 102). The pro forma accounts and notes to the accounts when fully completed will include all the information necessary for smaller charitable companies. Similarly, in Singapore a charity’s financial statements must comply with the formats of the financial statements as set out in the Singapore CAS (para 35 of CAS).

56 As referred in par. 51 of Appendix A above, NZ Tier 3 is accompanied by the optional explanatory guidance which provides template financial statements. However the templates conform to the Tier 3 not-for-profit standard and completing the templates properly will achieve compliance with this Standard. Similarly HK SME-FRF and SME-FRS provides illustrative example financial statements for guidance without mandatory status.

57 Staff did not identify template financial statements issued by the standard-setters in other jurisdictions.

J. Basis for conclusions

58 All jurisdictions except for Singapore CAS and HK SME-FRF and SME-FRS contain Basis for conclusions associated within the pronouncement. Singapore CAS refers the Financial

Reporting Framework for Charities Statement of Applicability which provides some information about the implementation of the Singapore CAS and a Questions and Answers section contained within.