Grant Thornton

Dr. Keith Kendall, Chair
Australian Accounting Standards Board
PO BOX 204
Collins St West Victoria 8007
standard@aasb.gov.au

Lodged electronically

Grant Thornton Australia Limited
Level 22 Tower 5
Collins Square
727 Collins Street
Melbourne VIC 3008
GPO Box 4736
Melbourne VIC 3001

T +61 3 8320 2222

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Dear Dr. Kendall

We welcome the opportunity to provide our feedback on AASB Exposure Draft ED 335 *General Purpose Financial Statements – Not-for-Profit Sector Tier 3 Entities*. We have responded only to those matters for which we have specific comments.

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We are generally highly supportive of the relief embodied by the proposed standard and appreciate the opportunity to provide feedback. We welcome any future opportunities to engage with the Board on the matters included in the proposed standard.

2: Do you agree with the Board proposals to simplify recognition and measurement requirements in the above-mentioned Tier 3 Standard including, but not limited to, the following requirements and options:

- **(a) an accounting policy choice to present consolidated financial statements or only separate financial statements with disclosures about the entity's notable relationships (ie entities with which the reporting entity has at least significant influence);**

The preparation of consolidated financial statements provides users with a full understanding of the financial performance of an economic entity. This conflicts with separate financial statements which limit that understanding to only that performance of the entity reported upon. By not mandating consolidation, users of the proposed Tier 3 financial reports will not be provided with fulsome information regarding the performance of the entity reported upon. This is contrary to the direction taken by the Board with regards to for-profit entities, whereby the ultimate Australian parent entity is required to prepare consolidated financial statements (AASB 10.4-Aus4.2).

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With this in mind, we recommend that entities be required to prepare consolidated financial statements where they are the ultimate Australian parent entity and are required to prepare financial statements by legislation or regulation, except where such legislation or regulation requires the provision of separate financial statements.

(b) modified retrospective application (ie no requirement to restate comparative period information) for changes in accounting policies or corrections of prior period errors;

Paragraph 1.1 of the proposed standard states "The objective of this Standard is to … require the reporting of useful, consistent and transparent information…". By removing a requirement to restate comparatives for material errors, entities that identify errors will not be required to prepare financial statements that comply with this component of the objective of paragraph 1.1.

We recommend that this proposal not be included in the proposed Standard.

6: Do the proposals create any auditing or assurance challenges? If so, please explain those challenges.

The introduction of a new basis of reporting will require assurance providers to ensure adequate understanding of a new basis of reporting for those individuals providing assurance services. This will require investment of resources into the provision of training to those individuals supporting not-for-profit entities.

Preparers of financial statements will also be faced with challenges in adapting to changes to recognition and measurement as it relates to common transactions. As a result of this and a general lack of resources to obtain external guidance where necessary, there will be significant challenges encountered when providing assurance over tier 3 general purpose financial statements, particularly in periods immediately following adoption.

9: The [draft] Tier 3 Standard (AASB 10XX) (paragraph 1.3) proposes that entities would apply the recording, measurement, presentation and transition requirements of the following Australian Accounting Standards, and any related disclosure requirements (other than transition) in AASB 1060:

AASB 141 Agriculture, in relation to biological assets, and agricultural produce at the point of harvest.

There is a growing subset of entities that operate community gardens or similar, with the generation of agricultural produce a key outcome of the entities' operations. For instance, entities may, as part of their operations, raise chickens for eggs, grow fruit trees, or grow vegetables with an intention that the produce of these gardens be consumed by the wider community or be sold to other groups.

For such entities, compliance with AASB 141 may be onerous. We recommend that the requirement to apply the fair value models defined in AASB 141 be replaced by a 'cost' model more consistent with Section 12 *Inventories* for this purpose.

14: Do you agree with the proposed Tier 3 reporting requirements in Section 8? Your response may address, but need not be limited to, the following requirements:

(a) As per paragraph 8.10, an entity applying the Tier 3 reporting requirements that has identified it has subsidiaries shall either:

i. present consolidated financial statements in which it consolidates its subsidiaries; or

ii. present, as its only financial statements, separate financial statements that do not consolidate its subsidiaries.

Paragraph 8.10 expressly permits separate financial statements to be prepared. This conflicts with paragraph 8.36 which states that separate financial statements are "(a) a second set of financial statements that a parent entity elects to present in addition to consolidated financial statements; or (b) financial statements prepared by an investor that is not a parent with one or more investments in associates or joint ventures."

Where the intent is that preparers may prepare separate financial statements in absence of consolidated financial statements, the paragraphs are not concordant and we recommend amendment.

Further, in order to improve readability for users, we recommend such a statement be relocated such that users may read 8.10, immediately followed by this explanation of the meaning of ‘separate’ and ‘consolidated’ financial statements.

18: Do you agree with the Tier 3 reporting requirements developed for financial assets and financial liabilities that are basic or commonly held by Tier 3 entities as set out in paragraph 10.2?

Transaction costs

Paragraph 10.5 requires that transaction costs and fees incurred by the entity be excluded from the measurement of a financial asset or financial liability initially. It also requires that financial assets be initially recorded at its fair value. Subsequent measurement is defined by paragraph 10.7 as being (for many instruments) “at cost”.

Paragraph 10.15 states that the cost of an asset, at any reporting date, is determined by reference to the amount initially recognised, minus any repayments of principal, plus or minus any prepayments or underpayments of principal.

Initial measurement give rise to specific concerns:

- The nominal/face value of a debt instrument is its fair value. This presumption is not stated in the section, or in Section 11. A loan which is not at fair value is only addressed if it is ‘concessional’ as per paragraph 10.6. There is no specific principle defined in the section that explains a method of amortising the concession (e.g., the amortised cost method) as ‘cost’, as defined, refers to contractual interest (10.15), as does paragraph 10.16 which defines interest expense/income.

  We recommend the Board include specific treatment for such transactions, potentially including:

  - A statement that cost (as defined) is considered fair value for specific classes of instrument; and
  - A clear statement as to the method of treatment of loans within the scope of paragraph 10.6.

- Transaction costs are excluded from the measurement of ‘cost’ and initial measurement. There is no explicit outcome defined for transaction costs, however it is presumed that the expected treatment is that the transaction costs be recognised as an expense.

  This represents a significant departure from Australian Accounting Standards as already implemented.

  In practice, in certain situations this will give rise to accounting outcomes that are undesirable. For instance, if an entity purchases ‘points’ this will result in a transaction cost that are immediately expensed while simultaneously potentially giving rise to a ‘concessional loan’ as contractual interest payments may not be interpreted as including such prepaid interest.

  We recommend that the Board consider requiring transaction costs be recognised as an asset/liability, for which there is mandatory offset, that is amortised on a straight-line basis over the shorter of the contractual and expected life of the financial instrument.

  Such an amendment will increase comparability with entities applying Tier 1 or Tier 2 GPFS.

Financial assets acquired or originated by the entity to generate both income and a capital return

The proposed standard requires financial assets of this class to be measured at fair value, whether through profit or loss, or, by irrevocable election at initial recognition, through other comprehensive income. When considered against the requirements of AASB 13, the fair value of certain classes of assets may only be determined by reference to significant estimates which rely on either (a) internally generated information of the investee or (b) on information that is publicly available. This information set may not be sufficient for a professional to estimate a fair value which is sufficiently precise for an assurance professional to assure, or may result in non-proportionate cost being incurred by the investee.

We recommend that the Board consider, for classes of asset where there is no active market, the inclusion of an optional scope exclusion from fair value. The Board may consider various options appropriate, including cost or the equity method.

21: Do you agree with the proposed Tier 3 reporting requirements in Section 13?

Upstream / downstream transactions

Section 13.16(e) retains the current requirements of AASB 128 to eliminate a proportion of profits realised in trading with an entity accounted for by applying the equity method (JV/Associate), while maintaining such accounting for the life of the asset in the hands of the JV/Associate. This requirement is often complex and may require visibility to financial information of the investee which is not practicable to obtain.

We note Exposure Draft 333 as it relates to the equity method and wish to highlight that in that exposure draft, it is proposed that the elimination of upstream / downstream transactions method not be retained – on the basis that control of the underlying assets has been lost.

We view such measures to be proportional and reasonable and encourage the AASB to adopt such a modification to the method described in this Section.

Initial measurement of equity method accounted investments

The definition of cost included within AASB 13.16 includes specific inclusion of costs incurred in relation to the acquisition of an equity method accounted investment. We note that this definition is in line with current application of AAS as informed by the July 2009 IFRIC Agenda Decision "Potential effect of IFRS 3 Business Combinations (as revised in 2008) and IAS 27 Consolidated and Separate Financial Statements (as amended in 2008) on equity method accounting (IAS 28 Investments in Associates)".

This IFRIC Agenda Decision is not reflected in the aforementioned Exposure Draft, whereby direct costs are addressed in a manner consistent with the requirements of AASB 3. We recommend that, in order to simplify the accounting treatment of equity-method investments, transaction costs be excluded from the definition of cost.

23: In relation to the proposed measurement choice in Question 22(a), the AASB is seeking information on the cost to smaller NFP entities of obtaining the fair value of donated non-financial assets. If possible, please provide an estimated cost of obtaining the fair value of donated non-financial assets. Are there any types of non-financial assets for which it is more costly to obtain a fair value?

As an auditor of many not-for-profit entities, we have been exposed to a large variety of donations of non-financial assets. Certain classes of these – e.g. property, are commonly traded, however the determination of fair value remains costly with regards to the relative resources of the entity required to obtain that fair value.

Other non-financial assets may be either relatively costly to obtain the fair value of, or, in some instances, there may be no basis for a valuer to provide such valuation.

As an example, we are aware of donations of the following classes of items where a lack of transactions may result in excessive cost:

- World War II-era aircraft
- Historic ships
- Untraded art works
- Intellectual property in research-phase
- Mining tenements

24: Do you agree with the proposed Tier 3 reporting requirements in Section 16?

Paragraph 16.5 refers to separate acquisition of an intangible asset and requires that the cost of that intangible asset be capitalised, regardless of class. Paragraph 16.7 requires that all research and development activities be expensed. Many not-for-profit entities operate in the research and development space and acquire in-process intellectual property, for which impairment testing becomes challenging and costly. This observation is made concurrent with our observation with regards to Section 23 as it relates to impairment of assets.

Generally, the requirement that separately acquired intangible assets be recognised as an asset gives rise to high costs in financial reporting (where impairment testing is required as a result of significant judgements

required to be made when determining fair value and subsequent assurance procedures) and does not provide valuable information to users of those financial statements.

We recommend that the Board consider requiring separately acquired in-process research and development to be expensed consistent with paragraph 16.7. We further recommend that the disclosure requirements of Section 16 be extended such that intangible assets that, in the opinion of management, represent material value to the reporting entity, be disclosed notwithstanding they are not recognised within the statement of financial position, including historic amounts invested and purpose of the intellectual property. In our opinion, this disclosure will give rise to more meaningful information to users of the financial statements while retaining proportionality with regards to the cost of preparation and maintenance of these financial statements.

25: Do you agree with the proposed Tier 3 reporting requirements in Section 17?

Assets without a carrying value

Paragraphs 17.6 and 17.7 describe that assets donated to the 'acquiree' that do not have an existing carrying amount are not required to be measured at fair value, contrary to other assets that do not have an existing carrying amount but were not donated (but may be fully amortised, or whose nil carrying amount arises from transition relief on transition to AAS via the application of AASB 1). This will require the acquiree to have sufficient records so as to understand the originating source of all assets with no carrying amount such that an assurance provider can obtain assurance that an asset was or was not donated to the acquiree, which may not be obtainable, resulting in a significant risk of modified opinions which will not be able to be remediated as it relates to the carrying amount of assets and related amounts in profit or loss.

The operationality of the standard as it relates to recording donated assets at fair value implicitly states that the information content of such fair value has been assessed as not being material to users of the financial statements, when compared to the cost of obtaining that information. It would therefore be inconsistent to require that assets that were not donated, but were, as an example, recorded at a nil deemed cost in a legacy period, have an inherently different information value to donated assets. We therefore recommend that paragraph 17.6 be amended such that the fair value requirement for assets or liabilities that do not have a carrying amount be removed.

Other observations

Paragraph 17.8 requires that entities with different accounting policies to record or measure assets or liabilities shall be adjusted as at the date of the combination to achieve uniformity of accounting policies. This will potentially result in non-comparable financial statements for a reporting entity (the consolidating entity or 'acquirer') where material assets experience a change in accounting policy from the perspective of the acquirer, which is inconsistent with paragraphs 2.23 to 2.29 which discuss the concept of comparability (and consistency) within the *Conceptual Framework for Financial Reporting*. As an example, there is no limitation inherent in the acquirer moving from a fair value model for classes of property, plant and equipment or intangible assets to a cost model for those same assets.

The current structure of the standard does not prevent an entity from entering into an entity combination with another entity for the sole purpose of altering their accounting policy for a specific class of transactions.

26: Do you agree with the proposed Tier 3 reporting requirements in Section 18?

Services excluded from lease payments

The requirement that an entity exclude services such as insurance and maintenance that are provided as a part of a lease does not include any guidance as to the method of separating the cost of such services from the underlying lease payments; that is, it may not be practicable for an entity to identify the relative cost of insurance, in particular, from the cost of lease of an asset, particularly in the common lease structure where the cost of all insurance, maintenance, and other services are pre-negotiated and included in a single 'fee'.

There is also a broader matter, being that the standard, as structured, does not describe a method of determining the relative value of such embedded services, or a method of separating the value of these services from the lease payment (e.g. a relative fair value method as described by AASB 3.2(b) or a residual approach as described by AASB 15.79(c)).

We recommend that the Board consider one or more of the following:

- An exception be included such that, where it is not practicable for a lease payment which is predetermined and not subject to variability for changes in cost of services, the reporting entity be permitted to include such services in the lease payment subject to straight-line treatment; and/or
- A specific method of measurement be described within the standard to ensure consistency of approach in this allocation.

Definition of cost

The definition of 'cost' as included in paragraph 18.3 includes initial direct costs for the acquisition of the lease as a component of the straight-line expense. This is in contrast with the treatment as described for financing obtained, as previously discussed in this letter and may not reflect a proportionate response to such costs, which are typically not material to the entity.

While an entity may exclude such costs from lease straight-lining on the basis that it is not material, the explicit requirement that such costs be included will result in incremental increases in the cost of assurance as a result of the ongoing requirement to demonstrate that the income statement is not materially misstated as a result of cumulative error.

As a result, we recommend that proportionality of such treatment be considered, and the Board consider either:

- Allowing initial direct costs of the lessee to be recognised as an expense as incurred; or
- Requiring initial direct costs of the lessee to be recognised as an expense as incurred.

27: Do you agree with the proposed Tier 3 reporting requirements in Section 19?

There is currently a lack of clarity in the marketplace (outside of larger providers of assurance) as to the meaning of the AASB 137 wording, as paraphrased in paragraph 19.7 as it relates to 'taking into account current information about conditions existing at the end of the reporting period').

This 'current information requirement' is currently interpreted by experienced appliers of AAS as including all data which is available to the entity but may not yet have been assessed for information content to produce a reliable estimate, which is consistent with the view espoused by the Australian Securities and Investments Commission. This interpretation is not readily achievable from the wording in AAS, or in the paragraph included within this standard. We recommend that either Interpretive Guidance be included as it relates to this matter, or that such information be explicitly described in paragraph 19.7 to clarify the meaning of this paragraph to less-experienced users of the proposed accounting standard.

28: Do you agree with the proposed Tier 3 reporting requirements in Section 20?

Recognition and measurement requirements

As drafted, revenue is deferred to the extent that both the entity and provider of an asset "have a common understanding that, in response, the entity will perform in a particular manner resulting in the related expenditure, transfer or using up of…" assets controlled by the entity and requiring that "revenue shall be recorded in the manner that most faithfully represents the amount and pattern of the entity's using up of the assets received".

For certain classes of assets – for example, land – the underlying asset is not 'used up' and may have an expectation of perpetual life. As an example, land donated to a not-for-profit entity with an intent that the land be used for the provision of services to youth may align so strongly with the reporting entity's mission that the land will be presumed to be utilised in perpetuity. In such an instance, paragraph 20.12 may be interpreted as not applying as the utilisation of the land is not 'to support the general operating costs of the entity over an unspecified period of time' where a reader does not interpret capital outlay avoided as being 'general operating costs'. Conversely, a preparer may view such a transaction as having an intent to 'support the general operating costs of the entity' by the avoidance of lease outflows as it relates to a hypothetical asset performing the same tasks.

We recommend that the Board clarify this comment to either include or exclude such rights to perpetual assets.

Pledges

Pledges do not meet the definition of an asset but may meet the definition of a contingent asset. We recommend that an explicit reference be made to the contingent asset disclosure requirements to support the use of the standard by preparers.

Volunteer services

Paragraph 20.22 includes a statement that may be interpreted as opinion – that professional services 'might have readily observable market prices'. In the context of optionality of the standard as it relates to an accounting policy choice for the recording of volunteer services at fair value, we recommend that such an observation be removed.

32: Do you agree with the proposed Tier 3 reporting requirements in Section 23?

Recognition and measurement requirements

Section 23 includes two impairment indicators, paraphrased as being: "damaged physically / are spoilt perishable items / have become obsolete" and "change of strategy". The language currently used is absolute – contrary to the language used in AASB 136, the language utilised may be interpreted as not providing 'indicators of impairment' but statements of when impairment has prima facie occurred.

These indicators do not apply to certain assets, in particular intangible assets, that may have been separately acquired, particularly assets that are not available for use in their current form (i.e. research and development assets). Such assets may have demonstrated lack of market, but not generate revenue at this time; paragraph 23.3(b) would not apply. Likewise, paragraph 23.3(a) would not apply as the intangible has not 'become obsolete'. As a result, there is risk that application of the standard would result in intangible assets not being impaired where there is significant loss of value to the entity.

We recommend that the Board consider adding an additional subparagraph 23.3(c) to the extent that "the entity's strategy, as it relates to the specific asset, has altered such that the recovery of value of the asset is not probable. The test of recovery of value of the asset is only triggered where a change in strategy as it relates to that asset occurs." or similar and that paragraph 23.3 be amended to explicitly to include a reference to intangible assets.

35: Do you agree with the proposed Tier 3 reporting requirements in Section 26?

The language contained within Section 26 does not contain any reference to functional currency. Many not-for-profit entities operate in multiple jurisdictions, including those for whom the Australian dollar is not the currency of the jurisdiction, and, applying AASB 121, would not identify the Australian dollar as its functional currency.

We recommend that a reference to functional currency be included, such that the entity may, by policy choice, elect to utilise a functional currency of Australian dollar for its foreign operations or apply the current requirements of AASB 121 as it relates to those foreign operations.

We also note that there is no explicit requirement that translation of foreign currency transactions be presented within the income statement. It is, however, implied by paragraph 6.8(b).

36: Do you agree with the proposed Tier 3 reporting requirements in Section 27?

The examples included within paragraph 27.3 include specific examples which, for many entities, will be considered 'business as usual'. As an example, the current wording of paragraph 27.3(a) and (b) will give rise to presumed mandatory disclosure of all grants issued for an entity that, as its ordinary activities, issues grants to others, whether unusual or not – for instance, a charitable fund is established to provide sporting funding to members of the community. Grants are provided on a monthly basis. The current wording would require the entity to report the total sum of grants issued in the period from reporting date to issuance of the financial statements. Such information may be less material to users than for an entity that issues grants on only an intermittent basis.

We recommend that paragraph 27.3(a) and (b) be amended such that it includes wording such as "where such grants / purchases and disposals are qualitatively material to the users of the financial statements".

38: Do you agree with the transitional requirements proposed in Section 29?

Scope and application & Procedures for preparing financial statements at the date of transition

Paragraph 29.4 includes an exception to the application of the standard to all assets and liabilities currently recorded (“In relation to some or all assets or liabilities existing on the transition date, first-time adopters of this Standard transitioning… may elect to continue applying all related Tier 1 or Tier 2 recording, measurement and disclosure requirements to those assets or liabilities.”).

This statement is then modified by paragraph 29.7(b) which requires that the entity “cease recording items as assets or liabilities if this Standard does not permit such recording”. This paragraph is currently unclear as it does not relate to ‘acceptable policies in the scope of this Standard’. We suggest an amendment to subparagraph 29.7(b) such that it is read consistent in meaning with “cease recording items as assets or liabilities if this Standard does not permit a policy which would give rise to those assets or liabilities”.

Further, where an asset is initially recognised under a standard that is not tier 3-compliant and subsequently recognised in that manner post transition, a lack of comparability and consistency will be introduced, potentially increasing ongoing cost to preparers as a result of additional assurance-related procedures being required.

Yours sincerely

GRANT THORNTON AUSTRALIA LIMITED

Owen Carew

Partner - Audit & Assurance