Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Private Sector Financial Reporting Framework**	**Meeting:**	M182
Topic:	**Change in Accounting Policies and Correction of Errors**	**Agenda Item:**	4.3
		Date:	26 July 2021
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The objective of this paper

1 The objective of this staff paper is for the Board to **decide** its preliminary views on Tier 3 reporting requirements for certain changes in accounting policies and correction of errors for a not-for-profit (NFP) private sector entity.

Background and reasons for bringing this paper to the Board

2 At its 24-25 February 2021 meeting, the Board agreed to develop a further reporting tier (Tier 3) for application by NFP private sector entities.[1] 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 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 This staff paper is one of a series of staff papers to assist the Board to form its preliminary views on Tier 3 reporting requirements. The purpose of bringing this paper to the Board is to develop preliminary views on the Tier 3 accounting requirements for changes in accounting and correction of errors for inclusion in a Discussion Paper (DP).[2] Developing preliminary views on these two topics will enable the Board to obtain useful feedback to inform whether its proposed approach is supported and should be further developed into an Exposure Draft.[3]

4 Note that the analysis in this paper was undertaken in light of the proposed methods of simplification and the flow chart in Agenda Paper (AP) 4.2. Further, the analysis and staff recommendations assume

1 Refer to Project summary: *Not-for-profit Private Sector Financial Reporting Framework* for detail.
2 Refer to AP 4.1 (paragraph 16) for the list of topics.
3 This staff paper has been drafted reflecting the staff view in Agenda Paper 4.2 that the Board's objective in developing Tier 3 reporting requirements is to form requirements that are simple, but that the extent of simplicity should be reflective of the needs of users and acknowledge the capabilities of preparers of entities within the $500,000 – $3million revenue size threshold that the Board has decided to use as a guide in forming its preliminary views on the extent of Tier 3 reporting requirements.

that Board members agree with the staff recommendation in AP4.2 that the primary objective for Tier 3 reporting requirements is "*to develop simplified requirements for financial reporting to meet the needs of users for smaller NFP entities*".

5 Note that changes in accounting estimates are not addressed in this paper. Staff are of the view no amendment to current Tier 2 requirements is needed for Tier 3 NFP private sector entities regarding the accounting of changes in accounting estimates. This is because, under existing accounting requirements in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, a change in accounting estimate is by its nature treated prospectively. All international jurisdictions reviewed (listed in Table 1) also apply a prospective approach for changes in accounting estimates for the same reason. Consequently, no further recognition or measurement simplification was identified. If there were any errors in prior period accounting estimates (e.g. in an input used or a measurement technique applied) that require retrospective treatment, these changes would be considered as correction of errors (AASB 108 paragraph 34A).

Structure of the paper

6 This paper is structured as follows:

Current Australian requirements and whether there is a reason for the Board to address:

- current requirements under Australian Accounting Standards (paragraphs 7-15);
- feedback from Australian stakeholders (paragraph 16-17);
- findings from academic research (paragraphs 18-20);
- findings from staff review of a sample of financial statements (paragraphs 21-22);

Considering options for simplification and staff analysis – Changes in Accounting Policies and Correction of Errors

- Summary of possible options for Tier 3 (paragraph 23):
    - Permitting changes in accounting policies (Table 1);
    - Treatment of changes in accounting policies (Table 2);
    - Treatment of correction of errors (Table 3);
- Evaluation of options against the Tier 3 Principles (paragraphs 24-26);

Staff recommendations

- Permitting changes in accounting policies (paragraphs 27-28);
- Treatment of changes in accounting policies (paragraphs 30-35);
- Treatment of correction of errors (paragraph 36).

Current requirements under Australian Accounting Standards

7 Currently, an NFP private sector entity preparing general purpose financial statements that comply with Australian Accounting Standards (Tier 1 or Tier 2) would comply with AASB 108 to account for any change in accounting policies and correction of errors.

Changes in accounting policies

8 AASB 108 addresses changes in accounting policies arising from three sources:

(a) the initial application (including early application) of an Australian Accounting Standard (AAS) containing specific transitional provisions;

(b) the initial application of an AAS which does not have specific transitional provisions; and

(c) voluntary changes in accounting policies.

9 AASB 108 only permits a change in accounting policy, if the change:

(a) is required or permitted by an AAS; or

(b) results in the financial statements providing more reliable and relevant information about the effects of transactions, other events or conditions on the entity's financial position, performance or cash flows.

10 Accounting policy changes under paragraph 8(a) should be accounted for in accordance with the specific transitional provision of that AAS. Generally, a change in accounting policy under paragraphs 8(b)or 8(c) should be applied retrospectively, to the extent practicable, which is applied to transactions, other events, and conditions as if it had always been applied.[4] This approach requires adjustment of each affected component of equity for the earliest period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied. The amount of the resulting adjustment is usually made to retained earnings. However, this will not always be the case. Any other information about prior periods, such as historical summaries of financial data, should also be adjusted.

11 While the Board may consider specific transition relief for entities transitioning from special purpose financial statements as part of the broader NFP financial reporting framework, this paper only considers changes in accounting policies under paragraphs 8(b) and 8(c). That is, this paper considers the accounting requirements from the perspective of the Tier 3 framework already applied by NFP entities.

Correction of errors

12 For correction of errors, the retrospective approach is also adopted in AASB 108, except to the extent that it is impracticable to determine the periods-specific effects or the cumulative effect of the error. See paragraph 15 for discussion on impracticable.

13 An entity shall correct material prior-period errors in the first set of financial statements authorised for issue after their discovery. The correction should be excluded from the profit or loss for the period in which the error was discovered. Instead, the information presented about prior periods should be restated as far back as practicable by restating the comparative amounts for the prior period(s) presented in which the error occurred; or if the error occurred before the earliest period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

14 When it is impracticable to determine the period-specific effects of an error, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period). When, at the beginning of the current period, it is impracticable to determine the cumulative effect of an error on all prior periods, the entity shall restate the comparative information to correct the error prospectively from the earliest date practicable.

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4 There are some exceptions to this, for example, a change to a policy of revaluing property plant and equipment assets in accordance with AASB 116 is not a change in accounting policy accounted for under AASB 108.

Restatement is impracticable

15 Restatement of comparatives is exempted if it is impracticable to apply the changes in accounting policies or correction of errors retrospectively to a prior period.[5] In most cases, impracticability is the basis on which specific exemptions are provided in IFRS from applying particular requirements when the effect of applying them is material.[6]

Feedback from Australian stakeholders

16 Stakeholders have not identified changes in accounting policies and correction of errors as an area of concern in the outreach activities to date. However, given the wide application of AASB 108 in the NFP private sector entities, staff think the Board should form preliminary views for inclusion in the DP on the accounting for changes in accounting policies and correction of errors.

17 Staff sought feedback from the NFP project advisory panel (PAP) meeting in May 2021. The majority of PAP members present did not support the full retrospective application for Tier 3 reporting requirements. One PAP member recommended keeping Tier 3 reporting requirements simple and applying a prospective approach for both changes in accounting policies and correction of errors.

Findings from academic research

18 Staff have not identified any relevant research examining changes in accounting policies and correction of errors for the Australian NFP sector. A study in the US suggests that donors value information about errors in NFP entities financial reports. Donations would fall following periods in which errors are disclosed in the financial reports if the report is widely accessible by donors.[7] Another study in the US shows that errors appear to be more prevalent in the NFP sector than its for-profit (FP) counterparts. Research has found that, in the US, public charities report errors at a rate "60 per cent higher than that of publicly-traded corporations, and almost twice as high as that of similar-sized corporations". Errors are given low visibility in the financial reports.[8] One of the possible reasons identified by the researcher for failure to disclose errors is the non-profit managers' lack of expertise about reporting requirements.

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5 AASB 108 (paragraph 5) defines impracticable as:
"when the entity cannot apply it after making every reasonable effort to do so".
Impracticable may occur in situations, such as:
(a) the effects of the retrospective application or retrospective restatement are not determinable;
(b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
(c) the retrospective application or retrospective restatement requires significant estimates of amounts, and it is impossible to distinguish information about those estimates that: objectively
(i) provides evidence circumstances that existed on the date(s) as at which those amounts are to be recognised, measured, or disclosed; and
(ii) would have been available when the financial statements for that prior period were authorised for the issue from other information.

6 IFRS 8 *Operating Segments* includes an exemption from some requirements if the necessary information is not available and the cost to develop it would be excessive. As explained in paragraphs BC46-BC47 of the Basis for Conclusion for IFRS 8, the IASB decided to use the wording "…the cost to develop it would be excessive" rather than the term "impracticable" to ensures convergence with SFAS 131 *Disclosures about Segments of an Enterprise and Related Information.*

7 Burks, J. J. (2018). "Reactions of Nonprofit Monitors to Financial Reporting Problems." Journal of Financial Reporting, 3(1): 47-71.

8 Burks, J. J. (2015). "Accounting Errors in Non-profit Organizations." Accounting Horizons 29(2): 341-361, cited in AASB Research Report 16 Financial Reporting by Non-Corporate or Small Entities (Public Sector Entities, Private Sector SMEs, Not-for-Profits including Charities and Non-Government Organisations). To the best of staff's knowledge, there is no similar study using Australian data at the of this staff paper.

19 Staff consider it is possible that Australian NFP entities, particularly smaller entities, are experiencing similar challenges in understanding the reporting requirements and believe that the association between NFP preparers' understanding of reporting requirements and the odds of errors in financial statements extrapolate to the Australian context. Yang and Simnett (2019) found inconsistent reporting of the basis of preparation referring to those charities which claimed to prepare GPFS on the AIS but were actually preparing SPFS. The misreporting rate for large charities that claim to prepare GPFS to the ACNC for the reporting years 2014 and 2015 is over 20 per cent.[9] These findings could indicate that these preparers do not fully understand the framework they are applying.

20 The research findings provide support for the need for the Board to consider possible avenues to simplify the accounting for changes in accounting policies and correction of errors for Tier 3 NFP private sector entities. Considering that Tier 3 entities usually are less well-resourced, there may be a case to argue that simplifying existing accounting requirements may improve the comparability and understandability of the financial statements.

Findings from staff review of a sample of financial statements

21 To analyse the prevalence of occurrences of voluntary changes in accounting policies and correction of errors in the Tier 3 entity population, staff reviewed 20 sets of financial year 2020 financial statements for a random sample selected from ACNC registered charities with annual revenue between $500,000 – $3 million. None of these entities voluntarily changed their accounting policies for the period.[10] In addition, none of these entities reported any correction of errors.

22 These preliminary findings could indicate that:

(a) when initially apply an AAS containing a limited retrospective approach as transitional provisions, Tier 3 entities would prefer a limited retrospective approach to save transitional cost;

(b) it is uncommon for Tier 3 entities to voluntarily change accounting policies; and

(c) it is uncommon for Tier 3 entities to disclose and correct errors from the prior period. Some of the reasons could be:

(i) the financial statements of these entities are generally simpler, and therefore, the chance of having material errors is relatively lower compared to larger entities;

(ii) all material errors have been identified in the period in which the errors occur, and the errors are corrected in the same period, or

(iii) material errors may not have been identified.

However, the results need to be interpreted with caution due to the limited sample size. Staff also acknowledge that it is also uncommon for Tier 1 and Tier 2 entities to change accounting policies voluntarily or correct errors. Therefore, staff analysis and recommendations in this paper primarily focus on simplification (as set in AP 4.2).

9 Yang, Y, & Simnett, R. (2019). "Large Charities' Financial Reporting Framework Choice in Australia", working paper. UNSW Sydney. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3412617.

10 One charity adopted AASB 15 *Revenue from contracts with customers* and AASB 1058 *Income of Not-for-profit* using the modified (limited) retrospective method of adoption with the initial application of 1 July 2019. Another charity mentioned in its financial statements that it initially applied AASB 16 *Leases* using the cumulative effect (modified retrospective) method and has not restated comparatives.

Options for simplification – Changes in accounting policies and Correction of errors

23 With reference to the flowchart in AP 4.2 (paragraph 15) for this meeting, staff have identified the following possible options for simplification for Tier 3 reporting requirements. This analysis takes into consideration current practice in Australia and international jurisdictions, feedback received from stakeholders, and research findings summarised in paragraphs 16 to 22 above:[11]

(a) Whether to allow an entity to change its accounting policy once selected, where an accounting policy choice is available (Table 1);

(b) The treatment of changes in accounting policies (Table 2); and

(c) The treatment of correction of errors (Table 3).

11 The focus in this paper is on simplification of recognition and measurement criteria as detailed in AP 4.2. Subject to the Board decision, staff will also consider other relevant aspects of simplification (e.g. explanation and more detailed disclosure requirements) in drafting of the DP.

Table 1 Summary of possible options and analysis for Tier 3 - Whether changes in accounting policies are permitted

Possible option for Tier 3 – whether changes in accounting policies are permitted	Jurisdictions adopting similar approaches (and pronouncements)	Support for the approach	Arguments against the approach
Option 1: Prohibit voluntary change accounting policies Entities are prohibited from changing accounting policies once selected, except when it is required by an AAS.	None of the jurisdictions reviewed for this paper.	• Provides simplified interpretation by reducing accounting policy choices. • Reduces managerial discretion, so there is no need for further significant judgement on whether a (voluntary) change in accounting policies is needed.	• Could impede the usefulness and relevance of the information provided in the financial statements. Financial statements may not faithfully represent the entities' financial position when there is a change in economic circumstance, which require changes in accounting policies for more reliable and relevant financial information.
Option 2: Permit a voluntary change in accounting policy Entities are permitted to change accounting policies voluntarily (i.e. in situations other than required by an AAS) if the change results in the financial statements providing more reliable and relevant information about the effects of transactions, other events or conditions on the entity's financial position, performance or cash flows.	• **AASB 108** • **IFRS for SMEs** (paragraph 10.8) • **Canada –** Section 1056 *Accounting Changes* (Part II of the CPA Handbook) (paragraph 6)[12] • **Hong Kong (HK) –** *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard* (paragraph 2.3) • **New Zealand** *Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit) (PBE SFR-A (NFP))*[13] (paragraph A182) • **Singapore –** *Charities Accounting Standards* (paragraph 11) • **United Kingdom (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* (paragraph 3.33); and FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* (paragraph 8.7) • **United States (US)** – ASC 250-10 *Accounting Changes and Error Corrections*	• Provides entities with the opportunity to provide more reliable and relevant information about the entities financial position.	• Could impede the simplicity principles for developing Tier 3 reporting requirements. • Requires managerial discretion and judgement to determine the appropriate policies given the economic circumstances.

12 An entity incorporated under the Canada Not-for-profit Corporations Act is required to prepare annual Canadian GAAP-compliant financial statements. An NFP private sector entity may prepare financial statements that comply with IFRS or with the requirements set out in Part III Accounting Standards for Not-for-Profit Organizations (ASNPO) of the CPA Canada Handbook. These include a requirement that the entity has regard to the requirements set out in Part II of the Handbook (Accounting Standards for Private Enterprises) for topics that are not addressed specifically by Part II – including the treatment of changes in accounting policies and errors.

13 NZ reporting requirements applicable to NZ “Tier 3” entities in their 4-tier differential reporting framework. These might include NFP entities of the size contemplated by the AASB.

Table 2 Summary of possible options and analysis for Tier 3 – Treatment of changes in accounting policies[14]

Possible option for Tier 3 – treatment for changes in accounting policies	Jurisdictions adopting similar approaches (and pronouncements)	Support for the approach	Arguments against the approach
Option 1: Prospective Apply the new accounting policy to transactions, other events and conditions from the beginning of the current reporting period. The effect of any changes due to the change in accounting policy is recognised in profit or loss for the period.	• **New Zealand -** [(PBE SFR-A (NFP))][15] (paragraphs A181-A185)	• Simplest and least costly simplification in recognition and measurement (R&M). Not creating additional costs for preparers to restate comparatives or adjustment cumulative effects. • Less interpretation and judgement is required as there is no need to assess impracticability for restatements of comparatives and cumulative adjustment to the current period's opening balance. • Enhances comparability between the Tier 3 cohort as all Tier 3 NFP private sector entities would apply the same accounting for changes in accounting policies. • May align with users' interest if focused on the effect of changes in accounting policies on future periods.	• Compromises inter-period comparability. Trend analysis can be more challenging as financial statements could be prepared under different accounting policies with no comparatives restated. • Inconsistent with the current requirement in AASB 108 and, therefore, reduces comparability across tiers. • User understandability of the current period's financial statements might suffer if users do not understand that the current period's results have been impacted by the accounting for a transaction that occurred during a past period. • May not be simplified accounting in all cases. Calculation of the cumulative effects is still needed in some cases. For example, when changing from cost method to fair value for property, plant and equipment, the cumulative effects of the change in accounting policy will be calculated and reflected through the statement of profit and loss. • Potential once-off impact upon the determination of an entity's reporting obligations.
Option 2: Limited retrospective The cumulative effect of any changes due to the change in accounting policy on prior periods is	• A form of the current approach in AASB 108 with the	• Simplified accounting compared to AASB 108 as preparers are not required to assess whether it is impracticable to restate	• Certain judgement is still required, e.g. entities need to assess the extent to which cumulative adjustment is practicable.

14 Column 2 of Table 2 and Table 3 below summarise the approaches identified by staff taken by other jurisdictions in relation to changes in accounting policies and the correction of errors. Detailed description of pronouncements of other jurisdictions is included in page 12, Staff Paper 3.1 (M181, June 2021). Staff limited our review to accounting pronouncements that require accrual accounting. The proposed options currently do not cover disclosure requirements. Staff will bring back the disclosure requirements at a future meeting sequent to Board deliberation on the principles to develop disclosure requirements for Tier 3 NFP private sector entities.

15 NZ reporting requirements applicable to NZ “Tier 3” entities in their 4-tier differential reporting framework. These might include NFP entities of the size contemplated by the AASB.

Possible option for Tier 3 – treatment for changes in accounting policies	Jurisdictions adopting similar approaches (and pronouncements)	Support for the approach	Arguments against the approach
recognised in the current period opening retained earnings (i.e. comparative years would not be restated). When it is impracticable to determine, at the beginning of the current period, the cumulative effect of applying a new accounting policy to all prior periods, this approach proposes that the entity is required to determine the cumulative effect of the new accounting policy prospectively from the earliest date practicable.	"impracticable out" from restating comparatives.	comparatives, thereby partially reducing the extent of judgement required and alleviating preparer costs in this regard. • This approach is considered as a cost-saving transitional relief adopted by some Standards (e.g. AASB 15 and AASB 16). • Maintains comparability with Tier 1 and Tier 2 NFP entities to a certain extent. • Reflects the effects of past events in the right time period, which is consistent with accrual accounting principles. • Required disclosure still provides information about trends, would help to meet users' information needs.	• Comparability may be compromised as the effect of any adjustments would not be reflected in the carrying amount of assets and liabilities in the prior period.
Option 3: Full retrospective application, unless impracticable or unless transitional provisions for adoption of a new standard provide otherwise. The opening balances of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented are adjusted as if the new accounting policy had always been applied. When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information, the new accounting	• **AASB 108** • **IFRS for SMEs** (paragraphs 10.11-10.14) • **Canada –** Section 1056 *Accounting Changes* (Part II of the CPA Handbook) (paragraphs 10-18)[16] • **HK[17] –** *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard* (paragraphs 2.3-2.9) • **Singapore –** *Charities Accounting Standards* (paragraphs 12-14)	• Enables comparability with Tier 1 and Tier 2 NFP private sector entities. • Provides more detailed information, enabling users to compare financial statements over time to identify trends. • Reflects the effects of past events in the correct time period, which is consistent with accrual accounting principles. • No cost to transitions as no simplification is given.	• Deviates from the simplification methods stated in AP 4.2: ○ Complex explanation, e.g. the concept of "impracticability", could be challenging for the smaller entities to understand. ○ Complex interpretation and R&M criteria as a high level of managerial discretion are required, for example, to determine the extent of impracticability. ○ Could be challenging for some users to understand the reporting outcomes due to the complex accounting.

16 An entity incorporated under the Canada Not-for-profit Corporations Act is required to prepare annual Canadian GAAP-compliant financial statements. An NFP private sector entity may prepare financial statements that comply with IFRS or with the requirements set out in Part III Accounting Standards for Not-for-Profit Organizations (ASNPO) of the CPA Canada Handbook. These include a requirement that the entity has regard to the requirements set out in Part II of the Handbook (Accounting Standards for Private Enterprises) for topics that are not addressed specifically by Part II – including the treatment of changes in accounting policies and errors.

17 While the Hong Kong reporting requirements also requires changes in accounting policies and the correction of errors to be treated retrospectively, it further provides for an 'undue cost or effort' exemption from restating comparative information. Staff consider that ''undue cost or effort'' is less restrictive than ''impracticable'', and consequently, note that preparers may have more opportunity to avoid fully retrospectively accounting for a change in accounting policy or correcting an error. Staff note that the Exposure Draft for revising the previous version of IAS 8 (i.e. IAS 8 *Net Profit or Loss for the Period Fundamental Errors and Changes in Accounting Policies*) proposed an exemption from the retrospective application when it gives rise to undue cost or effort. In the light of comments received on the Exposure Draft at the time, the IASB Board decided to retain the impracticability exemption in IAS 8. Paragraph BC24 of the Basis for Conclusions to IAS 8 explains that this is because the IASB considered an exemption based on management's assessment of undue cost or effort is too subjective to be applied consistently by different entities.

Possible option for Tier 3 – treatment for changes in accounting policies	Jurisdictions adopting similar approaches (and pronouncements)	Support for the approach	Arguments against the approach

policy is applied to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period. A corresponding adjustment is made to the opening balance of each affected component of equity for that period.
 	
When it is impracticable, at the beginning of the current period, to determine the cumulative effect of applying a new accounting policy to all prior periods, the entity is required to adjust its comparative information to apply the new accounting policy prospectively from the earliest date practicable.
	• **UK –** FRS 102 (paragraphs 3.32-3.34, 3.44-3.46); and *FRS 105* (paragraphs 8.7-8.10A)
	• **US** – ASC 250-10 *Accounting Changes and Error Corrections*
			• Preparers suffer a higher cost burden, as costs incurred in, for example:
			  ○ assessing whether the retrospective application is possible
			  ○ restating prior period financial statements for the effect of the change in accounting policy or correction of the error
			  ○ recruiting/training skilled accounting staff
			  ○ upgrading software package to enable restatement for the prior period
			• Board effort required to consider the transitional provisions for any new requirements they might want to introduce in the future.

Table 3: Summary of possible options and analysis for Tier 3 – Treatment of correction of errors[18]

Possible option for Tier 3 – treatment of correction of errors	Jurisdictions adopting similar approaches (and pronouncements)	Support for the approach	Arguments against the approach
Option 1: Prospective Material prior-period errors are corrected in the period in which they are identified. The effect of any adjustments is recognised in the result (e.g. in profit or loss) for the period.	None of the jurisdictions reviewed for this paper.	• Same as changes in accounting policies in Table 2.	• Same as changes in accounting policies in Table 2; and • Mismatch between the timing of inconsistent occurrence and correction of the errors.
Option 2: Limited retrospective Material prior-period errors are corrected in the period in which they are identified by adjusting the opening balance of the relevant asset, liability or retained earnings at the beginning of the financial year. No adjustments to past periods presented are required.	• **New Zealand**[19] **–** PBE SFR-A (NFP) (A181-A185)	• Same as changes in accounting policies in Table 2; and • Signal the effect of correcting errors that occurred in the past period through adjusting the opening balance.	• Same as changes in accounting policies in Table 2
Option 3: Full retrospective Adopt an approach consistent with AASB 108 and require the restatement of comparative amounts unless it is impracticable to do so.	• **IFRS for SMEs** (paragraphs 10.19-10.23) • **Canada –** Section 1056 *Accounting Changes* (Part II of the CPA Handbook) (paragraphs 26-29) • **Singapore –** *Charities Accounting Standards* (paragraphs 21-25) • **UK –** FRS 102 (paragraphs 3.36, 3.47-3.48); and FRS 105 (paragraphs 8.14-8.17) • **US –** ASC250-10 • **HK**[20] – Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (A28, A212)	• Same as changes in accounting policies in Table 2.	• Same as changes in accounting policies in Table 2.

18 The proposed options currently do not cover disclosure requirements. Staff will bring back the disclosure requirements at a future meeting sequent to Board deliberation on the principles to develop disclosure requirements for Tier 3 NFP private sector entities.

19 As shown above, in the main, the jurisdictions reviewed required a 'full' retrospective approach for the accounting for both changes in accounting policies and correction of errors. An exception is New Zealand, which requires a prospective approach for changes in accounting policies and a limited retrospective approach for the correction of errors. The Basis for Conclusions to NZ PBE SFR-A(NFP) does not include an explanation for the selection of the different approaches. Staff note one reason for the different approaches might be, for changes in accounting policies, users' interest for change in accounting policies is in the future, and there would be limited value in requiring entities to restate their comparatives to justify the additional cost. For correction of errors, it is about identifying and correcting events or transactions occurred in the past. Therefore, it would be sensible to adjust the opening balance to reflect the effect. No specific concerns were identified in the New Zealand post implementation review for PBE SFR-(NFP).

20 Same to accounting for changes in accounting policies, while the Hong Kong reporting requirements also requires the correction of errors to be treated retrospectively, it further provides for an 'undue cost or effort' exemption from restating comparative information.

Evaluation of options against the Tier 3 Principles

24 With reference to the flowchart in AP 4.2 (paragraph 15) for this meeting, in addition to the analysis in the tables above, staff also analysed each of the proposed options against the tentative Tier 3 principles agreed to by Board members at its 20-21 April 2021 Board meeting, including the proposed amendment to principle (d) in Agenda Paper 4.2 (paragraph 11).[21]

Ability to change accounting policy

25 Staff consider that Option 2 (permitting voluntary changes in accounting policies) proposed in Table 1 aligns with all Tier 3 principles. However, staff consider that Option 1 (prohibiting voluntary changes in accounting policies) does not align with the principles, with the following considerations in particular:

Principle	Discussion
• *The development of Tier 3 reporting requirements is subject to the [AASB Not-for-profit Standard-Setting Framework](); * • *Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of the financial statements*	Option 1 does not align with the principles against which Tier 3 accounting requirements are developed. Tier 3 financial statements are GPFS that should provide useful information to existing and potential resource providers. When the accounting policy choices do not provide reliable and relevant information about the effects of change in economic circumstances, financial statements may not faithfully represent the entities' financial position. And consequently, the usefulness and relevance of the information provided in the financial statements would suffer.

Changes in accounting policies and correction of errors

26 Staff consider that the proposed options for changes in accounting policies and correction of errors (in Table 2 and Table 3 respectively) are aligned with the principles, with the following considerations:

21 Tier 3 principles, including the proposed update to principle (d) in Agenda Paper 4.2, are as follows:
(a) the development of Tier 3 reporting requirements is subject to the AASB Not-for-Profit Entity Standard-Setting Framework;
(b) Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of the financial statements;
(c) consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable, but might not always be warranted, since Tier 3 requirements are being developed as a proportionate response to the costs incurred by certain entities whilst still meeting the needs of users of the financial statements for this cohort of entities. For example, opportunities for deviation from Tier 2 accounting principles that could give a similar outcome to users while reflecting an appropriate cost/benefit balance could include disclosure requirements instead of a Tier 2 measurement requirement or an approach of specifying minimum 'prescriptive' disclosures;
(d) where possible, leverage the information management uses to make decisions about the entity's operations. The ability to leverage the information management uses is made within the context of the not-for-profit conceptual framework, user needs and cost/benefit considerations and the aim for comparability within Tier 3 reporting requirements; and
(e) accounting requirements do not impose disproportionate costs on preparers, when compared to benefits of the information.

Principle	Discussion
The development of Tier 3 reporting requirements is subject to the [AASB Not-for-profit Standard-Setting Framework]	• Option 1's prospective approach is arguably consistent with the NFP Standard-Setting Framework. The Framework permits modification from IFRS where necessary to address user needs or because of undue costs or effort considerations. The option focuses on reducing undue costs or effort for preparers and may not adequately address user needs. This option considers that disproportionate costs/effort will be suffered by less well-resourced Tier 3 entities to collect information and prepare restated comparative financial information for little added benefit. Also, detail about the effects would be made available in the form of disclosure and because there is no ongoing consequential effect of not restating comparative information.
Consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable but might not always be warranted since Tier 3 requirements are being developed as a proportionate response	• Option 1 is not consistent with the Tier 2 accounting requirements for changes in accounting policies and corrections of errors. However, staff think departure is justified having regard to the costs of collecting and preparing the information versus the benefits of restated financial information. • Option 2's limited retrospective approach maintains a level of consistency with the accounting principles specified by Tier 2 as it requires the opening balances of the current period to be restated for the cumulative effects of the change in accounting policy or correction of the error, which is one of the required accounting treatments under the 'impracticable out' contemplated under the Tier 2 accounting requirements.
Accounting requirements do not impose disproportionate costs to preparers when compared to benefits of the information	• Option 3's retrospective approach does not impose disproportionate costs to preparers when compared to the benefits of having information reported in the period of the phenomena because, practice notwithstanding, changes in accounting policies and correction for errors should not be expected to occur regularly.

Staff recommendations

Permitting changes in accounting policies (Table 1)

27 Staff note that AP 4.2 (paragraph 16) contemplates that one of the possible avenues for simplification is to reduce accounting policy choices and that removing an entity's ability to change accounting policies once selected is arguably consistent with this. A 'precedent' of sorts is the irrevocable 'day 1' decision that applies to some transactions, for example, the designation of

equity investments as at fair value through other comprehensive income. However, staff do not recommend the Board consider this as a possible simplification avenue to pursue because not allowing changes in accounting policies once selected could impede the usefulness and relevance of the information provided in the financial statements. Consequently, staff think doing so would not align with the principles against which to develop Tier 3 accounting requirements.[22]

28 As paragraph 10 of AASB 108 requires, an entity's accounting policy choice should provide unbiased information that reflects the economic substance of transactions and should faithfully represent the financial performance, position and cash flows of a business. Entities may need to change accounting policies if the economic substance has changed so that financial statements can provide reliable and relevant information. Staff are of the view that removing the ability to change accounting policies will result in entities being unable to adapt their financial reporting as circumstances change and will therefore impede faithful representation of financial information.

29 Staff, therefore, recommend that changes in accounting policy are permitted if the change would result in the financial statement providing more reliable and relevant information about the effects of transactions, other events or conditions on the entity's financial position, performance or cash flows (Option 2 in Table 1).

Question 1 to the Board:

Do Board members agree with the staff recommendation to permit changes in accounting policy as outlined in Option 2? That is, changes in accounting policy are permitted if the change would result in the financial statement providing more reliable and relevant information about the effects of transactions, other events or conditions on the entity's financial position, performance or cash flows.

Treatment of changes in accounting policies (Table 2)

30 For the purposes of the DP, staff have mixed views as to the treatment of changes in accounting policies. Some staff support Option 2 (a limited retrospective application), whilst other staff support Option 1 (prospective application).

31 Staff who support Option 1 do so on the basis this option provides simplified accounting without significant loss of information for the users of Tier 3 financial statements. These staff are of the view that for Tier 3 entities, the additional cost incurred by entities being required to restate comparative information exceeds the benefit to users. These staff also gave weight to the fact that this approach is adopted in New Zealand.

32 Staff who support Option 2 note that a limited retrospective approach is often permitted by the IASB, for cost-benefit reasons, in setting transitional provisions for new IFRSs (most recently, in IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*). On balance, staff who support Option 2 consider that this option strikes an appropriate cost-benefit balance for entities of the Tier 3 size contemplated by the Board while importantly:

(a) providing simplified accounting treatment compared to that required by AASB 108, particularly via simplified interpretation and recognition and measurement criteria;

(b) distinguishing the cumulative effects of changes in accounting policies on prior periods recognised in equity from the impact of transactions and events occurring in the current period recognised in profit or loss statement; and

(c) maintaining comparability with Tier 2 and Tier 1 reporting requirements, thereby allowing for better comparability to entities preparing Tier 2 or Tier 1 financial statements.

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22 One agreed principle is that "Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of financial statements".

33 Staff acknowledge that the limited retrospective approach may sacrifice some comparability for information over time as comparatives will not be restated under this approach. Staff consider that this issue could be compensated by disclosure to provide information about trends and meet user information needs.

34 Staff who support Option 2 consider that under Option 1 (prospective application), the user understandability of the current period's financial statements might suffer if users do not understand that the current period's results have been impacted by the accounting for a transaction that occurred during a past period, particularly in scenarios where calculation of cumulative effects is still needed under this approach.[23]

35 Staff do not recommend Option 3 (full retrospective application). Option 3, while adopted by many other jurisdictions, does not provide any simplification for Tier 3 entities. Although staff acknowledge that this approach would provide the most useful information to users, staff consider that the extra benefit of having fully-restated prior period financial statements would be marginal in the context of Tier 3 NFP private sector entities, especially if it can be compensated by disclosures.

Questions to the Board:

Q2. Do Board members agree to form a preliminary view in the DP for accounting for changes in accounting policies and correction of errors?

Q3. If the Board members agree with Question 2, which option(s) for accounting for changes in accounting policies do Board members support for Tier 3 accounting requirements?

Treatment of correction of errors[24] *(Table 3)*

36 For the purposes of the DP, staff recommend Option 2 (a limited retrospective application) for the accounting for correction of errors. While having the advantages listed in paragraph 32 above, Option 2 recognises the effects of the correction of errors in the period relevant to the related phenomena (i.e. not the current reporting period). For the same reasons as outlined in paragraph 35, staff do not support Option 3 (full retrospective application) for Tier 3 accounting for correction of errors.

37 Staff do not support Option 1 (prospective application) for correction of errors. Staff consider this approach does not reflect the effects of prior errors in the corresponding periods.

Question 4 to the Board:

Do Board members support the staff recommendation to apply Option 2 (a limited retrospective application) for accounting for correction of errors for Tier 3 reporting requirements?

23 For example, when an entity changes its accounting policies for property, plant and equipment from cost method to fair value, the cumulative effects of the change will be calculated and reflected through the statement of profit and loss. It could be challenging for users to distinguish whether the current period's profit and loss are contributed by cumulative effects caused by changes in accounting policy or the current period's transactions. In addition, for those changes in accounting policy that can be applied prospectively on transactions occurring in future, the cost of application of two different accounting policies within the same class of transaction may well be not materially different to the incremental cost of recognising the cumulative impact of the change on the existing transaction under Option 2.

24 This recommendation is written assuming the Board members agree to form a preliminary view as to a preferred approach for inclusion in the DP in Question 2.