Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Financial Reporting Framework**	**Meeting:**	AASB October 2025 (M215)
Topic:	**Redeliberation – Financial instruments**	**Agenda Item:**	6.1
		Date:	16 September 2025
Contact(s):	Evelyn Ling eling@aasb.gov.au Maggie Man mman@aasb.gov.au	**Project Priority:**	High
		Decision-Making:	High
		Project Status:	Project redeliberations

Objective of this paper

1 The objective of this staff paper is for the Board to decide how to finalise the proposed requirements exposed in ED 335 *General Purpose Financial Statements – Not-for-Profit Private Sector Tier 3 Entities* regarding Section 10 *Financial Instruments*.

2 The Board's decisions to date regarding the proposed other topics for address in a Tier 3 Standard are summarised in the Not-for-Profit Financial Reporting Framework project summary and in Agenda Paper 6.0.

Structure of this paper

3 This paper is set out as follows:

(a) summary of staff recommendations: paragraph 4;

(b) background and reasons for bringing this paper to the Board: paragraphs 5 – 7;

(c) summary of the exposed Tier 3 requirements for financial instruments: paragraphs 8 – 14;

(d) developments since issue of ED 335: paragraph 15 – 19;

(e) summary of the feedback received: paragraphs 20 – 23; and

(f) staff analysis and recommendations: paragraphs 24 – 26, including Table 4.

Summary of staff recommendations

4 As set out in paragraph 26 below, staff recommend that the Board finalise, subject to any redrafting necessary to improve the clarity of the requirements, the Tier 3 requirements for financial instruments as exposed in Section 10 of ED 335, except as follows:

(a) to explicitly specify that an entity need not separately recognise and measure embedded derivatives;

(b) to no longer require the recognition of a commitment to provide a loan at a below market-rate;

(c) to amend paragraph 10.7(a) to clarify that all financial assets held to generate both income and a capital return for the entity are to be measured at fair value;

(d) to amend paragraphs 10.12 and 10.13 to avoid the apparent inconsistency with fair value as described in Tier 1 and Tier 2 reporting requirements;

(e) to amend paragraph 10.16 so that the calculation of interest income and expense is not limited by the carrying amount of the financial asset or financial liability at the beginning of a period;

(f) to amend paragraph 10.21 to require an impairment loss to be measured as the difference between the asset's carrying amount and the estimated future cash flows receivable; and

(g) to amend paragraph 10.27 to clarify that separate disclosure is required of those fair value measurements that are based are a quoted price in an active market for an identical asset or liability.

Background and reasons for bringing this paper to the Board

5 The Board decided at its 1 May 2025 meeting to proceed with developing a Tier 3 Accounting Standard with simplified recognition, measurement, and disclosure requirements for smaller not-for-profit (NFP) private sector entities, and commence redeliberations of the proposals in ED 335.[1]

6 At the May 2025 board meeting, the Board considered the summarised feedback on ED 335 and a proposed categorisation of the extent of the Board's re-deliberation efforts. This paper presents the staff analysis and recommendations for one of the identified Category B topics – Section 10: *Financial Instruments*. The Category B topics are proposals where stakeholders provided mixed feedback or expressed substantive concerns on one or more particular aspects of the proposals.[2]

7 The primary objective of this paper is for the Board to, in respect of the topic covered, decide whether to make any substantive changes to the proposals exposed in ED 335. Staff have not included any revised drafting in this paper. Consistent with the approach taken to the redeliberated topics to date, staff plan to present the revised drafting collectively in November 2025, as per the project timeline outlined in Agenda Paper 6.0. This approach will allow the Board to first consider all decisions on matters of principle, ensuring a comprehensive view of the overall draft Standard.

Summary of the exposed Tier 3 requirements for financial instruments

8 In Section 10 *Financial Instruments* of ED 335, the Board proposed to:

(a) specify requirements within a Tier 3 Standard for:

(i) 'basic' financial instruments; and

(ii) financial instruments commonly held by NFP private sector Tier 3 entities; and

(b) direct entities to apply the recognition and measurement requirements of AASB 9 and other applicable Australian Accounting Standards, and the disclosure requirements of AASB 1060, for:

(i) more 'complex' financial instruments; and

(ii) financial instruments less commonly held by NFP private sector Tier 3 entities.

9 Paragraphs 10.2 and 10.3 of ED 335 listed the following financial instruments as <u>examples</u> of these two groups of financial instruments:[3]

---

1 Per minutes of the 1 May 2025 AASB meeting

2 Refer Agenda Paper 4.2 of the 1 May 2025 AASB meeting for the categorisation of topics as Category A and Category B.

3 The Board developed these listings having regard to the types of financial instruments identified in the NZ Tier 3 Standard, *IFRS for Small and Medium-Sized Entities*, and on consideration of financial instruments identified in AASB Research Report 19 *Common Financial Statement Items: Charities with $0.5–$3 million in revenue*.

Basic/ commonly held financial instruments	More complex / less commonly held financial instruments
• cash and cash equivalents • trade and other receivables ('debtors') • security bonds (e.g. residential bonds) • term deposits • government and listed corporate bonds • units held in managed investment schemes, unit trusts and similar investment vehicles • non-convertible ordinary and preference shares held in listed and non-listed entities, including shares redeemable for a known amount of cash or the cash equivalent of their share of the investee's net assets • trade and other payables ('creditors') • loans (whether bearing interest at fixed or variable rates, interest-free or including terms that create leverage). Loans may be amounts borrowed or lent	• unlisted purchased debt instruments such as unlisted corporate bonds and convertible notes • acquired equity instruments other than non-convertible ordinary and preference shares • financial guarantee contracts • derivatives such as interest rate swaps and forward exchange contracts • commitments to provide a loan at a below-market interest rate

10 In general, ED 335 proposed that basic and financial instruments commonly held by NFP private sector Tier 3 entities are to be recognised initially at their fair value, excluding any transaction costs and fees incurred by the entity in acquiring/settling the financial instrument.[4] Subsequently:

(a) investments in equity instruments and other financial assets acquired or originated by the entity to generate both income and a capital return – are measured at fair value. Changes in fair value are recognised in profit or loss ('FVTPL').

However, an entity may elect to instead present the change in fair value in other comprehensive income ('FVTOCI'). This election applies by class of financial assets, and must be made at the time of initial recognition of the first asset in that class;

(b) other financial assets – are measured at cost, less impairment; and

(c) financial liabilities – are measured at cost.

11 As an exception to these requirements, concessional loans[5] received or granted are initially measured at their transaction price – defined as the cash borrowed/lent – rather than at their fair value.[6] Thereafter, these loans would be measured at cost less any accumulated impairment. In practice, this means that while a $100 cash donation is recognised at its fair value of $100, a $100 donation-in-kind in the form of interest foregone is recognised at $nil.[7]

12 In respect of unquoted equity instruments, ED 335 proposes specified criteria that must be met for a reliable measurement of an unquoted equity instrument's fair value to be regarded as

4 Agenda Paper 6.2 proposes that the initial measurement of debtors should be at their transaction price, rather than fair value. The ED 335 proposal was that debtors are initially measured at fair value. This was defined as the amount of consideration that the entity expects to be entitled to.

5 A concessional loan is defined in ED 335 as "a loan with a contractual interest rate significantly less than the market rate of interest for similar loans as at the date of initial recording, where that lower rate is contracted principally to enable the borrower to further its not-for-profit objectives".

6 AASB 9 requires such loans to be initially measured at fair value. Per AASB 9.B5.1.2A, the difference between fair value and the transaction price is deferred and recognised as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

7 This contrasts with the proposed accounting policy choice accorded to the measurement of donated non-financial assets: to measure the donation at fair value or at the nil or nominal amount. (At its 19 August 2025 meeting, as part of its redeliberations of ED 335, the Board decided that a Tier 3 Standard should continue to permit such accounting policy choice.)

being unavailable (refer paragraph 10.13 of ED 335). Where a reliable measurement of the equity instrument's fair value is:

(a) available – cost may be an appropriate estimate of the equity instrument's fair value in limited circumstances, including when there is:

  (i) insufficient more recent information available to measure fair value; and

  (ii) a wide range of possible fair value measurements, and the instrument's cost represents the best estimate of fair value within that range; and

(b) unavailable – the instrument is measured at a deemed cost, less impairment, until a reliable measure of fair value becomes available.

13 A financial asset measured at cost is impaired only when there is objective evidence of impairment. The impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the asset's contractual interest rate.

14 In respect of disclosures, in addition to those disclosures specified by Section 3 *Statement of Financial Position* (by class) and Section 4 *Statement of Profit or Loss and Other Comprehensive Income*, ED 335 proposes to require various disclosures to be made by subsequent measurement model, and for information about collateral, outstanding loan breaches and defaults, and significant loans made or borrowed, to be disclosed.

Developments since issue of ED 335

Issue of IFRS for SMEs (February 2025)

15 As noted in Agenda Paper 6.0, the International Accounting Standards Board (IASB) reissued the *IFRS for SMEs* in February 2025. As the Board had regard to the related IASB Exposure Draft in developing some of its proposals for financial instruments, staff reviewed the reissued IFRS for differences between the IASB ED (2022) and the final IFRS Standard. Staff note the following differences of potential relevance to the development of the Tier 3 Standard:

(a) the revised *IFRS for SME* requires issued financial guarantee contracts issued for nil consideration to another entity within the group to be accounted for in accordance with the provisions requirements of the IFRS; and

(b) the revised *IFRS for SME* requires disclosure of an analysis of the age of financial assets and a maturity analysis of financial liabilities.

16 The requirements regarding issued financial guarantee contracts are analysed as part of the staff analysis in Table 4 (refer stakeholder comment #4).

17 Staff have not considered further whether a Tier 3 Standard should include disclosure requirements for an aging analysis and a maturity analysis as AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* currently does not include these requirements: the Board's development principles for a Tier 3 Standard regards the disclosures specified by Tier 2 reporting requirements as an upper limit. Further, the previous version of the *IFRS for SMEs* did not include these disclosures even though similar disclosures were previously required by the version of IFRS 7 *Financial Instruments: Disclosures* relevant to an incurred loss impairment model.

Issue of AASB 2025-2 (March 2025)

18 In March 2025 and since the close of comments on ED 335, the Board issued AASB 2025-2 *Amendments to Australian Accounting Standards – Classification and Measurement of Financial Instruments: Tier 2 Disclosures*. The Amending Standard amends AASB 1060 to require Tier 2-compliant general purpose financial statements to:

(a) include information about financial instruments with contingent features that do not relate directly to basic lending risks and costs so that financial statement users can better understand the effect of contractual terms that could change the amount of contractual cash flows;

(b) relocate supplier finance arrangement disclosures from the "Basic Financial Instruments" section of AASB 1060 to the "Statement of Cash Flows" section.

These amendments were prompted by the issue of AASB 2024-2 *Amendments to Australian Accounting Standards – Classification and Measurement of Financial Instruments* in response to post-implementation review of the classification and measurement requirements in AASB 9 and related requirements in AASB 7.

19 Staff note that a financial instrument with contingent features that do not relate directly to basic lending risks and costs is unlikely to be viewed as either a basic financial instrument or a commonly held financial instrument. Therefore, a Tier 3 entity holding such financial instruments will be subject to these additional disclosures.

Summary of feedback received

20 ED 335 included four Specific Matters for Comment (SMC) questions regarding the accounting for financial instruments in general purpose financial statements complying with Tier 3 reporting requirements. Per Agenda Paper 4.3 of the 1 May 2025 Board meeting, of the 18 comment letters that responded directly to ED 335 and the total participants who attended a virtual/in-person outreach session, 9 submissions and between 19 to 22 respondents provided a response to SMCs 16 – SMC 18. In addition, 26 submissions responded to SMC 2(f) concerning the measurement of loans.[8]

21 SMC 16 sought stakeholder views regarding the appropriateness of the identified financial instruments as being either a basic financial instrument or a financial instrument commonly held by a Tier 3 entity, for which the Board proposed to specify simplified accounting requirements. Table 1 below provides an overview of the responses received:

Table 1 SMC 16 responses

	Agreed	**Agreed with exception**	**Disagreed**	**Unsure**
The identified financial instruments are either basic financial instruments or commonly held by a Tier 3 entity				
Out of 9 comment letters that commented on SMC 16	6 (67%)	2 (22%)	1 (11%)	-
Out of 22 participants who attended a virtual/ in-person outreach session and commented on SMC 16	21 (95%)	-	1 (5%)	-

22 SMC 17 sought stakeholder views regarding the appropriateness of the identified financial instruments as being either complex in nature or less commonly held by a Tier 3 entity, and the proposed accounting treatment of these financial instruments. Table 2 below provides an overview of the responses received:

8 The 26 submissions comprised 12 survey respondents and 14 written submissions.

Table 2 SMC 17 responses

	Agreed	Agreed with exception	Disagreed	Unsure
The identified financial instruments are either complex financial instruments or less commonly held by a Tier 3 entity, and their accounting should follow that specified by the topic-based Accounting Standards				
Out of 9 comment letters that commented on SMC 17	6 (67%)	1 (11%)	2 (22%)	-
Out of 21 participants who attended a virtual/ in-person outreach session and commented on SMC 17	17 (77%)	-	3 (14%)	1 (5%)

23 SMC 2(f) and SMC 18 sought stakeholder views regarding the Board's proposed recognition, measurement and disclosure requirements applying to basic financial instruments and financial instruments commonly held by a Tier 3 entity. Table 3 below provides an overview of the responses received:

Table 3 SMC 2(f) and SMC 18 responses

	Agreed	Agreed with exception	Disagreed	Unsure
Proposed recognition, measurement and disclosure requirements applying to basic financial instruments and commonly held financial instruments				
Out of 9 comment letters that commented on SMC 18	3 (33%)	6 (67%)	-	-
Out of 19 participants who attended a virtual/ in-person outreach session and commented on SMC 18	16 (84%)	-	1 (5%)	2 (11%)
Proposed measurement of loans, including concessional loans				
Out of 26 submissions that commented on SMC 2(f)	23 (88%)	-	3 (12%)[9]	-

Staff analysis of stakeholder comments

24 As per Tables 1 – 3 above, stakeholders in the main agreed with the Board's proposals in ED 335 regarding financial instruments. However, several respondents disagreed, or 'agreed with exception' or indicated they were unsure; expressing concern with some aspects of the proposals. Their concerns and comments are summarised and analysed in Table 4 below:

Table 4: Analysis of stakeholder comments

Stakeholder comments	Staff analysis
Requirements for financial instruments should be wholly specified by a Tier 3 Standard	
1. Four stakeholders making a written submission (3 professional bodies, 1 other) and several stakeholders in outreach sessions <u>do not support</u> the proposal to require an entity preparing Tier 3 general purpose financial statements to refer to AASB 9 and other	The Tier 3 Standard is intended to serve as a simple, proportionate response for smaller NFP private sector entities who are not expected to be engaged in complex transactions or generally hold complex or less common financial instruments. Therefore, where held, the Board considered that the highly specialised and complex nature of such financial instruments warrant entities applying the more advanced requirements of Tier 2 Australian Accounting Standards.[10] At its 3 July 2025 meeting, the Board re-deliberated its approach to addressing more complex transactions, balances and other events, including consideration of this aspect of the feedback received on SMC 17.[11] At that

9 While these stakeholders disagreed with SMC 2, their concerns were not specific to the measurement of loans.

10 Per the 13-14 September 2023 meeting minutes

11 Refer Agenda Paper 5.1 of the 3 July 2025 AASB meeting

Stakeholder comments	Staff analysis
applicable Australian Accounting Standards for any financial instruments that are complex or uncommon. Rather, stakeholders considered entities should be permitted to develop their own accounting policies or that a Tier 3 Standard should specify a simplified measurement basis for all financial instruments. In their feedback, a stakeholder (other) observed complexities of the Board's proposed approach include (1) the need for a Tier 3 entity to apply the 'solely payments of principal and interest' and 'business model' tests, (2) the different restrictions that apply for fair value through other comprehensive income (FVTOCI) measurement, and (3) the potential misalignment of the accounting for loan commitments at below-market rates and issued loans.	meeting, the Board decided to confirm its proposed approach of requiring NFP entities preparing Tier 3-compliant general purpose financial statements to apply Tier 2 reporting requirements to more complex and less common financial instruments. Consequently, staff are not seeking any further decision by the Board in address of the feedback on the left of this row seeking an approach of simplified requirements for all financial instruments.
Complete lists of identified basic-common/more complex-less common financial instruments vs. examples	
2. A stakeholder (professional services firm) considered that a Tier 3 Standard should identify an exhaustive (limited) list of basic or more commonly held financial instruments. This stakeholder was of the view that this makes the requirements simpler for preparers unfamiliar with financial instruments and	Having regard to the generally supportive feedback received, staff would ordinarily recommend the Board finalise the proposals as exposed. However, on reflection of the ED and the feedback received, staff think that the exposed proposals might specify accounting that is not wholly consistent with the Board's decisions when developing its financial instrument proposals. This is because the feedback suggests that paragraphs 10.2 and 10.3 are read as scoping the accounting for all financial instruments, whether or not specifically identified in these paragraphs.[14] However, staff understand the Board intent was to describe the accounting for some, but not all, complex financial instruments. Staff understand the Board decision was, consistent with its preliminary views in AASB Discussion Paper *Development of Simplified Accounting*

14 Paragraphs 10.2 and 10.3 of ED 335 state:

10.2 Section 10 applies to the recording, measurement and disclosure of financial assets and financial liabilities arising from basic financial instruments or financial instruments commonly held by not-for-profit private sector Tier 3 entities. Those financial instruments **include**: … [emphasis added]

10.3 An entity applying this Standard shall apply the requirements of AASB 9 *Financial Instruments* and other applicable Australian Accounting Standards to account for more complex financial instruments and financial instruments not commonly held by not-for-profit private sector Tier 3 entities, **such as** the following financial instruments: … [emphasis added]

Stakeholder comments	Staff analysis
who might otherwise struggle to determine which financial instruments should be accounted for in accordance with Section 10 vs AASB 9. Also, making the list exhaustive would promote consistency of treatment. Similarly, a stakeholder in an outreach session contemplated that the complex financial instruments list should be exhaustive to reduce the need for judgement and allow more unlisted financial instruments to fall under Tier 3 accounting requirements. In contrast, several stakeholders explicitly indicated support for:[12] • the list of basic and other more commonly held financial instruments identified in a Tier 3 Standard being non-exhaustive (2 professional services firms). Some of these stakeholders noted that financial instruments can change over time, which means an exhaustive list may become outdated;[13] and/or • the list of more complex and less commonly held	*Requirements (Tier 3 Not-for-Profit Private Sector Entities)* preceding ED 335, to: • specify simplified accounting for the basic financial instruments identified in paragraph 10.2. These financial instruments were identified as non-complex financial instruments that are expected to be commonly held by Tier 3 entities; • require Tier 2 accounting for the more complex financial instruments identified in paragraph 10.3; and • require the entity to develop an accounting policy for all other financial instruments.[15,16] Per the proposed hierarchy set out in paragraph 9.5 of ED 335, in forming its accounting policy a Tier 3 entity would first have regard to the principles and other reporting requirements in the Tier 3 Standard dealing with similar and related issues. As such, in applying the hierarchy: • some complex or less commonly held financial instruments might be accounted for consistently to basic financial instruments; and • it is less likely that an entity will need to apply the accounting specified by AASB 9 to a financial instrument not specifically identified in paragraph 10.3. As part of the outreach sessions, staff sought feedback as to whether it is practical for a Tier 3 Standard to specify examples of both (1) basic financial instruments or commonly held financial instruments, and (2) more complex financial instruments and less commonly held financial instruments, rather than specify a defined set of financial instruments for at least one of these two categories. The feedback received suggests that many stakeholders did not view this to be of concern. This possibly implies that a majority of stakeholders could be either: • less concerned that AASB 9 applies to the accounting for more instruments than the Board originally intended (as explicitly commented to in some submissions/ in outreach); or that • they do not regard the proposals as resulting in a situation whereby significant numbers of Tier 3 preparers would need to consider a Tier 3 Standard and also AASB 9, AASB 132 and AASB 139 in accounting for financial instruments. Or, some stakeholders may have simply not yet considered the practical implications of the proposal as exposed, given those financial instruments

12 It was not clear from other written submissions whether the stakeholder only agreed with the categorisation of the identified financial instruments as basic or complex (i.e. complete lists), or whether the stakeholders also supported that the set of basic and commonly held, and more complex and less commonly held financial instruments could be broader than identified (i.e. non-exhaustive lists).

13 Several stakeholders in outreach sessions provided similar feedback at the outreach session consistent to their written submissions. Stakeholders were concerned that a limited list could exclude other products with similar features from being classified as basic or common financial instruments.

15 Examples of such 'unaddressed' financial instruments include issued compound financial instruments, puttable financial instruments, treasury shares, loan commitments, contracts to buy or sell a non-financial item that can be settled net of cash, and financial instruments resulting from securitisation activity. These and other financial instruments were not specifically identified as part of the proposed Tier 3 Standard because the Board considered that such financial instruments would be uncommon to a Tier 3 NFP private sector entity. Hence, the Board did not want to develop specific accounting requirements for such financial instruments. In forming its decisions, the Board was keen to avoid a situation whereby significant numbers of Tier 3 preparers would need to consider a Tier 3 Standard and also AASB 9, AASB 132 and AASB 139 in accounting for financial instruments.

16 Refer Minutes and Agenda Paper 5.3 of the 29-30 November 2023 AASB meeting.

Stakeholder comments	Staff analysis
financial instruments identified in a Tier 3 Standard being non-exhaustive (3 professional services firms). Some of these stakeholders indicated that they expect the impact of the proposal to be minimal since the financial instruments are expected to be complex or uncommon.	not specifically identified are not expected to be commonly held by smaller NFP private sector entities. In view of the development history noted above and feedback received, staff are seeking the Board's reconfirmation or other decision on the scope of the financial instrument proposals. Staff think that the Board could either finalise the requirements as suggested by paragraphs 10.2 and 10.3 of ED 335, or refine the exposed requirements to better align to its intention in developing the requirement. Finalising the requirements as suggested by paragraphs 10.2 and 10.3 of ED 335 arguably provides clearer direction on the accounting for financial instruments as it specifies the accounting for all, rather than only some, financial instruments. Staff note that given the range of transactions, balances and other events for which Tier 2 accounting must be applied (per paragraph 1.3 of ED 335), there could be expected to be only limited other instances besides financial instruments for which the proposed Tier 3 Standard does not specify an accounting policy but require the application of the 'accounting hierarchy' in paragraph 9.4 of ED 335 (for example, accounting for termination benefits or service concession arrangements). However, limiting the scope of the financial instruments addressed by simplified accounting (or directed to AASB 9) appears to overall require simpler accounting compared to finalising the requirements as exposed. Further, doing so will be consistent with the preliminary view exposed in the Discussion Paper for which the Board received mainly supportive feedback. Given this, and that there is some stakeholder support for entities to develop accounting policies by reference to the Tier 3 accounting hierarchy, and the expected irregularity of a need to do so, staff's preliminary assessment is that departing from the exposed proposal in this regard will not of itself warrant re-exposure of the Board's Tier 3 proposals. *Staff recommendation – basic financial instruments and commonly held financial instruments* In view of the mostly supportive feedback received for a Tier 3 Standard to not describe a complete list of basic and other commonly held financial instruments, **staff recommend** that a Tier 3 Standard continue to specify, but not limit, the population of basic and other commonly held financial instruments. Keeping the Tier 3 Standard principles based: (a) helps future proof the requirements as the composition of 'commonly held financial instruments' could extend over time; and (b) is unlikely to result in any practical difference compared to restricting both lists. However, to help limit any potential diversity in practice and stakeholders suffering costs in interpreting "commonly held", staff note that the Board could communicate an expectation that, in the short-to-medium term, financial instruments not specifically identified in the Standard are unlikely to be regarded as being commonly held by Tier 3 entities. Staff think this could be communicated through comment in the Basis for Conclusions to a Tier 3 Standard. *Staff recommendation – more complex and less commonly held financial instruments* Staff think that a deciding factor regarding the accounting treatment for more complex and less commonly held financial instruments might be whether the Board considers that it is likely that there are 'more complex' financial instruments not listed in paragraph 10.3 for which the Tier 3

Stakeholder comments	Staff analysis
	simplified accounting policies and disclosures provide relevant and faithfully representative information (the Board has already decided that the items listed in paragraph 10.3 warrant the application of Tier 2 accounting requirements). On regard of the types of items listed in footnote #14 above,[17] and in view of the supportive feedback received for a Tier 3 Standard to not describe a complete list of more complex and less commonly held financial instruments, **staff recommend** a Tier 3 Standard continue to specify, but not limit, the population of more complex financial instruments and less commonly held financial instruments for which Tier 2 accounting requirements apply. Keeping the Tier 3 Standard principles based helps future proof the requirements as new financial instruments might be developed over time. *<u>Further Board direction required regarding embedded derivatives, if the Board agrees with the staff recommendation to not specify a complete list of more complex-less commonly held financial instruments</u>* In its Discussion Paper preceding ED 335, the Board formed a preliminary view that a proportionate response for Tier 3 reporting requirements would be to not require an entity to separately recognise certain derivative financial instruments when they are not readily identifiable and measurable, including any embedded derivatives. Stakeholders provided feedback indicating that smaller NFP private sector entities are less likely to enter into contracts containing embedded derivatives. The feedback was caveated that any embedded derivatives might not be simple to identify. Staff note that consequential to the drafting of paragraph 10.2 and 10.3 of ED 335, a preparer might be expected to identify whether any embedded derivatives in a contract exist, and where the conditions are met per AASB 9, recognise and measure these financial instruments separately in accordance with AASB 9. This adds further costs to a Tier 3 preparer even though, for many entities, no embedded derivatives might be present. Therefore, similar to hedge accounting, **staff recommend** that a Tier 3 Standard additionally explicitly specify that an entity need not separately recognise and measure embedded derivatives. *[Staff note: The search for embedded derivatives is less relevant where the listing of more complex and less common financial instruments is complete (i.e. does not use the words 'include' or 'such as'). This is because in such instances the accounting hierarchy applies instead of the scope of AASB 9. As such, entities will be required to develop an appropriate accounting policy: there is no explicit requirement to search for and identify embedded derivatives or to separately recognise and measure them.]*
3. A stakeholder (other) considered that there is no obvious distinction between basic financial instruments and complex financial instruments. The stakeholder noted that therefore, it is not clear which provisions to apply. Similarly, a stakeholder (professional services firm) in an outreach session noted a preference for the	Staff note that similar feedback about the 'blunt' categorisation of financial instruments was received as part of the Discussion Paper preceding ED 335, and considered by the Board in developing ED 335. Staff think that basic and complex should be interpreted having regard to their plain English meaning, and that adding further description to help explain the nature of these financial instruments will introduce unnecessary complexity to a Tier 3 Standard. The listings of basic financial instruments and more commonly held financial instruments, and more complex and less commonly held financial instruments, already provide guidance to help preparers determine which provisions apply. Further, in developing those listings, the Board's expectation was that many of the financial instruments held by Tier 3 entities should be on one of those lists; therefore, it should only be in rare instances that an entity would need to apply further judgement to

17 Staff also had regard to the hybrid financial instruments described by a stakeholder

Stakeholder comments	Staff analysis
Standard to include principles defining what constitutes basic or complex financial instruments.	determine the classification of a financial instrument. Consequently, **staff recommend** making no change to the proposals in response to the stakeholder feedback.
4. Three stakeholders (2 professional bodies, 1 other) identified financial instruments that they considered should be addressed by simplified accounting in a Tier 3 Standard: • commitments to provide a loan to another entity at a below-market interest rate (3 stakeholders); • financial guarantee contracts (3 stakeholders); and • hybrid financial instruments, particularly hybrids issued by banks (and others) that have debt-like returns but have associated franking credits (1 stakeholder). One of these stakeholders (other) considered that financial guarantee contracts should be accounted for consistently with other provisions requirements. The other stakeholders suggested that these contracts should be measured at their fair values.	The Board's decision to identify financial guarantee contracts and commitments to provide a loan at a below-market interest rate as being more complex in nature, or less commonly held, had regard to its findings from AASB Research Report 19[18] and its review of the types of financial instruments considered basic or addressed in the Accounting Standards of other jurisdictions dealing with smaller NFP private sector entities. Financial guarantee contracts and below-market interest rate loan commitments were also identified in the AASB Discussion Paper preceding ED 335 as possible examples of more complex financial instruments. The stakeholder feedback received on the Discussion Paper did not prompt the Board to change its position on the nature of, or the accounting for, these financial instruments between the Discussion Paper and ED 335. Additionally, in developing its proposals in ED 335, the Board considered similar stakeholder feedback received regarding the potential investment of a NFP entity in hybrid financial instruments. Having regard to its Research Report findings, the Board noted that these securities, besides possibly being convertible or containing a derivative, are not expected to be commonly held by smaller NFP entities. Therefore, the Board decided that a Tier 3 Standard should not specify simplified accounting requirements for these financial instruments. Nevertheless, in view of the repeated stakeholder feedback received on ED 335 about these financial instruments being basic or commonly held by smaller NFP private sector entities and given the time since issue of AASB Research Report 19, staff considered whether there is any new evidence to support that these financial instruments should also have their accounting also specified by a Tier 3 Standard. To be in line with other Board decisions, this would require the financial instrument to either be a basic financial instrument, or a type of financial instrument commonly held by Tier 3 entities. To this end, staff took two actions: (1) further inquiry of staff from the professional body stakeholders to understand the basis for their comments; and (2) review of a limited sample of the most recent financial statements of ACNC 'medium'-sized entities to identify whether such instruments are present.[19] From the work performed, staff have not identified any further evidence that would suggest that hybrid financial instruments, commitments to provide a loan at a below-market rate, or financial guarantee contracts are commonly held by smaller NFP private sector entities.[20]

18 AASB Research Report 19 *Common Financial Statement Items: Charities with $0.5–$3 million in revenue* (April 2023) analysed the financial reports of 260 ACNC-registered entities in the revenue range of $500k – $3million, and informed the Board as to the types of financial instruments held by smaller NFP private sector entities.

19 Staff reviewed the ACNC-lodged 2024 financial statements of 20 medium-sized entities. The entities were from a mix of geographical locations and undertook a mix of activities. Of the 20 financial statements selected, 14 were described as special purpose financial statements.

20 Staff note that the submission from the professional bodies suggested that loan commitments and financial guarantees should be identified as basic financial instruments. On further inquiry of staff from these stakeholders, staff understand that the stakeholder concern is that the proposed accounting (AASB 9) for these instruments is inappropriate, rather than a view that these instruments have a 'basic' nature. One of these stakeholders noted that their submission conveyed the feedback received from their members that financial guarantee contracts and loan commitments are transactions undertaken by NFP entities.

Stakeholder comments	Staff analysis
	<u>*Hybrid financial instruments*</u> Having regard to the above history and additional work performed, **staff recommend** that the Board make no changes to its proposals in response to the stakeholder feedback for the accounting for hybrid financial instruments. The accounting for these financial instruments should continue to be specified by AASB 9 or other relevant topic-based Australian Accounting Standards.[21] <u>*Financial guarantee contracts*</u> In addition to the work described above, staff note that in developing its proposals in ED 335, the Board decided that Tier 2 reporting requirements should apply to financial guarantee contracts because these are more complex financial instruments.[22] At that time, the Board observed that the Board's final decisions for a Standard may be informed by how the IASB completes its then-proposal for a revised *IFRS for SMEs* to regard all issued financial guarantee contracts as basic financial instruments. The revised *IFRS for SMEs* (February 2025) specifies that only issued intragroup financial guarantee contracts issued for nil consideration are to be measured similarly to a provision, rather than at fair value (as previously required). The impetus for the IASB decision was the feedback received that most financial guarantee contracts issued by SMEs are intragroup financial guarantee contracts, and that the fair value of such contracts can be difficult and subjective to measure resulting in the costs exceeding the benefits of doing so.[23] Unlike the IASB, the Board has not received feedback indicating that intragroup or other financial guarantee contracts are common transactions engaged in by smaller NFP private sector entities nor any significant contention to its proposals for financial guarantee contracts. Staff also note that the revised *IFRS for SMEs* does not depict issued financial guarantee contracts as basic financial instruments. Therefore, because neither the 'basic financial instrument' nor the 'more commonly held' financial instruments arms of the Board's condition for simplified accounting are met, **staff recommend** that the Board make no changes to its proposals in response to the stakeholder feedback regarding financial guarantee contracts.

21 As noted in stakeholder comment #1 above, a stakeholder observed that the conditions for FVTOCI measurement differ slightly between AASB 9 and the proposed Tier 3 requirements. Staff note that if the Board agrees with the staff recommendation regarding hybrid financial instruments as well as the staff recommendation for Tier 2 reporting requirements to apply to all more complex financial instruments, the election to present changes in the fair value of hybrid and other more complex financial assets that are held to generate income and a capital return for the entity in other comprehensive income can be made on an asset-by-asset basis. This potentially introduces some complexity into the Tier 3 financial statements as the FVTOCI election applies by class to basic financial instruments . However, staff think that such situation is likely to be rare.

22 ED 335 proposes that Tier 2 reporting requirements apply to both issued and received financial guarantee contract arrangements. Accordingly, a Tier 3 entity recipient (holder) of a financial guarantee contract has a contingent asset that is measured in accordance with AASB 137 *Provisions, Contingent Assets and Contingent Liabilities* and subject to the relevant AASB 1060 disclosures until such time as the conditions for recognition as an asset are met. In the main, these requirements are consistent with those applicable to contingent assets within the scope of Section 19 of ED 335. Therefore, unlike issued financial guarantee contracts, the practical implications of the Board's proposal for held financial guarantee contracts are expected to be limited.

23 Refer Basis for Conclusions paragraph BC11.25 of the *IFRS for SMEs*.

Commitments to provide a loan at a below-market rate

In respect of commitments to provide a loan at a below-market rate, having regard to the stakeholder feedback summarised in stakeholder comment #1 above, staff additionally analysed the interaction between the accounting for commitments to provide a loan at a below-market interest rate and the ED 335 proposals for loans granted. On further reflection, staff think the resultant accounting may not faithfully represent the performance of the entity issuing the loan. This is due to the interaction between the measurement requirements for the loan commitment with those for the issued loan, as illustrated below.

Assume the following example: On 1/1/X0 NFP Entity A enters into an arrangement to issue NFP Entity B a $1000 interest-free loan in a year's time. The loan is repayable is 3 years' time and the market interest rate of a comparable loan is 10%. NFP Entity A expects that there will be $nil expected credit losses associated with the loan.

Ignoring discounting, under AASB 9 the following journal entries are recorded:

1/1/X0

DR Loan commitment expense	$300	
CR Loan commitment liability		$300

Recognition of the loan commitment liability at fair value

1/1/X1

DR Loan commitment liability	$300	
DR Loan asset	$700	
CR Cash		$1000

Issue of loan and settlement of the loan commitment liability. Per AASB 9, the loan is initially recognised at fair value and thereafter at amortised cost.

30/12/X1 – 30/12/X3 (journal entries are aggregated)

DR Loan asset	$300	
CR Interest income (aggregate)		$300

Interest is recognised using the effective interest method

31/12/X3

DR Cash	$1000	
CR Loan asset		$1000

Receipt of monies due under the loan terms

However, under the ED 335 proposals, if the loan is a concessional loan, the loan asset is initially recognised at its transaction price and thereafter subsequently measured at cost less any accumulated impairment losses. It follows then that the extinguishment of the loan commitment liability has to be reflected in profit or loss, and there is no interest income to recognise as the loan is interest free. Consequently, in contrast to Tier 1/ Tier 2 reporting requirements, the following journal entries are recorded instead:

1/1/X0

DR Loan commitment expense	$300	
CR Loan commitment liability		$300

Recognition of the loan commitment liability at fair value

1/1/X1

DR Loan asset	$1000	
CR Cash		$1000

and

Stakeholder comments	Staff analysis
	DR Loan commitment liability $300 CR Extinguishment of the loan commitment liability (p/l) $300 *Issue of loan and settlement of the loan commitment liability. Per ED 335, the loan is initially recognised at the transaction price and thereafter at cost less impairment.* <u>30/12/X1 – 30/12/X3 (journal entries are aggregated)</u> DR Loan asset $nil CR Interest income (aggregate) $nil *Interest is calculated as the opening carrying amount of the asset x contractual interest rate (0%)* <u>31/12/X3</u> DR Cash $1000 CR Loan asset $1000 *Receipt of monies due under the loan terms* Staff think the resultant accounting may not faithfully represent the performance of the entity issuing the loan because conceptually, income should not arise from the issue of a loan at below-market rates.[24] To address the accounting outcomes resulting from the measurement of the loan asset on a different basis to AASB 9, **staff recommend** that the proposals be amended to no longer require the recognition of a commitment to provide a loan at a below market-rate, similar to how other loan commitments are not recognised under drawn. This action does not categorise the commitment to provide a loan at a below market-rate as a basic financial instrument nor as a commonly held financial instrument. However, the staff recommendation resolves the stakeholder concern that a

24 A similar outcome results in instances where the loan is not a concessional loan. If the loan is <u>not</u> a concessional loan, under the ED 335 proposals the loan asset is thereafter subsequently measured at cost less any accumulated impairment losses and there is no interest income to recognise as the loan is interest free. Consequently, on settlement of the loan asset, NFP Entity A may need to recognise a gain on settlement for the difference between the carrying amount of the loan asset and the cash received. In contrast to Tier 1/ Tier 2 reporting requirements, the following journal entries are recorded:

<u>1/1/X0</u>

DR Loan commitment expense $300
CR Loan commitment liability $300
Recognition of the loan commitment liability at fair value

<u>1/1/X1</u>

DR Loan commitment liability $300
DR Loan asset $700 (potentially higher)
CR Cash $1000
CR Gain on extinguishment of the loan commitment $nil (but could be up to $300)
Issue of loan and settlement of the loan commitment liability. Per ED 335, the loan is initially recognised at fair value and thereafter at cost less impairment.

<u>30/12/X1 – 30/12/X3 (journal entries are aggregated)</u>

DR Loan asset $nil
CR Interest income (aggregate) $nil
Interest is calculated as the opening carrying amount of the asset x contractual interest rate (0%)

<u>31/12/X3</u>

DR Cash $1000
CR Loan asset $700 (or other initial carrying amount)
CR Gain on loan settlement $300 (difference between $1000 and the loan carrying amount)

Receipt of monies due under the loan terms

Stakeholder comments	Staff analysis
	commitment to issue a loan at a below-market interest rate is recognised and measured in accordance with AASB 9. Staff think it is necessary to develop a requirement as otherwise, per the proposals in ED 335, AASB 9 will continue to apply; similar to the search for embedded derivatives. The staff recommendation presumes that the Board agrees with the staff recommendation for paragraphs 10.2 and 10.3 to be finalised as exposed. However, if the Board does not agree with that staff recommendation, staff think that the accounting concern could be addressed by simply removing the commitment to provide a loan at a below market-rate from the listing of more complex and less commonly held financial instruments.
Hedge accounting	
5. A stakeholder (professional services firm) disagreed that hedge accounting should be disallowed. This stakeholder considered that this would be inconsistent with the proposal to require entities to apply AASB 9 and other applicable Australian Accounting Standards to more complex and less commonly held financial instruments.	The Board's preliminary view to not permit hedge accounting was exposed in the AASB Discussion Paper preceding ED 335. In developing the proposals in ED 335, the Board considered feedback to its Discussion Paper consistent with that noted on the left hand side of this row. The Board decided to proceed with its preliminary view having regard to its objectives in developing Tier 3 reporting requirements as a proportionate response for smaller NFP private sector entities and on consideration that hedge accounting is unlikely to be a practice adopted by Tier 3 entities, even if available to the entity. Therefore, on consideration that: (a) both a majority of respondents to ED 335 and the AASB Discussion Paper indicated support for, or otherwise did not object to, the proposal to not allow hedge accounting in Tier 3 general purpose financial statements; (b) the stakeholder feedback does not provide any new compelling evidence that should cause the Board to change its views; and (c) the direction, offered as a simplification, stops entities from incurring potentially avoidable costs (if hedge accounting is attempted and ultimately determined to not be available); **staff recommend** that a Tier 3 Standard continue to explicitly disallow the hedge accounting available under AASB 9 as an applicable accounting policy in Tier 3-compliant general purpose financial statements. That is, to finalise the requirement as exposed in ED 335.[25]
Initial measurement	
6. A stakeholder (professional services firm) considered that ED 335 presumes but does not state that the fair value of a debt instrument is given by its nominal/ face value. The stakeholder recommended that a Standard include specific	In developing its proposals, the Board formed a preliminary view to require financial assets and financial liabilities to be initially recognised at their fair values because these would typically be an amount consistent to the transaction price. While the Board received feedback that the transaction price may not always be equal to the financial instrument's fair value, the Board did not receive any substantive disagreement to its proposal to do so. As such, in ED 335 the Board developed a requirement for financial assets and financial liabilities to be initially measured at their fair value.

25 Paragraph 10.8 of ED 335 currently specifies that hedge accounting is not permitted. On reflection, and assuming that the Board agrees with the staff recommendation for hedge accounting, staff think that such direction would be better presented closer, and possibly as a "notwithstanding"-type paragraph, to the instruction for complex and less common financial instruments to be accounted for in accordance with AASB 9 and other applicable Australian Accounting Standards. Staff intend to present this proposed change to the Board as part of its consideration of a draft Standard.

Stakeholder comments	Staff analysis
treatment for such transactions: potentially, a statement that cost is considered fair value for specific classes of instruments.	Staff note that the fair value of a debt instrument may, in certain circumstances, not be given by its nominal or face value; for example, if the collectability of the debt instrument is suspect or if the interest yield differs to that currently available on similar products. In addition, fair value is a market-based assessment, which may differ from the consideration paid by the entity in exchange for the financial instrument. Nevertheless, as suggested by the stakeholder feedback, entities may benefit from guidance that the fair value of a debt instrument will, in many instances, be given by the consideration exchanged for it. However, on balance, staff think that such guidance could potentially add unnecessary complexity to the Tier 3 Standard. Therefore, **staff recommend** making no change to the proposals in response to the stakeholder comment.
7. A stakeholder (other) observed that the market price of an acquired bond may differ from its face value. This difference results in either a premium or discount on the bond on their acquisition. The stakeholder considered that the proposals are unclear as to how these premiums or discounts are to be treated.	Staff note that the proposals require such bonds to be initially recognised at their fair value. Staff think it follows therefore that any premium or discount to the face value of the bond will be recognised as part of the asset's carrying amount. Income or an expense for the difference between the face value of the bond and the price paid is recognised when the financial asset is settled through repayment by the issuer of the face value of the bond.[26] Consequently, staff think that the proposals are sufficiently clear how such premiums and discounts are to be treated, and **staff recommend** making no change to the proposals in response to the stakeholder comment. *<u>Further Board direction required: Interest expense/income</u>* Paragraph 10.16 of ED 335 states "The interest expense (income) in a period equals the carrying amount of the financial liability (asset) as at the beginning of a period multiplied by the contractual interest rate for the period". As highlighted by the bond situation described by the stakeholder, the carrying amount of the financial asset/ financial liability might not be the same as its face value, leading to a situation where the interest calculated in accordance with ED 335 might not be the same as the contractual cash receipts/payments. In addition, on reflection, staff also note that the requirement as specified may not adequately address situations where the carrying amount of the financial asset/ financial liability changes during a reporting period and the interest owed correspondingly changes (for example, interest earnt on a bank balance, or a term deposit entered into during the period). In light of these observations, **staff recommend** amending paragraph 10.16 to acknowledge such situations. Staff intend to bring proposed drafting in this regard for the Board's consideration as part of a draft Tier 3 Standard.
8. A stakeholder (professional services firm) noted that the proposals do not explain how the discount in a concessional loan should be amortised.	Paragraph 10.6 of ED 335 proposes that the loan asset (or loan liability) is initially recognised at its transaction price, being the amount of cash lent. This measurement does not include the 'lost income' or 'saved expense' resulting from the concession given or received. That is, the discount component of the concessional loan is not recognised, and therefore, no amortisation of the discount is required. Consequently, staff think that there is no need for the Standard to address the discount in a concessional loan. **Staff recommend** making no change to the proposals in response to the stakeholder comment.

26 In contrast, under AASB 9 the initial carrying amount of the bond (fair value) would increase or decrease over its life through application of the effective interest method, until the carrying amount of the bond equals its face value on maturity.

Stakeholder comments	Staff analysis
9. Two stakeholders (1 professional services firm, 1 other) disagreed that transaction costs and fees should be immediately expensed. Rather, transaction costs should instead be capitalised and amortised on a straight-line basis over the life of the financial instrument. Such treatment would increase comparability with entities complying with Tier 1 and Tier 2 reporting requirements. One stakeholder (other) noted that transition costs could be significant. The other stakeholder considered the accounting policy to be a significant departure from Australian Accounting Standards that could give rise to undesirable outcomes. That stakeholder envisaged a scenario in which an entity purchases 'points' that are immediately expensed while simultaneously potentially giving rise to a concessional loan, as contractual interest payments may not be interpreted as including points.	The Board formed a preliminary view in its Discussion Paper preceding ED 335 to require transaction costs to be expensed as incurred as a simplification measure. In forming its proposals in ED 335, the Board considered the feedback received against its preliminary view, including potential capital gains tax implications, the profit and loss impact, and that transaction costs could be relatively large. The Board decided to develop proposals consistent with its preliminary view as it considered such action was unlikely to result in a material misrepresentation of the financial instruments while eliminating the costs of identifying, monitoring and amortising transaction costs. The feedback received on the Discussion Paper did not include the 'points' scenario. Staff think the submission is referencing mortgage discount points, which are upfront fees paid to the lender in exchange for a reduced interest rate on the loan: the points are in the nature of prepaid interest. As suggested by the stakeholder feedback, the resulting accounting might be complicated.[27] However, staff's research suggests that buying mortgage discount points is not common in Australia.[28] Rather, other actions such as managing the loan-to-value ratio are used to secure lower interest rates. Consequently, having regard to the simplification objectives of the project and the range and extent of those to whom the issue might apply, **staff recommend** that no changes be made to the proposed requirements exposed in ED 335 to address the scenario identified.
Financial assets originated or acquired to generate both an income and a capital return	
10. A stakeholder (professional services firm) considered that paragraph 10.7(a) of ED 335 could be interpreted as only allowing financial assets that have been originally originated or acquired to generate both income and a capital return to be	Paragraph 10.7(a) states "At the end of each reporting period, an entity shall measure financial assets and financial liabilities as follows, without any adjustment for transaction costs: (a) financial assets acquired or originated by the entity to generate both income and a capital return for it (including all investments in equity instruments) shall be measured at fair value …" On reflection, staff observe that the drafting may inadvertently limit the proposed requirement as staff's understanding is that the Board's intention is to require all financial assets that are held to generate both income and a possible capital return for the entity to be measured at fair value, even if this was not the original intention of the entity in acquiring or originating the

27 Staff note that accounting complexities that could arise might include identification of the component of the loan that reflects the concession (donation) vs. the reduction attributable to the points purchase, or estimate of the fair value of the non-concessional loan at initial recognition.

28 Staff performed a search engine keyword search on 5 first tier and 10 second tier lenders in Australia and 'mortgage points'. Staff identified only one financial institution offering a paid annual product that will give the customer a lower interest rate on their loan.

Stakeholder comments	Staff analysis
measured at fair value. The stakeholder recommended that the Board clarify that its intent is to require fair value measurement for all financial assets that generate returns in the form of income and capital regardless of the Tier 3 entity's original purpose in acquiring or originating these assets. The stakeholder considered that paragraph 10.7(a) as currently drafted would not necessarily result in the consistent treatment of investments in listed equities (at fair value) or investments in unlisted bonds (at cost less impairment).	asset.[29] Staff note that the reference to "held" was in drafting the ED amended to "originated or acquired" to address stakeholder feedback that the preparer could change their purpose over time for holding an asset resulting in different measurement for similar assets. The stakeholder feedback received on ED 335 reflects that the amendment may not have achieved its purpose, but merely changed the timing of the decision about the asset's purpose. Having regard to the intended entities for which the Tier 3 Standard is being developed and AASB Research Report 19's identified commonly held financial assets, staff think it would be in rare instances that a difference in practice would result from the drafting. However, staff agree that confusion could arise. Therefore, having regard to the stakeholder comment and acknowledging other stakeholder comments to reduce the verbosity of the Standard and to be clearer, staff recommend the Board take one of the following Actions: • Action A: amend paragraph 10.7(a) to clarify that all financial assets <u>held</u> to generate both income and a capital return for the entity are to be measured at fair value; or • Action B: amend paragraph 10.7(a) to clarify that all financial assets <u>capable of</u> generating both income and a capital return for the entity are to be measured at fair value. Action A aligns the accounting with the management intent for investing in the asset. It recognises that it might be possible for the entity to change its accounting policy for an asset (between fair value/cost) should the way the asset is used is changed. Action B focuses on the nature of the asset rather than the purpose/intent of the investment. Therefore, Action B prioritises consistency in the accounting treatment of similar assets between entities. On balance, **staff recommend** Action A (amending paragraph 10.7(a) to clarify that all financial assets <u>held</u> to generate both income and a capital return for the entity are to be measured at fair value). Staff think Action A is more consistent with the Board's principles for developing Tier 3 requirements.
11. 2 stakeholders (1 professional services firm, 1 other) raised concerns about mandating fair value measurement for <u>all</u> financial assets acquired or originated by the entity to generate both income and a capital return. These stakeholders noted that: (a) bonds may be issued or purchased on-market at prices differing from their par value, giving rise to a capital return (1 other); (b) the fair value estimate may not be sufficiently	<u>*Bonds acquired at a price different to their face value*</u> Staff think that issuing or purchasing bonds on-market at prices differing from their par value does not necessarily mean that the asset is being held to generate a potential capital return for the entity. This is because the condition for fair value measurement has regard to the intent of the entity in acquiring/ holding the asset. As such, staff think that these bonds could still qualify for measurement at cost less impairment under the ED 335 proposals. Having regard to the findings of AASB Research Report 19, staff do not expect smaller NFP private sector entities to be commonly engaged in the active trading of bonds to generate a capital return for the entity. Nevertheless, if so, staff think that fair value measurement for such assets is warranted and consistent with other investments held for similar purposes. <u>*Challenges in developing the estimate*</u> Developing an appropriate fair value estimate is not a challenge unique to smaller NFP private sector entities. When developing ED 335, the Board

29 Refer Agenda Paper 5.3 of the 29-30 November 2023 meeting and the associated meeting Minutes.

Stakeholder comments	Staff analysis
precise to assure (1 firm); and (c) an obligation to determine a financial asset's fair value could result in non-proportionate cost being incurred (1 firm). One of these stakeholders (professional services firm) suggested adding an optional exception from fair value measurement for classes of assets where there is no active market. The other stakeholder considered that cost was a more appropriate measurement basis for some financial assets.	determined that the benefits of fair value measurement for a smaller NFP private sector entity would exceed the costs of doing so for financial assets that are held to generate both an income and a capital return for the entity, especially with the addition of fair value measurement relief in circumstances when a reliable measure of fair value might not be available (paragraph 10.13 of ED 335) and guidance indicating when the cost of an unlisted equity instrument may be representative of its fair value (paragraphs 10.9 – 10.10 of ED 335). Noting the absence of contention in this regard from other stakeholders who are professional services firms, staff think that the relief available is sufficient to address the stakeholder concern that it might not be possible for the entity to develop a fair value estimate that is sufficiently precise for assurance purposes, at least without undue costs to the entity. Having regard to the above analysis, **staff recommend** that a Tier 3 Standard continue to require fair value measurement for <u>all</u> financial assets held by the entity to generate both income and a capital return for the entity.
12. A stakeholder (professional services firm) considered that the election to measure financial assets at FVTOCI should be made asset-by-asset, similar to AASB 9, as assets (such as shares) of the same class may be held for different purposes.	<u>*Making the election on an asset-by-asset basis vs. by class of financial asset*</u> Staff note that in forming its views, the Board did not specifically discuss whether the election should be available on an asset-by-asset basis rather than applying as an accounting policy to the entire class of financial assets held to generate both income and a capital return for the entity. However, staff think that a 'by class' decision is consistent with the simplification objectives of the Board project as it does not introduce another point of complexity to preparers for potentially little adoption difference in practice. Staff further note that the decision to allow a choice of accounting policy was already a simplification from the Board's preliminary views which would have required all assets held for an income and capital return to be measured consistently at FVTOCI.[30] Accordingly, on balance and observing the absence of any significant contention regarding this aspect of the proposals from other stakeholders, **staff recommend** making no changes to the proposed requirements in response to the stakeholder feedback. <u>*Shares held for different purposes*</u> Paragraph 10.7(a) of ED 335 expresses that all investments in equity instruments are financial assets acquired or originated to generate both an income and capital return for the entity. On reflection of the stakeholder comment, staff consider that it is possible that some ordinary shares may not be held by the entity in order to generate both income and a possible capital return for the entity. An example of this might be an equity interest held in another NFP entity which does not result in the reporting entity having at least significant influence over that NFP entity. In this instance, the financial asset might be primarily held to operationally facilitate the delivery of, rather than to fund, the entity's NFP activities.

30 The Board's preliminary view expressed in the Discussion Paper preceding ED 335 was for all financial assets that are held to generate both income and capital return for the entity to be measured at FVTOCI. As noted in paragraph BC69 of ED 335, having regard to the stakeholder feedback received, the Board decided to modify its views and propose instead that the fair value changes of these assets be recognised in profit or loss unless the entity makes an irrevocable decision to present such gains and losses in other comprehensive income.

Stakeholder comments	**Staff analysis**
	The Board's deliberations to date primarily focused on shares and other equity instruments held to earn an investment return for the entity's excess cash holdings as these are the type of equity instruments identified as being commonly held by smaller NFP private sector entities. As such, under the proposals, investments in the ordinary shares of another NFP entity that might be made as a way of delivering on the reporting entity's NFP service objectives would be measured consistently to ordinary share investments held to fund the entity's NFP activities, as they are both the same class of asset. Because these sorts of holdings were not specifically considered by the Board in its deliberations, staff are seeking the Board's confirmation as to whether all investments in equity instruments should be regarded as financial assets that are held to generate both income and a potential capital return for the entity. Staff think that the Board could take one of the following Actions in response to the observation above: (a) Action A – continue to regard all investments in equity instruments as financial assets held to generate both income and a capital return. *Reasons to support Action A:* • simple to apply, as it treats all equity instruments similarly; and • consistent with AASB 9, which requires holdings in equity instruments that do not give the entity at least significant influence over that other entity to be measured at fair value. *Reasons against Action A:* • imposes a rule for equity instruments. (b) Action B – refine the proposed requirement to distinguish between those investments in equity instruments that are held to fund the entity's operations and those that are held as a means of fulfilling the entity's NFP service objectives. For example, by clarifying that it is only investments in equity instruments of a for-profit entity that will always be financial assets that are held to generate both income and a capital return for the reporting entity. *Reasons to support Action B:* • acknowledges that some equity instruments may not be held for a financial return and requires these types of financial asset to be measured at cost; and • continues to provide clarity as to how to account for many investments in equity instruments. *Reasons against Action B:* • some stakeholders might inappropriately infer that investments in equity instruments of a NFP entity are conversely always not financial assets held to generate both income and a capital return for the entity, and therefore must always be measured at cost. (c) Action C – delete the reference in paragraph 10.7(a) expressing that all investments in equity instruments are financial assets acquired or originated to generate both income and a capital return for the entity. *Reasons to support Action C:* • does not focus on a particular type of financial asset; and • shortens the Standard. *Reasons against Action C:* • entities will have less guidance as to how to measure equity instruments held.

Stakeholder comments	Staff analysis
	On balance, **staff recommend** Action A in preference to the other identified Actions: that is, making no change to the proposed requirement exposed in ED 335. Given the expected infrequency of such circumstances, staff think entities would be better served by having a clear requirement in this regard. In addition, under the proposals, some of these unlisted equity investments may in any case default to a measurement at cost.
13. A stakeholder (professional services firm) considered the election to measure certain financial assets at FVTOCI rather than FVTPL should not be limited to being an irrevocable accounting policy choice. Rather, changes in the accounting policy could be supported by disclosures about the reasons for the change. This stakeholder noted that entities have the ability to change many other Tier 3 accounting policies, and that NFP entities may change the purpose of their investment portfolio or their key management personnel regularly. The stakeholder noted that they have regularly observed a change in the purpose of an investment portfolio from holding from long-term growth in reserves to using gains to fund operations.	Staff note that under the ED 335 proposals, a change in the purpose of a financial asset from being held to generate both income and a capital return for the entity to a different purpose (if possible)[31] would already necessitate a change in its accounting policy; from fair value to cost. However, a change in management strategy from the financial asset being held more 'passively' to being actively monitored and used to generate funds for operations would not. This is because ED 335 treats financial assets that are actively traded and those held more 'passively' to generate an income and a capital return for the entity as the same, consistent with the Board's determination that Tier 3 entities are less likely to hold financial assets for trading purposes[32] and the Board's simplification objectives for the proposed Standard. In forming its proposal in ED 335, the Board discussed whether its requirements should have regard to financial assets that are 'held for trading' and whether entities should be accorded a 'free' accounting policy choice for those financial assets that are held to generate both income and a capital return for the entity. While such action could have responded to the stakeholder comment on the left, as noted in paragraph BC69 to ED 335, the Board decided to propose specifying that the election is irrevocable to "… respond to the stakeholder feedback on the DP to simultaneously maintain, at least to some extent, comparability with Tier 2 requirements while enabling various intentions of Tier 3 entities holding these financial instruments to be reflected, acknowledging the potential effect on comparability amongst entities applying this Standard". Having regard to the above and observing the absence of any significant contention regarding this aspect of the proposals from other stakeholders especially in light of the proposal change between the Board's preliminary views exposed in the preceding Discussion Paper and ED 335, **staff recommend** making no changes to the proposed requirements in response to the stakeholder feedback.
14. A stakeholder (professional services firm) was concerned that paragraph 10.12 of ED 335 inappropriately contemplates that the fair value of an unlisted equity instrument might be unavailable. The stakeholder considered that AASB 13 indicates that a fair value is always able to be determined, even if it is a Level 3 valuation. The stakeholder suggested	Paragraphs 10.12 and 10.13 of ED 335 state "… If a reliable measurement of fair value of an investment in an unlisted equity instrument is unavailable as at the measurement date, its carrying amount at the last date the asset was reliably measurable becomes its new cost …" and "For the purposes of paragraph 10.12, a reliable measurement of the fair value of an investment in an unlisted equity instrument is unavailable as at the measurement date if: (a) the market price of the equity instrument, or a similar equity instrument, close to the measurement date is not observable; (b) the range of reasonable fair value measures is significant and the probabilities of the various measures cannot be reasonably assessed; and (c) for reasons such as those listed in paragraph 10.10, the cost of the equity instrument is not a reliable measure of its fair value." On reflection of paragraph 10.13, staff note that the proposed key condition to departing from fair value measurement is paragraph 10.13(b) ("the range

31 As noted in paragraph 5.96 of the Discussion Paper preceding ED 335, an entity invests in equity instruments for their potential capital return, in addition to any income return.

32 Paragraph BC69 of ED 335

Stakeholder comments	Staff analysis
rewording the requirements in ED 335 to reference undue cost or effort (or words with similar effect) instead.	of reasonable fair value measures is significant and the probabilities of the various measures cannot be reasonably assessed"). The condition in 10.13(b) references whether it is possible for a reliable measure of fair value to be estimated, rather than necessarily commenting on the cost or effort involved to obtain a reliable measurement.[33] AASB 13, which defines fair value similarly, conveys the expectation that a fair value for an equity instrument is always able to be determined. Staff note that for cost-benefit reasons, the *IFRS for SMEs* provides for an "undue cost or effort" exemption from the requirement to measure equity instruments at fair value (refer *IFRS for SMEs* paragraph 11.56).[34] The drafting of paragraph 10.13 had sought to avoid such exemption in order to eliminate the need for preparer judgement. However, on reflection staff observe that paragraph 10.13(b) arguably still requires preparers to exercise professional judgement in assessing whether the fair value of an unlisted equity instrument is reliably measurable. Therefore, on reflection, **staff recommend** that paragraphs 10.12 and 10.13 of ED 335 be amended to avoid the apparent inconsistency with fair value as described in Tier 1 and Tier 2 reporting requirements. Staff will consider and bring proposed wording to a future Board meeting as part of the Board's review of a draft Standard.
Impairment	
15. A stakeholder (other) observed that the requirements of paragraphs 10.18(e) and 10.19 of ED 335 appear "a bit vague for a general provision and not specific for individual borrowers". (However, another stakeholder (professional body) specifically stated that they found the guidance for objective evidence of an impairment in paragraph 10.18 to be useful.)	The loss events identified in paragraphs 10.18(e) and 10.19 of ED 335 are consistent to those described in the *IFRS for SMEs*. That these loss events were not amended as part of the recent IASB project to update the *IFRS for SMEs* suggest that there is no significant concern about their usefulness. On further consideration of the identified loss events, and noting that the impairment analysis may be in relation to a group of debtors/ other assets, **staff recommend** making no changes to the proposed requirements in direct response to the stakeholder feedback. *<u>Further Board direction required: Measurement of an impairment loss</u>* Paragraph 10.21 of ED 335 specifies that an impairment loss for a financial asset measured at cost shall be measured as "the difference between the financial asset's carrying amount and the present value of estimated cash flows discounted at the asset's contractual interest rate". On further reflection, while stakeholders did not provide feedback in this regard, staff note that the subsequent measurement provisions for such financial assets may not appropriately address instances where interest cash flows are expected to remain at the contractually agreed amount even if recovery of the full principal amount is in doubt. In such cases, a gain or loss on settlement of the asset might arise under the proposal as drafted. For consistency with other ED 335 proposals, **staff recommend** that paragraph 10.21 be amended to measure the impairment loss as the difference

33 This can be inferred also from *IFRS for SMEs* paragraphs 12.20 and 12.21, which draw a distinction between a reliable measure not being possible when the range of reasonable fair value measures is significant and the probabilities of the various measures cannot be reasonably assessed, and a reliable measurement that is not available without undue cost or effort.

34 *IFRS for SMEs* paragraph 11.56 states "If a reliable measure of fair value is no longer available without undue cost or effort for an equity instrument … its fair value at the last date that the instrument was reliably measurable without undue cost or effort is treated as the cost of the instrument. The entity shall measure the instrument at this cost amount less impairment until it is able to determine a reliable measure of fair value without undue cost or effort."

Stakeholder comments	Staff analysis
	between the asset's carrying amount and the estimated future cash flows receivable.
Disclosure	
16. A stakeholder (other) considered that the proposed disclosures in paragraphs 10.25 and 10.30 of ED 335 should be reconcilable to the primary financial statements.[35] The stakeholder was of the view that disclosures of financial assets/ financial liabilities measured using different measurement methods should be made by class rather than by category of measurement method.	On regard of the complexity and breadth of financial instruments held by the type of entities for which the Tier 3 Standard is being developed, staff do not expect there to be any significant cost involved for users of the financial statements to reconcile the disclosures specified by paragraphs 10.25 and 10.30 of ED 335 to the information presented on the face of the primary financial statements. Having regard to the above and noting that other stakeholders did not object to the proposed disclosure, **staff recommend** making no changes to the proposed requirements in direct response to the stakeholder feedback.
17. Paragraph 10.27 of ED 335 requires the disclosure of fair value amounts that are "based on a quoted price in an active market" separately from other fair value amounts, for financial assets and financial liabilities measured at fair value. A stakeholder (other) indicated that it is unclear whether the reference to quoted price is equivalent to AASB 13 *Fair Value Measurement* level 1 inputs only, or to a combination of level 1 and level 2 inputs. This is because level 2	AASB 13 classifies, as a level 2 input, the quoted prices of similar assets and liabilities. Therefore, on reflection, staff concur that the drafting is not necessarily clear whether the disclosure is intended to capture both level 1 and level 2 inputs of this nature. This proposed disclosure requirement was a simplification from the disclosure specified by AASB 1060.115, which requires disclosure of the basis of the fair value measurement and the assumptions applied in determining fair value when a valuation technique is used. Staff note that the intent of the simplification was simply to require entities to separately distinguish those fair value measurements that are based on a valuation technique from those that are not. Where the input is the quoted price of a similar but not identical asset or liability, a valuation technique will be used to estimate fair value. Consequently, **staff recommend** that the stakeholder concern be addressed through clarification of the drafting to make it clear that the requirement is to separately disclose those fair value measurements that are based are a

35 Paragraph 10.25 of ED 335 states "An entity shall disclose the nature and carrying amount of each of the following categories of financial assets and financial liabilities as at the reporting date, in total, either in the statement of financial position or in the notes:

(a) financial assets measured at fair value through profit or loss (paragraph 10.7(a));
(b) financial assets measured at fair value through other comprehensive income (paragraph 10.7(a));
(c) financial assets measured at cost less any accumulated impairment losses (paragraph 10.7(b)); and
(d) financial liabilities measured at cost (paragraph 10.7(c))."

Paragraph 10.30 of ED 335 states: "An entity shall disclose the following items of income and expense, and gains or losses:

(a) income, expense, gains or losses, including changes in fair value, recorded on:
    (i) financial assets measured at fair value through profit or loss;
    (ii) financial assets measured at fair value through other comprehensive income;
    (iii) financial assets measured at cost less any accumulated impairment losses; and
    (iv) financial liabilities measured at cost;
(b) total interest income and total interest expense (calculated using the contractual interest rate) for financial assets or financial liabilities that are not measured at fair value through profit or loss; and
(c) the amount of any impairment loss for each class of financial asset."

Stakeholder comments	Staff analysis
inputs are also based on quoted prices.	quoted price in an active market for an identical asset or liability, from other fair value measurements.
Other	
18. A stakeholder (other) recommended that paragraph 10.2(g) should simply refer to 'equity shares' so that it is clear that acquired listed shares are basic financial assets.	In developing ED 335, the Board decided to fully describe the type of shares that are basic financial instruments or commonly held by Tier 3 entities in response to stakeholder feedback received on the Discussion Paper preceding ED 335. Therefore, **staff recommend** that the Board make no changes to its proposals in response to the stakeholder feedback.
19. A stakeholder (other) considered that paragraph 10.10(a) of ED 335 should reference 'equity instrument' rather than 'share investment' because NFP entities often do not have shares.	Staff note that the paragraphs 10.9 and 10.10 concern financial assets held by the NFP entity rather than equity instruments issued by the NFP entity. These financial assets need not be in another NFP entity and consequently, it is not relevant whether NFP entities commonly issue shares. Nevertheless, on further review of the ED, staff think that the reference to 'share investment' in paragraph 10.10(a) should be updated for consistency with paragraph 10.9, which references investments in equity instruments. Staff intend to bring revised drafting in this regard as part of the Board's review of a draft Standard in a future Board meeting.

25 In addition to the stakeholder comments summarised in Table 4 above, as part of our consideration of Section 10 viz the stakeholder feedback received, staff have identified further possible editorial or minor amendments to Section 10 that have not been raised for the Board's consideration as part of this paper. Staff intend to bring these recommendations, together with the changes resulting from the Board decisions on the matters noted in Table 4, to a future Board meeting for consideration as part of the Board's review of a revised draft Tier 3 Standard (expected November 2025).

Summary of recommendations and Question to the Board

26 Having regard to the majority support for the proposals and staff's analysis of the stakeholder comments raised, staff recommend that the Board finalise, subject to any redrafting necessary to improve the clarity of the requirements, the Tier 3 requirements for financial instruments as exposed in Section 10 of ED 335, except as follows:

(a) to explicitly specify that an entity need not separately recognise and measure embedded derivatives;

(b) to no longer require the recognition of a commitment to provide a loan at a below market-rate;

(c) to amend paragraph 10.7(a) to clarify that all financial assets held to generate both income and a capital return for the entity are to be measured at fair value;

(d) to amend paragraphs 10.12 and 10.13 to avoid the apparent inconsistency with fair value as described in Tier 1 and Tier 2 reporting requirements;

(e) to amend paragraph 10.16 so that the calculation of interest income and expense is not limited by the carrying amount of the financial asset or financial liability at the beginning of a period;

(f) to amend paragraph 10.21 to require an impairment loss to be measured as the difference between the asset's carrying amount and the estimated future cash flows receivable; and

(g) to amend paragraph 10.27 to clarify that separate disclosure is required of those fair value measurements that are based are a quoted price in an active market for an identical asset or liability.

Question 1 for Board members
Do Board members agree with the staff recommendation in paragraph 26 above for the Board to finalise, subject to any redrafting necessary to improve the clarity of the requirements, the Tier 3 requirements for financial instruments as exposed in Section 10 of ED 335, except as noted in paragraphs 26(a) – 26(g)? If not, what do Board members suggest?