Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, AASB 1061 General Purpose Financial Statements – Not-for-Profit Private Sector Tier 3 Entities.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in AASB 1061. It sets out the reasons why the Board developed the Standard, the approach taken to developing the Standard and the bases for key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

The need for a further reporting tier for not-for-profit private sector entities

BC2 Prior to the issue of this Standard, entities required to prepare general purpose financial statements (GPFS) in accordance with Australian Accounting Standards (AAS) had a choice of two reporting tiers:

(a) Tier 1 reporting requirements – applying at least to the GPFS of for-profit private sector entities that have public accountability and of the Australian Government and State, Territory and Local Governments; and

(b) Tier 2 reporting requirements – applying to the GPFS of for-profit private sector entities that do not have public accountability, not-for-profit (NFP) private sector entities, and public sector entities other than the Australian Government and State, Territory and Local Governments.

However, NFP entities that self-assessed that they are not a 'reporting entity' as defined in Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity* could prepare special purpose financial statements (SPFS) instead.

BC3 The Board received stakeholder feedback and collected evidence indicating that the reporting entity concept, long embedded in the Australian accounting framework, was not working as originally envisaged. Rather, there remained a large population of Australian entities preparing SPFS rather than GPFS (which facilitate the comparability of financial reporting for entities in similar economic circumstances). Research indicated a mismatch between users' needs and the information reported by non-corporate and small entities. In respect of NFP private sector entities, the research showed that of charities preparing SPFS, only 26% of the charities sampled stated compliance with recognition and measurement (R&M) requirements of AAS. This fosters a lack of comparability in reporting the financial position and performance of charities.[1]

BC4 In 2015, the Board decided to commence a project to review the Australian financial reporting framework to respond to the stakeholder concern. Broadly stated, the Board considers that financial statements that are described as being compliant with AAS should be GPFS. Accordingly, an intended outcome of its work should be fewer entities presenting SPFS.

BC5 Considering the Board's own resource limitations and noting that recommendations arising from the 2017-2018 review of Australian Charities and Not-for-profits Commission (ACNC) legislation were likely to inform the Board's work on the NFP private sector, and having regard to the feedback received on AASB Invitation to Comment ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems* (May 2018), the Board in 2018 decided to progress its Australian financial reporting framework project in stages, beginning first with the review and revision of the reporting framework for for-profit private sector entities. That stage was completed with the issue of AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (March 2020) and AASB 2020-2 *Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* (March 2020).

BC6 In November 2019, the Board commenced the planned second stage of its review of the Australian financial reporting framework, focusing on NFP private sector entities. The stakeholder feedback on ITC 39 had

1 AASB Research Report 11 *Review of Special Purpose Financial Statements: Large and Medium-Sized Australian Charities* (August 2019) examined 407 large and medium-sized charities, drawn from a population of 5,674 charities, that claimed to lodge SPFS for the 2016 financial year. 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)* (April 2021) presented an overview of the academic literature on financial reporting by non-corporate and small entities with the objective of answering key questions about the coverage of their reports, their user and stakeholder needs, and their compliance and regulatory oversight.

indicated that it might be appropriate to develop a different reporting solution for these entities compared to for-profit private sector and public sector entities.

BC7 The Board recognised that there is likely to be a larger population of smaller NFP private sector entities required to prepare GPFS, compared to for-profit private sector entities, because the relevant legislation often sets a lower threshold to require NFP private sector entities to prepare financial statements that comply with AAS requirements. Consequently, the Board decided there is a need to develop a further reporting tier for NFP private sector entities concurrently with superseding the SAC 1 reporting entity concept for NFP private and public sector entities. This further reporting tier (Tier 3: Australian Accounting Standards – Simplified Accounting) is intended to serve as a proportionate response for NFP private sector entities that undertake less complex transactions but that are required by legislation or otherwise (such as by a constituting document) to prepare financial statements that comply with AAS.[2] As such, this reporting tier necessarily specifies simpler accounting requirements compared to Tier 1: Australian Accounting Standards and Tier 2: Australian Accounting Standards – Simplified Disclosures.

BC8 The Board exposed its intention to develop this further reporting tier in AASB Discussion Paper *Development of Simplified Accounting Requirements (Tier 3 Not-for-Profit Private Sector Entities)* issued in September 2022 and subsequently in AASB Exposure Draft ED 335 *General Purpose Financial Statements – Not-for-Profit Private Sector Tier 3 Entities* issued in October 2024 for public feedback. In initial outreach activities and in responding to the Discussion Paper, several stakeholders were concerned that Tier 3 reporting requirements would still be overly complex and onerous for some reporters. These stakeholders considered that, as such, there is a case for developing an even simpler reporting tier. The Board discussed what the key features of this reporting tier could look like in light of its decision to already develop a reporting tier that includes simpler R&M requirements, as well as what sort of entities such a reporting tier would be targeted at. Ultimately, the Board decided there is no case for it to develop an even simpler reporting tier beyond Tier 3 reporting requirements, because the resulting financial statements would not be describable as GPFS.

BC9 The Board conducted outreach events attended by over 280 attendees and received 263 responses from online surveys and 14 written submissions to the AASB Discussion Paper, which informed the Board in developing its preliminary views into proposals. Similarly, considerable outreach was conducted on the proposals in ED 335, including roundtables in Melbourne and Sydney and virtual outreach sessions throughout the comment period, attended by 75 stakeholders. External meetings were also held separately with NFP stakeholders, including practitioners, advisors and assurance providers. The Board received 12 online survey responses, 18 written submissions directly responding to ED 335 and two written submissions on ED 334 *Limiting the Ability of Not-for-Profit Entities to Prepare Special Purpose Financial Statements* that contained comments relevant to ED 335. Those 20 submissions were received from stakeholders representing professional services firms, regulators, professional bodies, academics, preparers and an individual. The 12 online survey responses were received from stakeholders representing preparers, an advisor and users.

Interaction with the AASB Conceptual Framework: Not-for-Profit Amendments project

BC10 The SAC 1 reporting entity concept is superseded for NFP private and public sector entities by AASB 2026-2 *Extending the Application of the* Conceptual Framework *and Limiting the Ability of Not-for-Profit Entities to Prepare Special Purpose Financial Statements*. AASB 2026-2 was issued concurrently with this Standard and extends the population of NFP entities to which AAS apply, resulting in more entities being required to prepare GPFS. The issue of this Standard and AASB 2026-2 concludes the Board's work on its NFP Private Sector Financial Reporting Framework project.

BC11 The implementation costs of the requirements set out in AASB 2026-2 are alleviated by the issue of this Standard. This Standard:

(a) provides NFP private sector entities with a further differential reporting response that is still GPFS, but is simpler to apply in recognition that NFP private sector entities often will be cost-constrained and not have entered into any complex transactions; and

(b) complements other Government red tape reduction initiatives to reduce the financial reporting burden for entities.

2 AASB Research Report 10 *Legislative and Regulatory Financial Reporting Requirements* (3rd edition, September 2022) identifies the private sector and public sector NFP entities with financial reporting obligations under Federal and State/Territory legislation to prepare financial statements complying with AAS.

Reporting thresholds

BC12 The Board received feedback throughout its project requesting that it develops financial reporting thresholds so that it is clear whether an entity may prepare financial statements that comply with Tier 3 Australian Accounting Standards – Simplified Accounting reporting requirements. The establishment of appropriate reporting thresholds (and hence a requirement to comply with a specified reporting tier of GPFS) is more appropriately within the remit of the relevant legislation or regulatory authority. For this and other reasons, the Board decided not to develop reporting thresholds that act as a 'boundary' limiting use of this Standard, but to liaise with various regulators in this regard.

BC13 The Board is conscious that its decision not to develop financial reporting thresholds for application of this Standard leaves entities with some uncertainty as to whether the Standard might be available to them in the future. There is also the risk that this Standard may be applied by larger entities, despite the Board not having developed the Standard with larger entities in mind. From its outreach activities, the Board does not expect many entities that are large or have complex transactions and are already preparing GPFS to adopt this Standard. Further, the Board observed that NFP entities are likely to assess carefully whether Tier 3-compliant GPFS are sufficient to meet the needs of their users, particularly where their preparation might affect the entity's funding prospects.

Principles underpinning the development of this Standard

BC14 The key features of Tier 3: Australian Accounting Standards – Simplified Accounting are reporting requirements that are simpler to understand and apply than those specified by the other reporting tiers. The Board reached its views on the form and key accounting aspects of the reporting tier by considering how it could contain or reduce preparer compliance costs while improving the usefulness of financial statements of NFP private sector entities to users. In doing so, the Board considered how it might depart from existing AAS through simpler expression (e.g. use of plainer English), R&M requirements and approaches to presentation and disclosure.

BC15 The requirements in this Standard were developed having regard to 'user needs' and 'cost/benefit' as overarching considerations, and the following principles:

(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 GPFS. As such, Tier 3 financial statements need to 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;

(d) where possible, requirements should leverage the information management uses to make decisions about the entity's operations. The ability to leverage information management uses is made within the context of the *Conceptual Framework for Financial Reporting* and the overarching considerations; and

(e) the reporting requirements do not impose disproportionate costs for preparers when compared to the benefits of that information for users of financial statements.

BC16 The Board considered that the disclosure requirements in AASB 1060 are relevant as a starting point for transactions for which the R&M requirements are the same, or substantially similar, across the different reporting tiers. That is, in these instances, AASB 1060 acts as a ceiling for the extent of disclosure warranted in Tier 3-compliant GPFS. In all other instances, the Board developed disclosures having regard in the first instance to the disclosures specified by selected other jurisdictions and other accounting frameworks that employed R&M requirements consistent with those in this Standard. In these instances, AASB 1060 was used as a point of reference to ensure internal integrity and consistency.

BC17 In developing this Standard, the Board had regard to the reporting requirements applying to smaller NFP private sector entities in selected other jurisdictions, including the *International Financial Reporting Standard for Small and Medium-Sized Entities* (*IFRS for SMEs* Accounting Standard) issued by the International Accounting Standards Board (IASB) and the Tier 3 (NFP) Standard *Reporting Requirements for Tier 3 Not-for-Profit Entities* issued by the New Zealand External Reporting Board, and to exposure drafts of the International Non-Profit Accounting Standard (INPAS) issued by the Chartered Institute of Public Finance and Accountancy in 2025.

BC18 In accordance with the *AASB Not-for-Profit Entity Standard-Setting Framework*, the Board develops requirements only when doing so improves the information provided to users of NFP financial statements.

Justifiable circumstances include situations where an assessment indicates that the cost of preparing and disclosing information is outweighed by the benefits to users, particularly given NFP-specific application issues, differences in resources available to NFP entities, and the prevalence of certain conditions, common transactions or balances, or asset types that affect many NFP entities. Accordingly, the Board observed that it would need a point of reference to inform it of the characteristics of entities for which it developed the accounting requirements set out in this Standard.

BC19 The Board decided to use the ACNC 'medium' size charities designation (revenue of $500,000 to less than $3 million) as a suitable reference point for identifying common transactions and balances of NFP private sector entities for which this Standard has been developed (henceforth referred to as "smaller" NFP entities).[3] This designation is simply intended to inform the Board's development of this Standard and is not intended to act as an indicative threshold for use of the reporting tier. Regulators may determine thresholds for the application of this Standard by the entities they regulate, which could allow NFP private sector entities larger than those envisaged by the Board to comply with this Standard.

Costs vs benefits

BC20 The Board expects the issue of this Standard to result in the following benefits:

(a) this Standard improves the quality of reporting for NFP private sector entities currently preparing SPFS, making financial statements easier to prepare, read and compare;

(b) the simplified recognition, measurement, presentation and disclosure requirements should strike an appropriate balance between limiting the cost of satisfying reporting obligations and preserving the integrity and usefulness of GPFS;

(c) this Standard accords entities a wider range of presentation and measurement options (including, in some cases, specifying simpler accounting requirements) compared with Tier 1 and Tier 2 reporting requirements. This allows entities to select an accounting policy that suits their circumstances, limiting transition and ongoing costs; and

(d) applying the recognition, measurement, presentation and disclosure requirements in a separate Standard will be easier for entities complying with Tier 3 reporting requirements, as this approach is user-friendly for the intended audience. It is also consistent with the Board developing AASB 1060 as a separate Tier 2 disclosure Standard.

BC21 The Board is conscious that introducing simplified R&M requirements could reduce comparability between Tier 3 entities and both Tier 1 and Tier 2 entities. Preparers and assurance providers would also need to learn a new basis of accounting and invest resources in training, to ensure they have regard to the appropriate framework. Having regard to its decisions, including the development of transitional provisions, the Board expects the benefits of this Standard to exceed any transition and increased ongoing costs.

Significant issues considered by the Board in developing this Standard

BC22 The remainder of this Basis for Conclusions sets out key aspects of the Board's deliberations on significant issues regarding the requirements in this Standard.

Stand-alone Standard

BC23 A key consideration for the Board when developing requirements applicable to Tier 3: Australian Accounting Standards – Simplified Accounting for GPFS was the ease of use and understandability of the reporting requirements for stakeholders. The Board was keen to ensure that preparers would not, in general, need to consider the entire suite of AASs, similar to the approach it has taken in respect of Tier 2 disclosure requirements. As such, the Board decided it is appropriate that requirements relevant to the preparation of Tier 3: Australian Accounting Standards – Simplified Accounting GPFS are contained in a single stand-alone accounting standard.

BC24 The Board recognised that a stand-alone Standard cannot address the whole breadth of transactions, other events and conditions that an entity may encounter. To do so would clutter this Standard with requirements irrelevant to many smaller NFP entities. For this reason, the Board decided that this Standard should:

3 The Board considered the findings from AASB Research Report 19 *Common Financial Statement Items: Charities with $0.5–$3 million in revenue* (April 2023). Research Report 19 analysed the financial statements of 260 medium-sized ACNC-registered charities and identified the line items commonly reported in financial statements of entities of this size.

(a) require certain types of transactions, other events and conditions expected to occur less commonly with smaller NFP entities to be accounted for in accordance with the R&M requirements of the relevant topic-based AAS and the related disclosure requirements of AASB 1060. The Board considered that the requirements of those Standards would be relevant to apply as they appropriately reflect the complexity of those transactions, other events and conditions; and

(b) provide entities with direction on how to develop an appropriate accounting policy for transactions, other events and conditions for which this Standard does not specify a requirement.

BC25 With respect to paragraph BC24(a), some stakeholders were concerned that the requirements in AASB 9 *Financial Instruments* and AASB 141 *Agriculture* will be overly complex for smaller NFP entities to apply, even though only a small number of entities might be impacted. The Board noted that agricultural activity is a highly specialised and complex topic, and accordingly concluded that biological assets should continue to be accounted for using the more advanced requirements in Tier 2: Australian Accounting Standards – Simplified Disclosures. The Board also noted, drawing on the findings from AASB Research Report 19, that while smaller NFP entities typically do not hold complex financial instruments, the nature of those instruments similarly warrants application of Tier 2: Australian Accounting Standards – Simplified Disclosures. On that basis, the Board decided that neither biological assets nor the financial instruments specified in paragraph 10.4 of this Standard should be addressed through simplified Tier 3 requirements.

BC26 With respect to paragraph BC24(b), the Board initially considered that entities applying this Standard should first consider the relevant Tier 2 requirements. This was expected to be more straightforward for preparers, and also referring entities directly to the Tier 2 requirements would enhance comparability between entities, including across the reporting tiers. The Board expressed this view in its Discussion Paper preceding ED 335. However, the Board received feedback that a stand-alone Standard should largely avoid the need for an entity to apply Tier 2 reporting requirements. In this regard, stakeholders considered an entity should be required to develop an accounting policy by first referring to the principles and requirements in this Standard dealing with similar or related issues.

BC27 The Board noted that stakeholders were concerned that requiring entities to begin with Tier 2 requirements could introduce unnecessary complexity and increase the judgement and cost involved in developing accounting policies, particularly where this Standard already contains related or analogous requirements. On reflection of the impact to the financial statements, the Board was persuaded not to reaffirm its proposal. The approach adopted in this Standard maintains internal consistency with similar or related issues, supports simpler application for smaller NFP entities, and ensures Tier 2 requirements are considered only where no relevant Tier 3 guidance exists.

BC28 The Board also noted that, consistent with paragraph BC24, there is necessarily guidance on some issues in a topic-based AAS that is not replicated in this Standard. The Board observed that where there are no significant recognition or measurement differences between the topic-based AAS and this Standard, the guidance in that topic-based AAS could be applied by an entity. For example:

(a) Appendix E *Australian implementation guidance for not-for-profit entities* in AASB 10 *Consolidated Financial Statements* may help an entity to assess whether it controls another entity; and

(b) the Application Guidance in AASB 11 *Joint Arrangements* may help an entity to assess whether it has joint control of an arrangement.

However, the Board expects that this Standard should provide sufficient guidance for entities applying the Standard. The Board does not intend for an entity to consider whether the requirements and guidance in a topic-based AAS impact the application of the requirements in this Standard.

Applying an accounting policy permitted or required by Tier 1 or Tier 2 Australian Accounting Standards

BC29 From its initial outreach activities, the Board heard that some entities might already comply with accounting policies prescribed by Tier 1 or Tier 2 reporting requirements and that these entities may want to continue applying those existing policies. Consequently, the Board considered whether this Standard should, as a general rule, permit an entity preparing Tier 3-compliant GPFS to 'step up' to an R&M policy permitted or required by Tier 1 or Tier 2 reporting requirements in place of the accounting policies specified by this Standard.

BC30 The Board was informed by stakeholder feedback on its Discussion Paper preceding ED 335 as to whether it should develop requirements that would:

(a) allow an entity to freely apply the accounting policies specified by a topic-based AAS;

(b) allow an entity to apply the accounting policies specified by a topic-based AAS only for certain topics; or

(c) require an entity to apply only the accounting policies specified in this Standard.

BC31 Some stakeholders noted that an option to 'step up' would provide entities with the flexibility to provide information to users that might more faithfully reflect the nature and complexity of the transaction or other event. Other stakeholders were concerned that such flexibility would reduce comparability between entities.

BC32 The lack of comparability between entities currently preparing SPFS is one of the problems this project aimed to address. In developing this Standard, the Board considered that permitting entities to opt up to Tier 1 or Tier 2 accounting policies could reintroduce similar issues by allowing entities to choose between multiple frameworks, thereby reducing consistency and comparability among Tier 3 preparers and increasing complexity. The Board also observed that prohibiting an entity from freely applying an accounting policy specified by a topic-based AAS would help ensure this Standard functions as a stand-alone, simpler and more understandable framework for smaller NFP entities. While the Board acknowledged that this approach requires this Standard to include sufficient reporting requirements relevant to smaller NFP entities, it concluded that the benefits of a coherent and self-contained Standard outweighed the disadvantages associated with developing a more comprehensive set of requirements.

Primary financial statements (Sections 3–6)

BC33 In determining the components of the primary financial statements of an entity applying this Standard, the Board applied the principles underlying the development of the Tier 3 reporting requirements, including the principle in paragraph BC15(c) that consistency with Tier 2 accounting principles is desirable where appropriate. Accordingly, the Board decided to use the presentation requirements in AASB 1060 as the starting point, with further simplifications to reflect the user needs and circumstances of smaller NFP entities. The Board considered it is generally accepted that some form of statements about the entity's financial performance for the period and financial position, including notes, must be presented because they provide crucial financial information about the entity to the users of its GPFS. However, the Board observed there is less consensus about the usefulness of the level of detail and location of the information about other comprehensive income, changes in the entity's equity (or accumulated funds) and cash flows for entities applying this Standard. As such, the Board considered there might be a reason to simplify requirements regarding the statement of financial performance, statement of changes in equity and the statement of cash flows.

Statement of financial performance (Section 4)

BC34 In its initial outreach, the Board heard that users of financial statements of smaller NFP entities might not fully understand that items of other comprehensive income often are unrealised gains and losses. Also, users might be less informed that these gains or losses may or may not subsequently be reclassified to profit or loss. As an alternative to requiring some items to be classified as 'other comprehensive income', the Board discussed whether simply requiring a statement of profit or loss would be a proportionate response for Tier 3 GPFS. However, the Board considered that the benefits of providing more complete and transparent information about the entity's performance would outweigh the cost of providing such information (which should be reduced by further education about the nature of the amounts reported). As such, the Board decided that a statement of profit or loss and other comprehensive income remains useful and therefore should be required for Tier 3 GPFS without imposing significant costs on preparers.

BC35 The Board decided to align the presentation requirements for a statement of financial performance with Tier 2 reporting requirements, including presenting a statement of comprehensive income in which the bottom line is labelled 'profit or loss' if the entity has no items of other comprehensive income, to maintain consistency with Tier 2 reporting requirements. Some stakeholders suggested that more prescriptive requirements were needed regarding when to aggregate or disaggregate information on the face of the statement of profit or loss and other comprehensive income. However, based on the strong support from most stakeholders for aligning presentation requirements with AASB 1060, the Board decided to retain that approach. The Board concluded that this approach would better enable entities to use the financial statements to reflect their circumstances, allow management to determine the appropriate level of aggregation or disaggregation based on user needs, and help build preparer capability as entities grow and their users' information needs become more sophisticated.

BC36 The Board also received feedback from stakeholders that a mixed presentation of expenses according to the nature of some and the function of others is commonly applied in practice for presenting an analysis of expenses, reflecting views that a mixed presentation provides useful information to users of GPFS. Stakeholders further noted that AASB 18 *Presentation and Disclosure in Financial Statements*, which will apply to Tier 1 NFP entities from 1 January 2028, permits such a presentation approach and therefore

encouraged alignment with AASB 18 in this respect. In considering this feedback, the Board observed that allowing a mixed presentation is consistent with its Tier 3 development principles, including ensuring consistency with the accounting principles specified in Tier 2 reporting requirements and leveraging information that management already uses for decision-making. Accordingly, the Board decided that this Standard should permit the analysis of expenses on a mixed presentation basis.

BC37 The Board also decided to align the titles of the primary financial statements with those in AASB 18 ahead of outcomes from its project considering how AASB 1060 should be amended as a result of the issue of AASB 18. The Board considered that this action would improve clarity for preparers and users and promote consistency across reporting tiers. At the time of issue of this Standard, the Board was developing an exposure draft proposing to align AASB 1060 with AASB 18.

Statement of changes in equity (Section 5)

BC38 From its initial outreach, the Board heard that the statement of changes in equity might help users assess the integrity of the financial statements and provide useful information about the effects of changes in accounting policies and corrections of prior period errors. However, the Board observed that, for many smaller NFP entities, changes in equity might consist solely of the profit or loss for the reporting period. Accordingly, the Board considered whether an alternative presentation of disclosing changes in equity other than profit or loss in the notes to the financial statements might be sufficient to meet users' needs.

BC39 Stakeholders provided mixed feedback on whether a statement of changes in equity should be required. Those supporting its inclusion considered that the information about movements in reserves (if presented), as well as adjustments arising from accounting policy changes and the correction of prior period errors, is useful to users and should be retained. Those opposing it noted that, for many smaller NFP entities, the only movement in equity for the reporting period would be their profit or loss and therefore considered the statement of changes in equity would not add value to users. A few stakeholders suggested that, if the statement was not required, the relevant information should instead be disclosed in the notes.

BC40 After considering the feedback, the Board decided that, consistent with Tier 2 reporting requirements, this Standard should require the presentation of a statement of changes in equity only in limited circumstances; otherwise, a statement of income and retained earnings may be presented instead. This approach ensures that entities continue to provide information to users when it is relevant. The Board noted that, although many NFP private sector entities experience few changes in equity beyond profit or loss, the existing flexibility to present a statement of income and retained earnings already addresses those concerns by avoiding unnecessary reporting when equity movements are minimal. In forming its decision, the Board also observed that its findings from research and outreach indicate that some entities do experience movements in other comprehensive income – particularly arising from revaluations of non-financial assets.

BC41 The Board observed that AASB 1060 permits certain equity movements, such as dividend payments, to be made without triggering the requirement to present a statement of changes in equity. As dividend payments are expected to be highly uncommon for NFP private sector entities, the Board decided not to include a similar reference to dividend payments.

Statement of cash flows (Section 6)

BC42 From its initial outreach, the Board heard that while the statement of cash flows is useful to users, it is often the most difficult statement for smaller NFP entities to prepare. The Board therefore considered whether requiring entities to distinguish investing and financing cash flows would provide sufficient incremental benefit to justify the costs involved, particularly given that major classes of gross cash receipts and payments are disclosed regardless.

BC43 Some stakeholders expressed concern that not requiring separate presentation of investing and financing activities in the statement of cash flows might reduce users' ability to evaluate the sources of cash flows and their use. They also noted that many entities already have internal systems capable of producing those categories. Further, stakeholders considered that both the direct and indirect methods of presenting cash flows from operating activities should be permitted by this Standard, consistent with the findings in Research Report 19 that most smaller NFP entities apply both the direct and indirect methods.

BC44 After considering the feedback, the Board concluded that permitting, but not requiring, entities to present investing and financing activities separately provides an appropriate balance between simplification and relevance. The Board noted that entities already capturing this information internally retain the flexibility to present investing and financing activities separately when useful to their users. At the same time, not mandating separate presentation reduces judgement and preparation burden for smaller NFP entities whose users may focus primarily on overall cash movements. The Board considered this approach would ensure consistency with Tier 2 principles where appropriate while allowing proportionate simplification leveraging information the entity's management already uses. Similarly, the Board decided this Standard should allow

both the direct and indirect methods for presenting cash flows, as this approach maintains consistency with Tier 2 principles and enables entities to select the method that best reflects how management communicates cash flow information to its users.

Consolidated and separate financial statements (Section 8)

Choice as to whether to prepare consolidated financial statements

BC45 The Board heard that avoiding consolidation might be a reason some NFP private sector entities prepare SPFS, rather than GPFS. The Board is aware from its initial outreach activity that some preparers:

(a) find it challenging and costly to identify a complete set of controlled entities because information to make this assessment is not readily available to the NFP private sector reporting entity; and

(b) consider that consolidated financial statements do not provide useful information for a NFP private sector entity compared with the 'single entity' financial statements. The Board heard anecdotally that, sometimes, this is because of disagreement between the preparer and its auditor as to whether an entity is actually controlled by the reporting entity.

BC46 Consolidation provides more relevant and faithfully representative information about the financial position and financial performance of the economic entity, comprising a parent entity and its controlled entities. It provides transparent information to users of the financial statements about the resources available to, the financial risk associated with, and the funding provided to, the group as a whole. However, the Board noted that:

(a) the costs incurred by a smaller NFP entity to prepare consolidated financial statements are likely to be proportionately larger than for entities applying Tier 1 or Tier 2 reporting requirements because much of those costs arise from the consolidation procedures (and are not proportionate to the group's volume of transactions) and because of the challenges encountered by some smaller NFP entities in identifying the entities they control. Given their limited resources, smaller NFP entities often need to engage external advisors to make these assessments, increasing the cost of compliance;

(b) benefits from consolidated financial information for managing the group as a whole are likely to be limited because managements of smaller NFP entities often do not use consolidated financial information for management purposes;

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

(d) in many instances, an NFP private sector entity that is a subsidiary must lodge financial statements even if it forms part of the consolidated financial statements of its parent entity, resulting in duplication of some costs.

BC47 Mainly for those reasons, the Board decided that it would be a proportionate response, having regard to those cost/benefit considerations, for Tier 3 reporting requirements to permit, but not require, a parent entity to consolidate its subsidiaries. In making this assessment, the Board noted that permitting but not requiring parent entities to prepare consolidated financial statements would reduce comparability between different groups of entities applying Tier 3 reporting requirements. However, the Board:

(a) expects that not many smaller NFP entities would be parent entities; and

(b) considers that the reduction in comparability could be ameliorated by supplementary disclosure requirements.

BC48 In forming its view, the Board considered whether a parent entity's financial statements need to recognise all assets the entity controls and all liabilities it incurs, and changes in those assets and liabilities, in order to be described as GPFS. The Board observed that exceptions to preparing consolidated financial statements already exist in AASB 10 in respect of investment entities and in certain other situations. Hence, the Board concluded that GPFS can include financial statements of a parent entity in which its controlled entities are not consolidated.

BC49 The Board rejected an approach of simply developing further guidance to guide entities when determining whether a control relationship exists. The Board considered that this approach:

(a) would not adequately respond to the stakeholder concern that, for smaller NFP entities, the usefulness of consolidated financial statements may be less apparent relative to the cost of preparing them; and

(b) might have unintended implications for entities applying AASB 10.

Measurement in separate financial statements

BC50 The approach in this Standard acknowledges the stakeholder feedback that it can often be challenging to identify whether the relationship between the reporting entity and another entity is that of control, joint control or significant influence. Where consolidated financial statements are not prepared, this Standard requires an entity to treat all of these relationships as a single class of assets. That is, a notable relationship entity can be a subsidiary or an associate of the investor or an entity that the investor jointly controls with one or more other parties. However, the Board noted that an arrangement over which the entity has joint control but that is not structured through a separate vehicle (eg some joint operations) is never a notable relationship entity. Instead, such arrangements are accounted for in accordance with Section 13: *Investments in Associates and Interests in Joint Arrangements*.

BC51 The Board decided to require an entity that accounts for investments in notable relationship entities to subsequently measure these investments at cost, fair value or the equity-accounted amount. In reaching this decision, the Board took into account the following considerations in determining both the availability of an accounting policy choice and the suitable measurement models:

(a) despite offering a choice of measurement models, it expects that many entities will measure the investments at cost;

(b) noting its finding that some entities consider that their relationship with a controlled entity might be more akin to that of an investment in an associate, specifying the equity method as an available measurement method accords an entity the opportunity to measure its investment in a controlled entity in a manner consistent with that specified by Section 13 for investments in associates;

(c) specifying fair value as an available measurement model allows entities to measure these investments in a consistent manner to its other investments in equity instruments; and

(d) the specified measurement models are consistent with those specified by AASB 127 *Separate Financial Statements*.

BC52 The Board received feedback that the equity method is not an appropriate method for accounting for investments in notable relationship entities because its use would be inconsistent with the decision permitting entities not to consolidate and the principles underlying equity accounting involve considerable complexity. The Board noted that although the equity method of accounting employs some consolidation procedures, it is not the same as consolidation. Therefore, the Board concluded that allowing investments in notable relationship entities to be accounted for using the equity method of accounting is not inconsistent with the Board's decision about consolidation. In addition, the Board noted that permitting use of the equity method would achieve consistency with the accounting policies permitted under Tier 1 and Tier 2 reporting requirements in respect of separate financial statements. Hence, the Board decided to affirm its proposal that investments in notable relationship entities may be subsequently measured at their equity-accounted amounts.

Disclosures about notable relationship entities

BC53 This Standard requires an entity that accounts for investments in notable relationship entities to disclose whether the financial statements of the entity's notable relationship entities are audited or reviewed. The Board considered that this disclosure provides useful information to users of the financial statements because this information assists users to assess the reliability of those financial statements. The Board noted that, in some cases, financial statements of notable relationship entities are made publicly available by regulators, enabling users to obtain and review that information directly if they consider it necessary. In this context, the Board concluded that requiring disclosure of the assurance status might assist those users who need more information about the notable relationship entities to decide whether to access publicly available financial statements independently, while avoiding the burden on preparers compiling or reproducing information that may already be publicly accessible, is a proportionate response to the matter.

BC54 The Board considered whether to require the disclosure of key metrics (eg total assets) for each notable relationship entity. However, the Board decided not to do so because it concluded that making such disclosures would likely reduce considerably the cost savings from not preparing consolidated financial statements.

Accounting policies, estimates and errors (Section 9)

BC55 The Board decided for this Standard that the treatment of changes in accounting estimates should remain consistent with Tier 2 principles as the Board did not identify any reasons to depart from this approach based on previous stakeholder outreach. However, the Board decided to require a modified retrospective approach for changes in accounting policies as this approach would strike an appropriate cost/benefit balance for smaller NFP entities while remaining compatible with AASB 108 *Basis of Preparation of Financial Statements*. Requiring a modified retrospective approach for changes in accounting policies is already permitted in

AASB 108 for transition to new or amended Standards, meaning that its use is familiar to preparers and designed for circumstances in which historical information may be difficult to reconstruct. Therefore, the Board considered the benefits of restating comparative information presented for prior periods resulting from changes in accounting policies might not exceed the related costs since these adjustments are generally one-off in nature and users of Tier 3 GPFS might not regard such restatements as crucial.

BC56 The Board proposed a similar modified retrospective approach for the correction of prior period errors in ED 335, mainly so that NFP entities would not be required to reopen their prior financial statements. However, many stakeholders were concerned that leaving known misstatements uncorrected in comparative information could mislead users or create opportunities to manipulate reported trends. Assurance providers also noted that leaving known errors uncorrected in comparative information may affect their ability to express an unqualified opinion. In addition, the Board received evidence that the cost savings expected from a modified retrospective approach would be limited, as entities would still need to quantify the cumulative effect of the error and adjust opening balances. Stakeholders observed that, for only modest additional effort, full retrospective restatement would provide corrected comparative information that users find more useful and that enhances year-to-year comparability. On this basis, the Board concluded that the benefits of restating comparative information outweigh the costs for preparers. As such, the Board decided in this Standard that prior period errors should be corrected using full retrospective restatement, as this better supports users' understanding of an entity's performance over time and maintains confidence in the integrity of the comparative information presented.

BC57 The Board noted that its decision to require full retrospective restatement for correction of prior period errors is consistent with, but distinct from, its decision to allow a modified retrospective approach for voluntary changes in accounting policies. In respect of voluntary changes in accounting policies, the application of a modified retrospective approach represents faithfully comparative information in terms of the accounting policies adopted in those comparative periods. By contrast, the correction of prior period errors concerns past misstatements that users generally expect to be fully corrected. Accordingly, while the cost/benefit considerations justify a modified retrospective approach for changes in accounting policies, they do not justify the same approach for correcting prior period errors.

Financial instruments (Section 10)

BC58 This Standard specifies accounting requirements for those financial assets and financial liabilities that are basic financial instruments or are financial instruments that are commonly held by smaller NFP entities. Further, the Board decided to specify that certain financial instruments must be accounted for in accordance with the requirements of AASB 9 and are subject to the disclosure requirements of AASB 1060. The Board determined this distinction in treatment to be appropriate but refined its preliminary views (including the specifically identified financial instruments) on consideration of stakeholder feedback received on its public consultation documents. The Board's decisions:

(a) provide clarity for smaller NFP entities, which are unlikely to hold financial instruments other than those listed. Framing the applicability of the simpler requirements set out in Section 10 as a broader principle recognises that it is possible that industry-specific instruments may not have been captured by the Board's research and consultation process and also that, as practices evolve, other financial instruments may come into common use by entities for whom this Standard was developed. However, given the extensive consultation process and research undertaken regarding this project, the Board expects that there will be no further financial instruments identified as being a basic financial asset or financial liability or an instrument commonly held by smaller NFP entities, at least in the short to medium term;

(b) reflect its view that the accounting specified by AASB 9 remains appropriate for transactions that give rise to the identified financial instruments (see paragraph 10.4 of the Standard). This is because it is uncommon for smaller NFP entities to hold complex financial instruments and the highly specialised and complex nature of those financial instruments warrants applying the more advanced Tier 2 AAS requirements regardless of the entity's size; and

(c) are consistent with its policy under the *AASB Not-for-Profit Entity Standard-Setting Framework* of developing NFP entity-specific requirements only for NFP-specific application issues concerning transactions, other events or conditions that are common to many NFP entities, or where there are differences in resources available to NFP entities, and the benefits of the solution are expected to exceed the costs.

BC59 The Board rejected delineating the treatment of financial instruments between the 'simpler' requirements in Section 10 and those in AASB 9 by reference to a financial instrument's characteristics and features. The Board considered this would be unnecessarily complex and that it is more important to provide clarity in the simplest way possible, given the relatively limited complexity and breadth of the financial instruments expected to be commonly held by smaller NFP entities.

BC60 In developing this Standard, the Board initially framed its delineation proposals in terms of 'basic and commonly held' and 'more complex or less commonly held' financial instruments as it did not intend to develop special requirements for financial instruments that might be regarded as having a basic nature but that are not commonly held by smaller NFP entities. However, in finalising this Standard, the Board noted that its primary objective is to clearly specify the accounting for those financial instruments that it had identified through its research and consultation process as being more commonly held by smaller NFP entities. The finalised requirements in Section 10 reflect this intention, including that AASB 9 presents the appropriate accounting response for specific instruments. An entity will need to apply judgement to determine an appropriate accounting policy for all financial instruments that have not been specifically identified. Also, as new financial instruments develop and the use of financial instruments evolves, the Board's normal standard-setting process will apply to any concern about the appropriateness of the requirements in Section 10.

BC61 The Board was informed through previous outreach that many stakeholders regard AASB 9 to be a complex accounting standard. This view is consistent with the broad scope of that Standard, being to provide useful information to users of the financial statements of financial instruments held by financial institutions and non-financial institutions, financial instruments held by start-ups and other simple businesses and those held by entities employing more complex financial management strategies. Hence, the Board considered it necessary to develop simpler reporting requirements for financial instruments than those specified by Tier 2 reporting requirements. The significant issues and departures from AASB 9 considered by the Board are detailed in paragraphs BC62–BC69.

BC62 In developing the specified recognition and derecognition criteria for financial assets and financial liabilities, the Board observed that the derecognition criteria of AASB 9 needed to address situations where it may not be clear whether the entity has lost control of the financial asset. The Board decided simpler derecognition criteria for financial assets are appropriate for this Standard after considering:

(a) its expectation about the infrequency of securitisation and similar other activity by smaller NFP entities;

(b) the costs of assessing pass-through transactions and whether the entity retains a continuing involvement in a financial asset; and

(c) the usefulness of the resulting financial information for users of Tier 3-compliant financial statements.

For similar reasons and on noting that the practical impact will be limited given its decisions regarding the measurement of financial liabilities, the Board decided that this Standard need not specifically address instances of exchanges of debt instruments or the modification of the terms of a financial liability.

BC63 The Board considered whether transaction costs incurred as part of the acquisition of a financial asset or financial liability should be included in the initial carrying amount of the financial instrument. The Board observed that if so, an entity might be required to identify, monitor and account for such costs. Having regard to the transaction costs ordinarily associated with the financial instruments identified in paragraph 10.2, the Board considered that immediately expensing such costs would be unlikely to result in any material misrepresentation of the financial position or performance of the entity. Hence, the Board decided to require transaction costs incurred to acquire basic and other commonly held financial instruments to be immediately expensed. Prioritising consistency for preparers, the Board also decided to specify a similar requirement for transaction costs incurred in acquiring an investment in a subsidiary, an associate, a joint venture or a notable relationship entity as the 'cost' of equity instruments would otherwise differ unnecessarily depending on the relationship accorded by the shareholding.

BC64 This Standard requires a concessional loan to be measured at its transaction price on initial recognition. The Board considered that it is necessary to specify for these instruments requirements that depart from the general initial measurement requirements for the following reasons:

(a) the cost and complexity of determining an appropriate market interest rate for a concessional loan; and

(b) the relevance of the accounting outcomes of the general measurement requirements for loans.

BC65 The Board considered historical cost, less impairment, to be an appropriate measurement basis for many of the financial instruments identified in paragraph 10.2 of this Standard. Likewise, the Board decided to require interest income and expense to be measured by reference to a financial instrument's contractual interest rate. The Board concluded that these simpler measurement requirements provide sufficient useful information for the purposes of Tier 3 GPFS when considering the costs of applying an amortised cost measurement model using the effective interest method against the nature of these financial instruments and the comparative decision-usefulness for users of the financial statements of information from the two measurement models.

BC66 The Board reflected that a fair value measurement model remains appropriate for financial assets held for investment purposes, including all investments in equity instruments. This includes the entity's investments

in microbusinesses in delivering on its NFP objectives, as the entity could reasonably expect the investment to generate a capital return for it, as a means of funding the entity's future NFP operations. This also includes the equity instruments that an NFP entity might hold primarily for the purposes of advocacy, because there is a potential capital return for the entity if it divests the investment.

BC67 Nevertheless, the Board was cognisant that estimating the fair value of unlisted equity instruments can be a complex and costly exercise and could be disproportionately so for smaller NFP entities. As such, the Board decided that this Standard should:

(a) include guidance on when cost might be an appropriate estimate of fair value; and

(b) unlike AASB 9, provide an exception from fair value measurement when certain conditions are met. These conditions reflect the subjectiveness of the fair value measurement in those situations and that, as such, the last reliably determinable fair value may provide as much useful information to users of the financial statements as an updated fair value estimate as of the reporting date. In finalising its requirements, the Board refined the conditions exposed in ED 335 to exclude situations in which an active market is not present, because the presence of an active market is not necessary for a fair value to be able to be established.

BC68 In response to stakeholder concerns noted in the Discussion Paper preceding ED 335 that the inclusion of fair value gains and losses in profit or loss might not appropriately depict an entity's objectives in holding investment assets, the Board decided to permit the presentation of fair value gains and losses in other comprehensive income. For these financial assets, the Board decided that, consistent with stakeholder feedback, the principal objective is consistency with Tier 1 and Tier 2 R&M requirements. However, the Board decided to require this accounting policy determination to be made in respect of a class of financial assets, rather than asset-by-asset. The Board considered this simplification from AASB 9 to be appropriate as it is consistent with smaller NFP entities being less likely to have operations that include having different business strategies for different investment assets.

BC69 The Board noted that the expected credit loss models for impairment in AASB 9 can be complex to apply and that there may only be marginal, if any, additional benefit for users of Tier 3 financial statements from a more refined measurement of impairment. Also, features of the expected credit loss model are inconsistent with the Board's decision not to require use of the effective interest method. Therefore, the Board decided that this Standard should simply express the measurement principle for impairment without specifying more detailed requirements for the determination of an impairment loss.

Fair value measurement (Section 11)

BC70 The Board considered that AASB 13 *Fair Value Measurement* serves as an appropriate reference point for the development of requirements about fair value measurement. This approach avoids the potential costs of misinterpretation and retraining required if fair value were to be measured differently to AASB 13.

BC71 The Board noted that entities are not required to apply a revaluation model to non-financial assets. In this context, the Board rejected:

(a) allowing entities to use other current value measurement bases as 'shortcuts' to estimating fair value. For example, the Board considered whether it should permit an entity to use, on a stand-alone basis, a rateable or other government valuation or the recent market selling price of a similar asset. The Board rejected such valuation shortcuts because it was concerned that they might not result in measurements that represent faithfully the value of the asset held (eg rateable value calculation bases might differ between jurisdictions);

(b) permitting the use of historical cost as an approximation of fair value to reduce the cost and the potential volatility of fair value measurements. The Board also concluded that, whilst historical cost might in particular circumstances (eg for some recently purchased assets) coincide closely with an asset's or a liability's fair value, deeming historical cost to represent fair value will often not result in a faithful representation of fair value; and

(c) excluding transport costs from the fair value measurement amount in the absence of clearer guidance on when location is a characteristic of the asset. The Board decided this Standard should be consistent with Tier 1 and Tier 2 requirements for the treatment of transport costs when location is a characteristic of the asset, noting that treating transport costs as if they were transaction costs would not be representationally faithful. The Board also decided not to develop additional guidance on identifying when location is a characteristic of the asset because it might have unintended implications for Tier 2 NFP entities applying AASB 13 and would lengthen this Standard.

BC72 The Board considered that AASB 13 is, however, expressed in a manner that is overly complex for the types of assets and liabilities typically held by smaller NFP entities applying this Standard. Therefore, the Board decided to express requirements for fair value measurement in a manner that will be easier for readers of this

Standard to follow and sufficient to guide the measurement of the assets and liabilities typically held by smaller NFP entities without sacrificing consistency with the principles in AASB 13. This included:

(a) not requiring the inputs to a fair value measurement to be classified as Level 1, Level 2 or Level 3 inputs, noting that AASB 1060 does not require disclosures for these categories that correspond to the disclosures currently required by AASB 13; and

(b) in respect of non-financial assets – rather than referring to a use that is financially feasible, to refer instead to a use that makes financial sense and thus gives the requirement an NFP context.

BC73 The fair value of a non-financial asset has regard to its highest and best use. So that entities do not unnecessarily expend effort and incur costs to identify an asset's highest and best use, the Board decided to include a rebuttable practical expedient for entities. This practical expedient is similar to that in AASB 13 applying to NFP public sector entities, and states that a non-financial asset's current use is presumed to be its highest and best use unless it is highly probable that, within one year of the measurement date, the asset will either be sold to a buyer who would use the asset for a different use or be redeployed by the entity.

BC74 The Board decided that incorporating a clear time boundary as part of the practical expedient would provide entities with a clear filter as to when an asset's current use must be reviewed if an indication of a future sale or change in use arises and is an appropriate simplification from AASB 13 for smaller NFP entities to reduce costs. In identifying a suitable period, the Board observed that if a relatively short time limit was not included, entities would need to consider possible changes in an asset's use that are much more difficult and costly to assess because uncertainty and the likelihood of a change in use increase with time. Conversely, a shorter consideration period than one year might be unrealistic, because the process to sell or redeploy some non-financial assets (including obtaining necessary approvals) can be lengthy.

Non-financial assets acquired for significantly less than fair value (Sections 12, 14 and 15)

BC75 In general, this Standard requires a non-financial asset to be initially measured at its cost. The cost of an asset acquired in exchange for consideration is, at initial recognition, usually consistent with its fair value and is a relevant measure of the economic benefits that the entity expects to recover from the asset. However, the cost of an asset transferred to the entity without charge, or at a significantly discounted price, will not approximate the asset's fair value. In these cases, cost may not be a relevant measure of the value of the asset to the entity.

BC76 The Board considered whether it should instead require smaller NFP entities to initially measure assets acquired for significantly less than fair value (referred to in this Standard as 'donated assets') at their fair value or, for inventories, at current replacement cost. In its deliberations, the Board considered feedback from some stakeholders that measuring such assets at cost would result in the omission of important information relating to philanthropic giving. In this regard, some stakeholders had noted that the Australian Taxation Office requires certain entities to report the market value of non-cash donations made to deductible gift recipient-endorsed entities.

BC77 The Board also heard from stakeholders that smaller NFP entities would find it challenging and costly to estimate the fair value of a wide range of donated assets, particularly because various non-financial assets donated to them are not typically sold or lack readily available market evidence (eg some inventories held for distribution) and because such entities tend to lack experience in estimating fair values of non-financial assets. Further, the Board noted that for-profit entities applying Tier 1 or Tier 2 reporting requirements generally do not receive donated non-financial assets and are not required to fair value non-financial assets they acquire.

BC78 Hence, the Board decided to allow entities an accounting policy choice to initially measure donated non-financial assets at either their cost or fair value (or, for inventories, current replacement cost). This requirement reflects the Board's view that flexibility is appropriate, as some entities consider fair value information to be more useful to users of their financial statements while others regard obtaining fair values as disproportionately costly for certain donated assets.

BC79 The Board also heard feedback from stakeholders that fair values can be more costly and difficult to determine for some donated assets than for others. Therefore, the Board decided that whether a donated non-financial asset is initially measured at cost or fair value/current replacement cost should be an asset-by-asset election. This would accord entities the flexibility to use fair value or current replacement cost where it can be determined without significant difficulty, while applying cost for assets that present greater measurement challenges.

BC80 The Board considered the implications of an entity initially measuring a donated asset at cost and subsequently revaluing the class of assets to which it belongs, noting that the donation income that would have been presented in profit or loss if the asset had initially been measured at fair value is presented in other comprehensive income when the asset is revalued. The Board observed that while this outcome is not ideal, prohibiting revaluation of donated non-financial assets initially measured at cost would inappropriately bind

future management teams to the measurement decisions of their predecessors. Therefore, the Board did not impose that restriction. Consequently, the initial choice of measurement of a donated non-financial asset is independent of the subsequent measurement model applied to that asset.

Investments in associates and interests in joint arrangements (Section 13)

BC81 The Board had not received feedback from stakeholders in its preliminary outreach that entities were concerned about the accounting requirements for an entity's investments in its associates and joint ventures under AASB 128 *Investments in Associates and Joint Ventures.* As such, the Board decided that AASB 128 and AASB 11 *Joint Arrangements* serve as appropriate references for developing Tier 3 reporting requirements for investments in associates and interests in joint arrangements; in particular, that the equity method of accounting is suitable as a measurement method.

BC82 The Board considered that the equity method specified by AASB 128 should be modified consistently for the same reasons that the Board decided to use a book-value approach to the initial recognition of an investment in a controlled entity. As such, this Standard requires:

(a) investments in associates and joint ventures to be initially measured at the investor's share of the carrying amounts of the investee's assets and liabilities, instead of at the amount of consideration paid. Such an approach may result in the carrying amount of these investments differing from the economic resources sacrificed by the investor. However, the Board noted this approach is consistent with the Tier 3 requirements developed for entity combinations;

(b) the consideration/transaction price of the acquisition is measured by reference to the carrying amounts of the investor's net assets given in exchange, rather than fair value; and

(c) the difference between the transaction price and the investor's share of the book value of the investee's net assets is recognised directly in equity.

BC83 Noting that the equity method can be complex to apply, the Board considered whether other simplifications of the model are warranted. The Board additionally decided:

(a) not to specify different requirements for pre- and post-acquisition dividends. The Board made this decision because smaller NFP entities may not have access to the detailed information needed to determine whether distributions arise from pre- or post-acquisition surpluses, which could result in a disproportionate burden for these entities; and

(b) to permit, but not require, an investee's accounting policies to be aligned with the investor's accounting policies. The Board made this decision because mandating uniform accounting policies would add costs and complexity to the accounting for associates and joint ventures (eg it might be difficult for investors to obtain the information required). Rather than requiring adjustments unless impracticable, the Board opted to provide entities with an election, offering flexibility to adjust the investee's accounting policies for uniformity if desired.

BC84 The Board discussed whether to allow an investor that is not a parent entity to measure an investment in an associate or a joint venture using a different measurement model to the equity method of accounting. The Board decided to also allow the cost and fair value models for the following reasons:

(a) it allows the selection of a measurement basis that an entity considers would best meet the needs of the users of its financial statements;

(b) fair value provides information useful to users for assessing the investee's future cash flows or loan security;

(c) the equity method may be more challenging for an investor in an associate to apply compared with cost or fair value; and

(d) consistency with the measurement requirements for investments in notable relationship entities. Otherwise, an entity with an investment in an associate or a joint venture could access the option to use cost or fair value instead of the equity method simply by identifying the investee as a notable relationship entity.

BC85 In addition, the Board decided to require transaction costs incurred in acquiring an investment in an associate or a joint venture to be expensed immediately, to maintain consistency with the treatment of transaction costs required in other sections of this Standard.

Intangible assets (Section 16)

BC86 The Board was informed by Research Report 19 that, although it is uncommon, some charities hold intangible assets. Also, although the feedback was mixed, the Board received stakeholder feedback that smaller NFP entities commonly hold certain intangible assets and that an NFP entity's use of intangible assets is likely to increase in the future. As such, the Board decided that it is appropriate for this Standard to specify requirements for intangible assets.

BC87 The Board decided to require entities to recognise intangible assets in a manner consistent with Tier 2 reporting requirements (ie AASB 138 *Intangible Assets*). However, on consideration of the potential costs, the Board decided to depart from AASB 138 in the following respects:

(a) not to permit the recognition of internally generated intangible assets, including any in-process research and development. In forming its view, the Board noted that entities often find it challenging to distinguish between costs arising in a research phase or a development phase. The Board rejected allowing entities an accounting policy choice in this regard, as doing so would unnecessarily add to the judgements required of management and on consideration that the resulting financial statements may become less comparable;

(b) require indefinite-life intangible assets to be assessed as having a finite useful life that does not exceed ten years; and

(c) require review of the useful life, residual value and amortisation method of intangible assets only if an indicator is present.

The Board considered that these departures simplify the accounting for intangible assets in a manner that is proportionate to smaller NFP entities.

BC88 When considering the accounting for internally generated intangible assets, the Board heard requests from some stakeholders for this Standard to include simplified accounting requirements for configuration or customisation costs in a cloud computing arrangement. However, the Board decided not to develop such guidance because it would not necessarily reduce the complexity of assessing the capitalisation of configuration or customisation costs in cloud computing arrangements and might have unintended implications for NFP entities applying AASB 138. For similar reasons, the Board decided not to develop requirements for development costs of a website that facilitates donations to the NFP entity.

BC89 The Board received feedback on ED 335 that, as a further simplification, this Standard should not permit intangible assets to be measured using the revaluation model as very few intangible assets are likely to meet the conditions for doing so and having regard to the costs of applying the revaluation model. The Board acknowledged that many entities will likely not apply the revaluation model for the reasons given, but decided to retain the accounting policy option for consistency with the requirements in this Standard for property, plant and equipment and other assets, and with Tier 1 and Tier 2 reporting requirements for intangible assets. The Board noted that retaining the accounting policy option does not change costs for entities using the cost basis.

BC90 The Board also received feedback that information about certain unrecognised intangible assets would likely be useful to users (eg the amount invested and the asset's purpose). However, the Board observed that no such requirement exists for entities complying with Tier 2 reporting requirements. Consequently, the Board decided not to develop a requirement in this regard. Further, entities are not prevented from disclosing additional information about unrecognised intangible assets in their financial statements if they wish to do so.

Entity combinations (Section 17)

BC91 The Board received stakeholder feedback that smaller NFP entities may engage in combination activity currently or more commonly in the future and that the approach in AASB 3 *Business Combinations* might be disproportionately complex for such entities. Consequently, the Board decided that this Standard should include requirements for combination activity.

BC92 The Board decided to specify requirements that acknowledge the 'merger' nature of much of the combination activity of NFP private sector entities as the Board heard that mergers and amalgamations, rather than true acquisitions, are the most common form of combination activity undertaken by NFP private sector entities. In deciding to adopt a book-value approach (commonly associated with mergers), the Board observed that:

(a) smaller NFP entities might experience difficulties and burdensome costs in obtaining the fair values of assets acquired and liabilities assumed in entity combinations, but the benefits of reporting those fair values do not clearly exceed those costs;

(b) it has made decisions elsewhere in this Standard to not require certain assets to be initially recognised at their fair values; and

(c) the specified book-value approach precludes the recognition of goodwill or a gain on a bargain purchase.

BC93 The Board observed that the accounting records of an acquired entity or operating unit might not comply with AAS and, as such, some assets or liabilities that AAS require to be recognised might not be recognised (for example, if the entity applied cash accounting). So that assets and liabilities of the group are at least recognised, the Board decided to require that any major assets and liabilities that do not have a carrying amount determined in accordance with AAS are initially measured at their combination-date fair value, except for donated non-financial assets and internally generated intangible items.

BC94 The Board proposed in ED 335 that an entity combination should be recognised from the beginning of the reporting period during which the combination takes place. The Board formed this view after considering the cost of restating pre-combination comparative information and on feedback that it is not always evident when control is obtained. However, stakeholders were concerned that recognising an entity combination from the beginning of the reporting period during which the event takes place would not result in a faithful representation of when the entity gains control over another entity or operating unit or of the post-combination income and expenses for the new group. In general, stakeholders responding to ED 335 supported the principle that combination activity should be reflected in the financial statements of an entity only from the time the entity gains control of the other entity or operating unit.

BC95 The Board noted that these matters had formed part of its considerations in developing the proposal, but that it had nonetheless developed the proposal as a practical expedient for entities. However, in light of the feedback received, the Board decided not to reaffirm this proposal. Rather, the Board decided to include guidance to acknowledge that it is possible for the combination to be recognised at a date different to the 'actual' date of gaining control. The Board considered that this would serve to alleviate some of the costs that entities might bear in instances where the date of gaining control of another entity is less clear.

BC96 In developing its requirements for entity combinations, the Board rejected requiring restatement of the entity's previous financial statements as though the group had always existed. The Board considered this approach would add unnecessary complexity for smaller NFP entities and was unlikely to be a proportionate response for Tier 3 reporting requirements. The Board also observed that many smaller NFP entities may choose not to consolidate subsidiaries, meaning the entity combination requirements in this Standard may not often be applied, further reducing the justification for imposing a more complex restatement approach.

BC97 The Board decided to refer to 'entity combinations' instead of 'business combinations' in this Standard, to use an expression better reflecting the operating environment of NFP private sector entities.

Leases (Section 18)

BC98 The Board observed that leases appear to be common and possibly material transactions to smaller NFP entities. While the Board noted that users of financial statements might benefit from comprehensive information about leases from requirements consistent with AASB 16 *Leases*, the Board considered that applying AASB 16 to account for leases would impose disproportionately greater costs on these entities because many of those costs arise from the lease accounting procedures (and are not proportionate to the entity's volume of transactions), which do not leverage information management uses to make decisions about the entity's operations. The Board also heard that many users of financial statements of smaller NFP entities do not find the information resulting from applying AASB 16 (specifically, recognised liabilities for commitments to make future lease payments and recognised assets for rights to use leased items) to be useful for their purposes and do not use that information in their decision-making about those entities. Consequently, the Board decided it is appropriate to develop simpler lease accounting requirements than those in AASB 16.

BC99 The Board decided that this Standard should not require conformity with AASB 16 for the following additional reasons:

(a) for the purposes of Tier 3 reporting requirements, disclosure of an entity's lease commitments provides an adequate substitute for the users of the financial statements;

(b) an entity that wishes to recognise lease assets and lease liabilities may elect to prepare Tier 1- or Tier 2-compliant GPFS; and

(c) concessionary leases (ie leases that have significantly below-market terms and conditions principally to enable the entity to further its objectives) are likely in most cases to be treated consistently under AASB 16 and this Standard.

BC100 The Board considered whether to require lessees and lessors to separate the cost of services such as insurance and maintenance (ie non-lease components) from the lease payments. The Board received stakeholder feedback that there is a lack of guidance on the method of separating these costs, as these elements are commonly pre-negotiated and included, without separate identification, as part of the lease payments. The Board concluded that the costs of requiring this separation are likely to exceed the benefits of distinguishing

expenses in this regard. Therefore, the Board decided to exempt lessees from separating these components from the underlying lease payments. The Board decided that this exemption should only be provided to lessees as the Board expects that lessors would be able to separate the cost of such services from the lease income.

BC101 The Board rejected allowing lessees to choose whether to separate non-lease components or to only exempt the separation if it is impractical to do so, as these approaches would make the requirements unnecessarily complex.

BC102 Some respondents to ED 335 suggested further simplification of lease accounting by requiring matching of the recognition of lease incentives (such as rent-free periods) or discounts with the timing of the lease cash payments, supported by disclosures about those lease incentives or discounts. The Board acknowledged that this approach would be simpler to apply and less costly while still arguably providing users with relevant information, such as the benefits of a rental holiday or other lease incentive being reflected in the period in which the benefit is provided. However, the Board ultimately rejected this approach because the timing of lease payments may not necessarily represent the time pattern of the lessee's consumption of the value of the leased asset. The Board also considered it important to continue to adhere to accrual accounting principles.

BC103 In its deliberations, the Board considered whether to develop specific requirements for variable lease payments, including increases for inflation. The Board decided not to do so as it expects the costs to an entity to collect and apply the information about the variability in the lease payments are likely to exceed the benefits of a more faithfully representative lease expense for the period.

Revenue (Section 20)

BC104 After considering stakeholders' feedback during preliminary outreach, the Board decided that smaller NFP entities:

(a) should not be required to apply two different Standards (AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities*) to account for their various types of income (as is required of Tier 2 NFP entities) or, similarly, to account for income based on the nature of the transaction (eg donations, sales or grants); and

(b) should defer recognising income from inflows of resources if there is an unsatisfied, commonly understood expected use of those resources by the entity.

BC105 In developing its revenue recognition requirements, the Board considered and rejected:

(a) requiring an entity to assess whether the common understanding between it and the resource provider about the future expenditure or use of transferred resources is 'sufficiently specific', based on a simplified version of the criteria for that principle in AASB 15. Stakeholder feedback indicated that those criteria are inherently complex and require judgements that would often be prone to inconsistent application; and

(b) requiring the deferral of income only when conditions are attached to the inflows of resources that are enforceable by the transferor, such as a 'use or return' condition or other means of enforcement. The Board considered that this approach would not adequately address stakeholder concerns about the usefulness of the resulting information to users of the financial statements.

BC106 Some stakeholders argued that revenue recognition should be deferred only if the entity has an enforceable obligation to perform or a binding agreement (as defined in International Public Sector Accounting Standard IPSAS 47 *Revenue*) exists. The Board reflected that a common understanding that the entity will perform in a particular manner can exist without an enforceable obligation and noted that the binding agreement principle in IPSAS 47 also requires an enforceable obligation to be present. In relation to the approach noted in paragraph BC105(b), the Board observed that the Tier 3 (NFP) Standard *Reporting Requirements for Tier 3 Not-for-Profit Entities* issued by the New Zealand External Reporting Board previously required a 'use or return' condition for revenue deferral. This condition was changed following feedback from a post-implementation review that the condition was inappropriately restrictive and led to revenue recognition occurring when the entity had an unsatisfied moral obligation to perform in response to a transfer for a particular purpose.

BC107 The Board decided to include a practical expedient whereby revenue is recognised immediately for donations received that do not specify a time period and are intended to support an entity's operations. The Board considered it will not usually be possible to identify when these particular transferred assets have been used up by the entity. To avoid misinterpretation that such donations qualify for deferral because a common understanding is arguably still established between the transferor and the entity on how the funds should be used, the practical expedient explicitly confirms immediate recognition.

BC108 In forming its requirements, the Board considered whether the term 'common understanding' differs from the expression 'shared understanding' that applies between an entity and a counterparty regarding the terms and

conditions of a share-based payment in AASB 2 *Share-based Payment.* The Board concluded that the context of these terms' use is different in the following respects:

(a) in AASB 2, the expression 'shared understanding' is important for establishing the measurement date of an arrangement, when expense recognition for the share-based payment often occurs or begins. In contrast, a 'common understanding' applied in this Standard is relevant for establishing whether revenue deferral is required upon recognising a transferred asset;

(b) AASB 2 states that the grant date might occur after the employees to whom the equity instruments were granted have begun rendering services in respect of that grant. Therefore, assets might not be received before the parties have a shared understanding of the terms of an agreement. In contrast, under this Standard, assets will always have been received by the reporting entity at the time the parties have a common understanding of what the reporting entity will do in exchange;

(c) a common understanding applied in this Standard refers to what the entity will do in exchange for transferred assets. The context is one-directional, focusing only on the reporting entity's performance. In contrast, a shared understanding is used in AASB 2 in relation to the terms and conditions of the arrangement, with both parties having commitments under the arrangement; and

(d) parties to an arrangement can reach a 'common understanding' before a 'shared understanding' because:

  (i) a common understanding that an entity will perform in a particular manner does not require a documented explicit stipulation, an enforceable right accorded to the transferor regarding the exchange or a mandated threshold of specificity regarding how the transferred resources are to be used; however, in contrast,

  (ii) AASB 2 indicates that parties do not have a shared understanding of terms and conditions while there is still ambiguity about the agreed terms and whether the transferor has an enforceable right against the reporting entity.

Impairment of non-financial assets (Section 22)

BC109 The Board's initial research suggested that, in practice, smaller NFP entities consider and recognise impairment losses only when there has been a significant event and it is clear that the asset's carrying amount is no longer recoverable. In general, AASB 136 *Impairment of Assets* requires an entity to assess whether an indicator of impairment is present and, if so, to determine the asset's recoverable amount and recognise any related impairment loss. Consequently, under AASB 136, impairment losses are often recognised before the loss crystalises.

BC110 In recognition of the complexities in the existing impairment model in AASB 136*,* the Board considered whether to develop simpler requirements for recognising impairment. In forming its views, the Board was conscious of needing to strike an appropriate balance between the costs of impairment assessments and determining recoverable amount and the benefits of not overstating the entity's assets.

BC111 The Board decided that this Standard should employ a simplified version of the approach in AASB 136. This Standard also requires entities to determine the asset's recoverable amount only when an indication of impairment exists. However, the Board decided to specify only two indicators for when an entity should assess for impairment: physical damage, spoilage or having become obsolete; and changes in strategy or external demand (see paragraph 22.2). These indicators reflect findings from the Board's initial research, being events where typically it is clear that the asset's carrying amount cannot be recovered or will only be partially recoverable. The Board concluded that the other indicators of impairment in AASB 136 would require forward-looking or probability-based assessments (eg those involving projections of cash-flow recoverability or detailed external market analysis) and would undermine the objective of providing simple and more tangible indicators that reduce the need for judgement. The Board further observed that the two indicators are broad enough to capture the types of events relevant to smaller NFP entities and the assets typically held by them. For this reason, the Board decided to apply the same indicators of impairment to inventories and not require the more detailed measurement-based requirements for impairment required in AASB 102 *Inventories*, as those would trigger write-downs even when no impairment indicator exists. The Board considered that this simplified approach focuses on the most likely sources of impairment and substantially reduces application cost, and that any delayed recognition of impairment losses (compared with AASB 102) would be infrequent and not result in a significant loss of useful information for users. Consistent with this approach, the Board also determined that there is no need to develop requirements for the reversal of previously recognised impairment losses because the impairment losses suffered are unlikely to reverse following these impairment events.

BC112 The Board had regard to its conclusions about certain regularly revalued assets reflected in AASB 2016-4 *Amendments to Australian Accounting Standards – Recoverable Amount of Non-Cash-Generating Specialised*

Assets of Not-for-Profit Entities, and noted that Tier 3 reporting requirements are limited to smaller NFP entities, which mostly hold non-financial assets for the continuing use of their service capacity. The Board concluded that developing a requirement for regularly revalued assets to also be subject in this Standard to impairment assessments would add unnecessary complexity because it is unlikely to have any significant practical implications but could add to the costs of applying this Standard. Therefore, the Board decided that the impairment requirements in Section 22 should apply only to non-financial assets subsequently measured at cost or on a cost basis. Consequently, non-financial assets that are regularly revalued to fair value are scoped out of the impairment requirements, with any impairment therefore reflected in the revalued amounts.

BC113 In developing the requirements, the Board considered and rejected:

(a) requiring entities to assess whether an impairment indicator is present at least annually (or on another periodic basis). The Board made this decision having regard to the types of non-financial assets typically held by smaller NFP entities; and

(b) developing an alternative measure of recoverable amount or allowing entities flexibility in determining recoverable amount. The Board decided not to do so as this would be an unnecessary complexity for preparers and assurance providers and could have unintended implications for the assurance process.

BC114 Some stakeholders responding to ED 335 were concerned that the requirements for impairment remain overly complex for entities. However, in the main, stakeholders supported the two-step approach of assessing impairment only when one of the limited impairment indicators is present. In its redeliberations, the Board considered stakeholder feedback that the indicators of impairment should include:

(a) assets being held for sale or other disposal – stakeholders considered these instances to be similar to instances where an asset is damaged or its capacity to provide services or generate sales revenue is adversely affected. The Board decided that it was not necessary to do so as this Standard requires assets held for sale to be measured in accordance with AASB 5, and accordingly such assets are outside the scope of Section 22. Practically, these assets will similarly be written down to their amount recoverable; and

(b) changes in the technological, legislative or market environment – stakeholders contended that such changes may compel an entity to change its strategy. This could, in turn, impact the recoverability of the entity's assets. The Board decided that it was not necessary to do so because significant changes in the technological, legislative or market environment should already be captured by the specified impairment indicators. Separately including this indicator could also result in more impairment testing for entities without any reasonable certainty of impairment being present.

BC115 The Board observed that NFP entities often hold non-financial assets for the asset's service potential, rather than the asset's ability to generate cash flows. In these cases, the asset's fair value less costs of disposal will often exceed its value in use, as value in use is calculated by reference to the asset's future cash flows while fair value might have regard to the amount the entity would have to pay to replace that service potential. To provide clearer direction and alleviate potential costs of the impairment exercise, the Board decided that this Standard should specify a rebuttable presumption that the fair value less costs of disposal of an asset will be the most appropriate measure of the asset's recoverable amount.

BC116 The Board decided not to develop specific requirements for evaluating and measuring impairment at a cash-generating unit level. The Board initially contemplated requiring non-financial assets that do not generate cash flows that are largely independent from those of other assets to be grouped into cash-generating units and testing impairment on this basis. However, the Board decided not to do so, having regard to stakeholder feedback that requiring impairment testing at a cash-generating unit level would make the impairment requirements unduly complex and acknowledging that smaller NFP entities often hold non-financial assets for their service potential rather than their ability to generate cash flows. Further, the Board observed that the requirements of this Standard do not result in the recognition of goodwill, which is ordinarily assessed for impairment at a cash-generating unit level.

Employee benefits (Section 23)

BC117 Employee benefit costs are often one of the larger expenses of a smaller NFP entity. The Board understood from outreach activities that smaller NFP entities would encounter challenges in accounting for accrued paid absences if the R&M requirements of AASB 119 *Employee Benefits* applied to those entities. The Board agreed that the requirements specified by AASB 119 might be overly complex for smaller NFP entities, having regard to the forms of employee benefits typically provided to employees of these entities. Accordingly, to strike an appropriate cost/benefit balance for Tier 3 reporting requirements, the Board decided that AASB 119 serves as an appropriate reference point for the development of requirements about employee benefits but with the following simplifications:

(a) to restrict recognised employee benefit obligations to those that are payable to employees when they depart the entity if the entitlement is unused. The Board considered that this simplification remains compatible with the accrual accounting principles in AASB 119 with regard to the types of employee benefits offered by smaller NFP entities and the Board's understanding of how those employee benefits are consumed, such that any unrecognised accumulated balances are unlikely to be material to the entity. On that basis, recognising accumulated unused sick or parental leave balances would require additional record-keeping and estimation effort without significantly improving the information provided to users of Tier 3 financial statements;

(b) employee benefit obligations are measured using current rates of pay and without discounting future expected payments to their present value. The Board noted that measuring employee benefit obligations at undiscounted amounts would largely offset the impact of excluding expected future pay rises, thereby simplifying the calculations without significant loss of information for users of the financial statements; and

(c) not requiring employee benefit obligations to be categorised as short-term or long-term obligations for measurement purposes.

BC118 The Board considered and rejected requiring all paid absences to be expensed only when the absences occur. Such a requirement would be easier to understand and apply as the entity's obligations for outstanding employee benefits would not be recognised as a liability. However, the Board considered this approach would unnecessarily depart from accrual accounting and that the resultant reported financial position would not provide users with an appropriate picture of the entity's commitments and solvency, which could be materially important given the commonality and significance of employee benefit balances.

BC119 The Board heard from initial stakeholder outreach that determining the likelihood of employee entitlements vesting (eg for long-service leave) can be complex. The Board investigated whether it might be possible to provide more guidance or direction for entities, by having regard to industry-specific guidelines or by specifying a formula for calculating the liability. The Board's findings suggest that it is not possible to do so as this determination is specific to each entity and any rule could quickly become outdated. Consequently, the Board decided that the accounting requirements for long-service leave and other similar employee benefits should remain expressed as principles. However, in acknowledgement of the stakeholder feedback, the Board decided to develop an illustrative example to provide entities with some guidance.

Related party disclosures (Section 27)

BC120 The Board was cognisant of the importance of related party disclosures for users of Tier 3-compliant GPFS. The Board also noted that existing NFP private sector entities that are charities are already required under the ACNC legislation to make related party disclosures regardless of the size of the entity. Therefore, the Board decided to require entities complying with Tier 3 reporting requirements to present information about their related parties.

BC121 The Board considered the costs and benefits of the related party disclosures specified in AASB 1060 when deciding what information should be required to be disclosed. Having regard to feedback received about the usefulness of certain related party information to users of the financial statements of smaller NFP entities, the Board decided not to require entities to disclose information about:

(a) donations received from related parties, unless there is evidence indicating that the donations could influence the entity's activities or use of resources. The Board considered many related party donations are unlikely to influence the resource allocation decisions of an NFP private sector entity; and

(b) compensation paid to key management personnel. The Board noted that, where such information is considered important, the relevant regulatory requirements or other document would ordinarily already require an NFP entity to disclose it. In addition, the Board noted privacy issues can arise when an NFP private sector entity has only one member of key management personnel.

Other topics

Non-financial assets (Sections 12, 14 and 15)

BC122 Feedback received on the Board's Discussion Paper preceding ED 335 indicated that the accounting requirements for inventory, property, plant and equipment and investment property specified by AASB 102, AASB 116 *Property, Plant and Equipment* and AASB 140 *Investment Property* serve as appropriate reference points for the development of Tier 3 reporting requirements. On review of these Standards, the Board decided

to modify certain aspects of the R&M requirements specified by those Standards to simplify the accounting for inventory, property, plant and equipment and investment property, including:

(a) not to require production overheads incurred in the conversion process to be capitalised as part of the cost of inventory and, similarly, not to require the use of other assets to be included as part of the cost of self-constructed items of property, plant and equipment and investment property. These departures from the requirements of AASB 102, AASB 116 and AASB 140 acknowledge:

  (i) the constraints under which smaller NFP entities operate;

  (ii) that management is unlikely to monitor the entity's operations to this costing level; and

  (iii) that users of Tier 3 financial statements are unlikely to change their resource allocation decisions had the cost of the asset been represented more faithfully by including this type of cost. In particular, the Board considered that while making overhead allocation optional may result in some entities recognising expenses earlier, this would not affect the analysis of performance margins for those assets that are distributed rather than sold and therefore would not diminish information relied on by users; and

(b) to require mixed-use properties to be classified as property, plant and equipment. The Board noted that mixed-use properties can present practical challenges in terms of identifying their purpose of use, the unit of account at which separate classification should occur and in estimating the fair value of an investment property component of mixed-use assets. The Board concluded that compliance with AASB 140 would likely be time-consuming and costly and that the main implication of how mixed-use property is classified is whether fair value changes of revalued property are presented in profit or loss or in other comprehensive income. Therefore, the Board concluded that it would not be proportionate to require smaller NFP entities to comply with AASB 140 for the classification of mixed-use properties, as the improvement in user understanding would not justify the additional reporting burden.

Additionally, the Board made the modifications noted in paragraphs BC75–BC80 (donated non-financial assets) and BC109–BC116 (impairment of non-financial assets).

BC123 The Board also decided to include guidance on the measurement of inventories held by service providers and of inventories an entity holds for distribution. This guidance is consistent with that previously included in AASB 102, but which has since been deleted. The Board considered that this remains useful guidance for preparers applying this Standard because such inventories are likely to be held by smaller NFP entities and the guidance is not readily intuitive.

BC124 AASB 123 *Borrowing Costs* requires the capitalisation of borrowing costs relating to qualifying property, plant and equipment and other qualifying assets. Capitalising borrowing costs would require entities to determine whether the asset meets the definition of a qualifying asset and the point at which the borrowing costs qualify, or cease to qualify, for capitalisation, and record keeping to ensure that any capitalised costs are depreciated over an appropriate useful life. The Board decided that this complexity is not warranted for Tier 3 reporting requirements as the costs of that accounting are likely to exceed its benefits, especially if borrowing costs are not significant compared with the purchase price of the asset. Hence, the Board decided to require all borrowing costs to be expensed when incurred.

Provisions and contingencies (Section 19)

BC125 The Board similarly received feedback on its Discussion Paper preceding ED 335 that the accounting requirements for provisions, contingent liabilities and contingent assets specified by AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* serve as an appropriate reference point for development of Tier 3 reporting requirements. However, the Board decided that this Standard should require provisions to be measured on a different basis to AASB 137 – at the entity's best estimate of the undiscounted amount to be paid. The Board considered that consistent measurement requirements should apply to both provisions that are employee benefits (see paragraph BC117(b)) and other provisions, to keep Tier 3 reporting requirements straightforward for preparers. Further, the Board expects the impact of discounting would often be minimal for provisions settled within a short-to-medium term.

Income taxes (Section 24)

BC126 The Board noted that AASB 112 *Income Taxes* is often regarded as one of the more complex AAS to apply. That Standard requires the recognition of deferred tax assets and deferred tax liabilities for the temporary differences between the tax base and accounting carrying amount of assets and liabilities. The Board decided that this complexity is not warranted for Tier 3 reporting requirements as the costs of that accounting are likely to exceed its benefits, and developing requirements based on AASB 112 would impede efforts to develop a simplified Tier 3 Standard, especially when considering that many NFP private sector entities will not be

subject to income taxes. Hence, the Board decided to require entities to account for their income tax obligations in a manner consistent with the accounting specified for creditors and provisions.

Foreign currency translation (Section 25)

BC127 The Board observed that an NFP private sector entity, regardless of its size, might be engaged in transactions and events outside Australia. As such, the Board decided to specify requirements for foreign currency in this Standard. Having regard to smaller NFP entities, the Board decided that it was not necessary to develop requirements that envisage a functional currency other than Australian dollars. Similarly, the Board decided it is appropriate for this Standard to require the financial statements to be presented in Australian dollars. The Board noted that several NFP regulators require financial information to be lodged in Australian dollars, and alignment with these regulatory expectations would avoid unnecessary compliance effort for preparers.

Service performance information

BC128 The Board received feedback in initial outreach activities and also to its Discussion Paper preceding ED 335 of the importance of service performance information to users of the financial statements of smaller NFP entities. The Board confirmed that it considers reporting of service performance information useful to those users. However, the Board decided not to develop proposals for reporting service performance information as part of this project because the complexities in developing such proposals are likely to disproportionately delay progress on this Standard. At the time of issue of this Standard, the Board is undertaking a research project on service performance reporting by all NFP entities.

Transitional requirements (Section 28)

BC129 The Board observed that entities transitioning from SPFS to Tier 3-compliant GPFS for the first time would encounter similar challenges to those transitioning from SPFS to Tier 1 or Tier 2 reporting requirements, for example addressing the costs of retrospectively applying an accounting policy as though that policy had always applied. Therefore, the Board decided to develop transitional requirements to provide guidance and relief for such entities. The Board decided to locate these transitional requirements in this Standard rather than directing entities to AASB 1 *First-time Adoption of Australian Accounting Standards* as this is consistent with its decision to present Tier 3 reporting requirements in a stand-alone Standard.

BC130 The Board also decided to amend AASB 1053 *Application of Tiers of Australian Accounting Standards* to clarify the requirements for transitioning between tiers. The Board decided that the transitional requirements set out in Section 28 of this Standard should apply whenever an entity transitions from another reporting framework to Tier 3 reporting requirements, except if the entity is resuming application of this Standard and its R&M policies are consistent with this Standard. Otherwise, these entities would face challenges similar to those encountered when transitioning from SPFS to Tier 1 or Tier 2 GPFS. The Board noted that, regardless of the starting point, entities moving into Tier 3 may confront challenges akin to those faced by entities transitioning from SPFS to Tier 3 for the first-time – for example, determining the cumulative effects of retrospectively applying Tier 3 R&M requirements and aligning prior-period information with Tier 3 accounting policies. The Board therefore considered that allowing the use of the transitional relief in Section 28 in these cases reflects a practical and proportionate transition approach as it minimises unnecessary cost and complexity and recognises that full retrospective application of Tier 3 reporting requirements may be of limited benefit to users of the financial statements.

BC131 The Board had regard to AASB 1 when developing the transitional requirements set out in this Standard. The Board considered that, in general, entities transitioning to this Standard for the first time should have access to at least the same exceptions or extent of relief as an entity applying AASB 1. In addition, to further alleviate the costs of transitioning to Tier 3 GPFS, the Board initially proposed that:

(a) entities complying with Tier 3 reporting requirements should be permitted to apply the recognition, measurement and disclosure requirements in this Standard only prospectively, to new transactions and balances, if their existing policy is consistent with another AAS; and

(b) on transition to this Standard, entities should have access to optional exemptions of a similar nature to those available to for-profit private sector entities transitioning from SPFS to preparing Tier 2 GPFS. While, for for-profit private sector entities, these exemptions were time-limited to encourage and assist early adoption of Tier 2 GPFS, the Board decided not to impose a similar time limit on the optional exemptions available to entities adopting this Standard. The Board considered that otherwise the exemptions would serve little purpose since early adoption of Tier 3 reporting requirements by SPFS preparers is expected to be uncommon.

BC132 In the main, stakeholders supported the Board's proposed transitional requirements. However, the Board received feedback that giving entities the option to continue applying the recognition, measurement and disclosure requirements of an existing AAS to assets or liabilities that existed on the date of transition would increase the complexity, and reduce the comparability and understandability, of the financial statements. Stakeholders also observed that some assets and liabilities have long lives or maturities, so that the proposal would result in long-term mixed treatments of financial statement items. The Board acknowledged that application of the proposed exemption would result in outcomes contrary to its objectives in making the Standard. Consequently, it decided not to reaffirm the proposed exemption identified in paragraph BC131(a).

BC133 The Board noted that its decision in paragraph BC132 might appear inconsistent with its decision to permit an entity to continue to apply its pre-transition recognition policies to the financial assets and financial liabilities listed in Section 10 that existed on or prior to the date of transition. However, the Board observed that this option is provided by AASB 1, and the Board gave precedence to consistency with AASB 1 over consistency with removing the option to continue applying the requirements of an existing Standard to assets or liabilities that existed on the date of transition (particularly as the alternative would be more onerous transition requirements than those applicable to entities applying Tier 1 or Tier 2 reporting requirements).

BC134 This Standard requires prior period errors to be corrected retrospectively. However, given the short-term impact on financial statements of corrections of prior period errors, the Board did not want to impose on entities the costs of distinguishing changes in accounting policies and the correction of prior period errors on transition to this Standard. Consequently, the Board decided to allow entities to apply a modified retrospective approach to correcting prior period errors on transitioning to this Standard.

BC135 To avoid transitional requirements that are more onerous than those in AASB 1, the Board decided to permit entities to apply Section 17: *Entity Combinations* and Section 13: *Investments in Associates and Interests in Joint Arrangements* prospectively to entity combinations and acquisitions of investments in associates and interests in joint arrangements from the date of transition or from a selected date before the date of transition. The only exception to the permitted prospective application of Sections 17 and 13 is that any balance of goodwill existing at the date of transition or the selected date is required to be written off. This is because the continued recognition of some goodwill is inconsistent with the Board's decision not to recognise goodwill for entity combinations and would impose on an entity costs associated with developing and implementing a suitable accounting policy for that goodwill.

Effective date (Appendix B)

BC136 When selecting a suitable effective date for the Standard, the Board had regard to feedback received about the adequacy of the implementation period following the issue of AASB 2020-2, the size of the population of potentially affected NFP entities and the nature of the requirements. The Board also had regard to the status of regulatory efforts to improve the consistency in the reporting requirements for various types of NFP entities and when other current reporting developments will become effective. Stakeholders supported an implementation period of at least three years from the issue of the Standard.

BC137 The Board decided that the effective date of this Standard should be aligned with the effective date of AASB 2026-2. This ensures that NFP private sector entities that will be required to prepare GPFS once AASB 2026-2 is effective will have access to a 'simpler' form of GPFS on having to do so, subject to any regulatory response. Similarly, the Board decided to require entities that adopt this Standard early to do so only if AASB 2026-2 is adopted at the same time, so that the *Conceptual Framework* applies consistently to all entities applying this Standard.

BC138 When finalising the effective date, the Board received feedback that a three-year implementation period might be insufficient because NFP private sector entities do not yet have clarity as to whether they will be prevented from preparing financial statements that comply with Tier 3 reporting requirements by their relevant regulatory body. The Board observed that the effective date could be revisited and extended in the future, if circumstances necessitate it being reviewed. A staggered effective date approach was considered and rejected by the Board as being unnecessarily complex.

BC139 The Board noted the risk of unnecessary transition costs if an entity were to adopt this Standard before its effective date but was later prohibited from doing so by legislative changes introduced by an entity's relevant legislative or regulatory body. Accordingly, the Board considered whether to include an exception preventing early adoption by entities currently preparing Tier 1- or Tier 2-compliant GPFS to mitigate the risk. The Board observed that a regulator or other legislative authority is not limited by the Board's decision to permit early adoption of this Standard and could disallow early adoption by entities under their purview if they considered it necessary to do so. The Board therefore decided not to include such an exception to early adoption of this Standard.