Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Conceptual Framework – Not-for-Profit Private and Public Sector Entities**	**Meeting:**	AASB September 2020 (M177)
Topic	**Initial staff proposals on NFP amendments to the Conceptual Framework for Financial Reporting**	**Agenda Item**	10.1
		Date of Paper	2 September 2020
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OBJECTIVE OF THIS PAPER

1. The objective of this paper is for the Board to:

   (a) **consider** the draft 'Aus' amendments to the *Conceptual Framework for Financial Reporting* (the Revised Conceptual Framework or 'RCF') to address needs for not-for-profit guidance within Stage 1 of the AASB's project to replace the existing *Framework for the Preparation and Presentation of Financial Statements* applicable to not-for-profit entities;

   (b) **consider** whether any other amendments to address needs for not-for-profit guidance should be made within Stage 1 of the project;

   (c) **note** feedback from the NFP CF Project Advisory Panel; and

   (d) **decide** the next steps of the project.

REASONS FOR BRINGING THIS PAPER TO THE BOARD

2. At the June 2020 AASB Board meeting, the Board approved a project plan to modify the AASB's *Conceptual Framework for Financial Reporting* where necessary to address not-for-profit (NFP) private and public sector considerations in order to apply the Revised Conceptual Framework to NFP entities. That project plan has two stages. This paper focuses mainly on Stage 1, the primary purpose of which is to make the Revised Conceptual Framework available for NFP entities.

3. Staff have drafted amendments to modify the RCF where necessary for public sector and NFP private sector issues (using the NFP modifications in the *Framework for the Preparation and Presentation of Financial Statements* (2014) as the starting point). Staff have also incorporated additional amendments after considering:

   (a) differences between the RCF and the existing Framework; and

(b) the comparison between the Revised Conceptual Framework and the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Agenda Paper 10.2).

4. The staff-proposed drafting of the amendments was discussed with the Board's NFP Conceptual Framework Project Advisory Panel on 21 August 2020. Feedback provided by Panel members during the Panel meeting is summarised in italics beneath the related issue description in this paper.

5. Some Panel members also provided comments after the Panel meeting. Staff have not yet had the opportunity to consider all feedback from Panel members; therefore, this paper provides only an interim summary of Panel member feedback. Other issues and arguments of Panel members will be brought to the Board's attention in future agenda papers.

ATTACHMENTS

Agenda paper 10.2	A comparison of the Revised Conceptual Framework and the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*
Agenda paper 10.3	AASB Staff proposals on the draft NFP amendments to *Conceptual Framework for Financial Reporting* (note that all draft NFP modifications to the RCF are identified by marking up, and a brief explanation of each is contained in an adjacent 'bubble' comment in the margin)

STRUCTURE

6. This staff paper is set out as follows:

(a) Background

(b) Draft NFP-specific modifications of the AASB's RCF for Stage 1

(c) Key issue for consideration – Chapters 6 and 8

(d) Other matters for consideration

(e) Suggested next steps and timeline

(f) Appendix A: Elaboration of key change proposed to the Framework

BACKGROUND

7. The IASB issued the Revised Conceptual Framework in March 2018. The RCF describes the objective and other concepts for general purpose financial reporting under IFRS Standards. However, the RCF's concept of 'reporting entity' is different from the reporting entity concept in SAC 1 *Definition of the Reporting Entity* and some Australian Accounting Standards.

8. To date, the Board has removed the ability to prepare special purpose financial statements for certain for-profit private sector entities, in tandem with adopting the Revised Conceptual Framework for those entities. The Board's project to adopt the Revised Conceptual Framework for NFP entities mirrors its dual approach to the replacement of the existing Framework and special purpose financial statements for certain for-profit private sector entities, with the additional step of identifying which NFP-specific modifications of the RCF are necessary before it can be applied by NFP entities.

Stages of the project

9. **Stage 1** of this project seeks to amend the RCF where necessary for public sector and NFP private sector issues (using the NFP modifications in the existing Conceptual Framework as the starting point), to make the RCF available for these sectors.

10. **Stage 2** of this project will explore NFP considerations through research and outreach in order to improve the RCF for NFP entities as a long-term measure.

Linkage to the NFP Private Sector Financial Reporting Framework project

11. In order to make the Revised Conceptual Framework applicable for NFP entities, the Board determined that SPFS must be removed beforehand due to the reporting entity clash referred to in paragraph 7. To provide appropriate substitution for SPFS, the NFP Private Sector Financial Reporting Framework project aims to introduce a tiered framework catering for smaller NFP private sector entities.

12. Under a revised Financial Reporting Framework, current NFP Tier 1 & Tier 2 regimes would remain for larger entities, while implementing new simplified frameworks for small- and medium-sized NFP private sector entities. Tier 1 & Tier 2 frameworks and likely the medium-sized Tier would refer entities to the Revised Conceptual Framework to develop accounting policies in certain circumstances.

Questions to the Board

13. Specific questions for the Board regarding staff's views are contained in each section of the paper.

DRAFT NFP-SPECIFIC MODIFICATIONS OF THE AASB'S RCF FOR STAGE 1

14. The draft NFP modifications include the transfer of six Aus paragraphs from the *Framework for the Preparation and Presentation of Financial Statements* (the existing NFP Framework), edited as appropriate for differences between the two Frameworks. The numbering of these Aus paragraphs in the two Frameworks is set out in the table below.

Table of concordance between Aus paragraphs in existing NFP Framework and draft revised RCF

Existing NFP Framework	Draft revised RCF	Reference to Agenda Paper 10.2
AusOB2.1	Aus1.2.1	Issue 1
AusOB3.1	Aus1.3.1	Issue 2
AusOB18.1	Aus1.18.1	Issue 4
Aus49.1	Aus4.4.1	Issue 22 & 30
Aus54.1	Aus4.16.1	Issue 22
Aus54.2	Aus4.16.2	Issue 22

15. **Panel feedback:** Panel members raised two issues regarding how Aus paragraphs were proposed to be transferred from the existing NFP Framework:

    (a) *two Panel members argued that the discussion of 'primary users' of general purpose financial reporting in paragraph Aus1.2.1 should be re-examined (although not necessarily in Stage 1). One of them read that paragraph as indicating primary users include regulators and those advising members of parliament, in which case they would disagree with designating those users as 'primary'*; and

    (b) *one Panel member made a drafting recommendation that draft paragraph Aus1.18.1 (which is a transfer of paragraph AusOB18.1) should be combined with newly drafted paragraph Aus1.16.1.*

16. Staff's views are that the issue identified by Panel members in paragraph 15(a) is important for the RCF, and that there should be time in Stage 1 to address this issue. Although neither paragraph 1.2 nor paragraph Aus1.2.1 uses 'primary', that term is used in paragraph 1.5, which effectively flows back into paragraph 1.2 and, by derivation, paragraph Aus1.2.1. Therefore, staff recommend that the implied wording about 'primary users' in paragraph Aus1.2.1 should be reviewed within Stage 1 of

the project, having regard to (at least) the IPSASB Conceptual Framework and the discussion of secondary users (such as regulators and members of the public) in paragraph 1.10 of the RCF.

17. Staff propose to consider the Panel member's drafting recommendation noted in paragraph 15(b) and update the Board at a future meeting, but would also welcome any initial feedback on the issue from Board members.

Question 1 to the Board:

Do Board members agree with the inclusion of the draft updated Aus paragraphs transferred from the existing NFP Framework including edits as presented in Agenda Paper 10.3? If not, which amendments on those issues would Board members suggest?

Question 2 to the Board:

Do Board members agree with the staff recommendation that the implied wording about 'primary users' in paragraph Aus1.2.1 should be reviewed within Stage 1 of the project?

18. The draft NFP modifications also include the new Aus paragraphs listed below, together with a brief explanation of their theme/purpose.

Draft new Aus paragraph	Theme/purpose
Aus1.1	The application paragraph Aus1.1 has been amended to make the RCF applicable for NFP private and public sector entities.
Aus1.15.1	For NFP entities, transactions in equity instruments and distributions to investors typically do not occur (for background, see Issues 4, 19 & 20 in Agenda Paper 10.2).
Aus1.16.1	For NFP entities, users need information for predicting the volume and cost of future services and the sustainability of future service delivery (for background, see Issues 4, 14 & 37 in Agenda Paper 10.2)
Aus2.41.1	Include more sector-neutral expression to balance the references to more efficient functioning of capital markets and a lower cost of capital (for background, see Issue 14 in Agenda Paper 10.2).
Aus4.25.1	Add examples of NFP entities acting as agent of another entity without controlling economic resources held on behalf of the principal (for background, see Issue 25 in Agenda Paper 10.2). See also paragraph 19 below for details of Panel members' comments.
Aus4.67.1	For NFP entities, residual interests are not necessarily held in the form of equity claims (for background, see Issues 4, 19, 20 & 31 in Agenda Paper 10.2).
Aus6.30.1, Aus6.41.1	Clarify that, for NFP entities, the predictive value of historical cost or current cost information, respectively, is not limited to predicting future margins.
Aus6.56.1	Scopes out paragraphs 6.55 – 6.56 (which relate to whether non-financial assets and liabilities produce cash flows directly or indirectly) in relation to particular non-financial assets and related non-financial liabilities held/owed by NFP entities. (This is a key modification, discussed in paragraphs 29 –32 and Questions 5 – 8 below.)
Appendix	NFP entity definitions of 'economic resource', 'equity claim' and 'primary users (of general purpose financial reports)'.

19. **Panel feedback:** *Two Panel members expressed concerns that draft new paragraph Aus4.25.1 regarding agency relationships does not add anything in a NFP context and might create confusion about whether grants are provided as agency agreements.*

20. Paragraph Aus4.25.1 was drafted by staff to provide NFP balance to paragraph 4.25 (which has a distinctly for-profit tone) and to give conceptual recognition to the principles in AASB 1050 *Administered Items*, which seem consistent with paragraph 4.25. Staff propose to review the paragraph in more detail in light of the Panel members' comments, and invite Board members to provide initial feedback on this issue.

Question 3 to the Board:
Do Board members agree with the draft new Aus paragraphs summarised in the table above? If not, which amendments would Board members suggest?

KEY ISSUE FOR CONSIDERATION – CHAPTERS 6 AND 8

21. Staff's view is that the key topic for the Board to address at this meeting is whether the AASB's RCF for application by NFP entities (developed in Stage 1 of the project) should incorporate Chapter 6 (on Measurement) and Chapter 8 (on Concepts of Capital and Capital Maintenance)—as an interim step—without addressing some fundamental potential NFP-specific issues staff consider would be infeasible to address in Stage 1 (ie the first revision of the Framework to apply to NFP entities).

22. Staff considers Chapters 6 and 8 to be closely related, and that each of them might warrant significant modification (beyond the range of what is feasible in Stage 1) to address the fact that, whilst staff consider all assets of a for-profit entity are held primarily to generate net cash inflows, in contrast, many non-financial assets of NFP entities are held primarily for their service capacity (or operational capacity) – this difference might lead to different conclusions about which measurement bases provide the more useful information to users. Staff note that a 'justifiable circumstance' for modifying an IASB treatment identified in paragraph 28(a) of the AASB's NFP Entity Standard-Setting Framework for considering a NFP modification of Chapters 6 and 8—namely, that the prevalence and magnitude of NFP-specific transactions/circumstances/events would result in a failure to reflect economic reality if the IASB treatment was applied—is potentially met for of Chapters 6 and 8. This is because revaluations of non-financial assets are much more common in the NFP public sector, and staff consider only NFP entities hold some non-financial assets primarily for their service potential.

23. In considering this issue, it would seem pertinent to have regard to the 'measurement objective' in the IPSASB Framework and developments in the IPSASB's current project to develop an IPSAS on Measurement (see also the discussion of Issue 33 in Agenda paper 10.2). Because these considerations seem infeasible to complete in Stage 1 of the project, staff recommend including this topic in Stage 2 of the project.

24. Staff consider that arguments against including Chapter 6 (and possibly Chapter 8—although it should be noted it is unchanged from the existing NFP Framework) in the revised NFP Framework emanating from Stage 1 of the project include:

    (a) until the AASB completes its consideration of all the NFP-specific issues potentially affecting application of those Chapters by NFP entities, there is a risk that, in the absence of a Standard covering a measurement issue, NFP entities might need to apply concepts that do not take adequate account of the NFP environment and consequently might produce measurements that result in sub-optimal attainment of the qualitative characteristics and/or result in undue cost and effort in trying to apply for-profit-focused concepts in a NFP environment; and

    (b) the IPSASB is developing an IPSAS on Measurement, and has targeted approved of an Exposure Draft in December 2020. Arguably, it would be premature to expose for public comment an Exposure Draft of a NFP Revised Framework before the IPSASB finalises its Standard on Measurement (and the AASB considers the implications of that IPSAS for its NFP Framework).

25. If Chapter 6 (and possibly Chapter 8) were to be excluded from the revised NFP Framework, staff consider it would be doubtful whether a revised NFP Framework should be issued until Stage 2 of the

project is completed. This is because of the significant difference between the existing NFP Framework and the AASB's RCF regarding measurement concepts, and because of the importance of measurement to the Framework as a whole. This is particularly the case bearing in mind the effect on practitioners who deal with for-profit and NFP entities and need to deal with two different vintages of measurement concepts (an issue that presently exists, but would ideally be overcome by the revision of the NFP Framework).

26. Staff consider arguments in favour of including Chapters 6 and 8 in the revised Framework emanating from Stage 1 of the project are that:

    (a) including the two Chapters in a revised NFP Framework would seem unlikely to require significant changes in practice because:

        i. the Chapters are generally non-prescriptive regarding the measurement bases and concepts of capital and capital maintenance to apply: they focus on factors to consider in making decisions about these aspects; and

        ii. the measurement requirements for assets and liabilities are fairly comprehensively covered in Australian Accounting Standards—therefore, the primary 'user' of the concepts in Chapters 6 and 8 is the AASB; and

    (b) full consideration of the eventual IPSAS on Measurement (for which the AASB is monitoring the development of the IPSASB Exposure Draft) is only necessary for completion of the further revised NFP Framework developed through Stage 2 of the project.

27. Staff agree with the arguments in paragraph 26, and therefore recommend issuing a NFP RCF—as an interim step—without addressing all of the potential NFP-specific issues relating to Chapters 6 and 8.

28. **Panel feedback:** *Panel members did not express adverse views about including Chapter 6 in Stage 1. One Panel member expressed reservations about Chapter 8; however, that Chapter is unchanged from the corresponding text of the existing NFP Framework.*

Question 4 to the Board:

Do Board members agree with the staff recommendation that the NFP RCF issued as an interim step should include Chapters 6 and 8 in Agenda Paper 10.3 without addressing all the potential NFP-specific issues relating to those Chapters? If not, in which manner do Board members consider the NFP revision of the RCF should proceed?

Key NFP modification proposed to the Framework

29. The key NFP modification to the RCF recommended by staff is in relation to paragraphs 6.55 – 6.56 of the RCF, which indicate that the comparative relevance of different measurement bases for a non-financial asset depends to a large extent on whether the asset produces cash flows directly or indirectly. Staff recommend excluding from the scope of paragraphs 6.55 – 6.56:

    (a) non-financial assets of NFP entities held primarily for their service potential and not primarily to generate net cash inflows; and

    (b) non-financial liabilities, eg provisions for restoration, that arose in connection with the use of those scoped-out assets.

30. This scope exclusion is recommended because staff consider that whether these assets and liabilities generate cash flows directly or indirectly has no bearing on the relevance of different measurement bases to them. Background to this issue is set out in Appendix A to this paper.

31. **Panel feedback:**

    (a) *One Panel member said they would prefer that paragraphs 6.55 – 6.56 are reworded in a more NFP-oriented manner, rather than scoped out;*

    (b) *Another Panel member questioned the proposal to also scope out non-financial liabilities, eg provisions for restoration, that arose in connection with the use of those scoped-out assets. They* *commented that the NFP-specific case for that proposal had not been made clearly in the Panel's agenda papers; and*

(c) *No Panel members expressed disagreement with the staff's recommendation that paragraph 6.57 should not be scoped out for financial assets and financial liabilities of NFP entities.*

32. Staff will explore the possibility outlined in paragraph 31(a) above (which is generally the preferred option) further, whilst mindful to avoid pre-empting more significant measurement considerations for NFP entities that staff propose for Stage 2 of the project. Staff will explore the issue raised in paragraph 31(b) further and update the Board at a future meeting. Nevertheless, Board members are asked for their initial feedback on both issues (see Questions 5 and 6) subject to that further staff investigation.

Question 5 to the Board:

Do Board members agree with the staff recommendation to scope paragraphs 6.55-6.56 out for non-financial assets of NFP entities held primarily for their service potential? If not, which amendments would Board members suggest? (*See the discussion of Chapter 6 (Measurement) in Appendix A to this staff paper.*)

Question 6 to the Board:

Do Board members agree with the staff recommendation to scope paragraphs 6.55-6.56 out for non-financial liabilities that arose in connection with the use of non-financial assets of NFP entities held primarily for their service potential (eg provisions for restoration)? In that regard, do you agree instead with the Panel member's comment that a NFP-specific case for that scope exclusion has not been made clearly? (For example, the question whether to measure non-financial liabilities at a value not incorporating current estimates of the amount, timing and uncertainty of future cash flows would be relevant for any entity—not NFP entities in particular.) (*See the discussion of Chapter 6 (Measurement) in Appendix A to this staff paper.*)

Question 7 to the Board:

Do Board members agree with the staff recommendation not to exclude from the scope of paragraphs 6.55 – 6.56 of the RCF non-financial assets of NFP entities held primarily to generate net cash inflows (because staff consider there is not a NFP-specific reason to exclude them)? In this regard, do Board members consider applying paragraphs 6.55 – 6.56 to these assets would be likely to give rise to undue cost and effort (as referred to in paragraph 28(d) of the AASB's NFP Standard-Setting Framework) specifically for NFP entities because of the way the other assets of NFP entities are managed? (*See the discussion in paragraph A12 of Appendix A to this staff paper.*)

Question 8 to the Board:

Do Board members agree with the staff recommendation that paragraph 6.57 should not be scoped out for financial assets and financial liabilities of NFP entities (because, in essence, there is not a NFP-specific issue affecting the measurement bases that could be applied to financial assets and financial liabilities)? (*See the discussion in paragraph A23 of Appendix A to this staff paper.*)

OTHER MATTERS FOR CONSIDERATION

Accountability/Stewardship

33. At its June 2020 meeting, the Board considered a Project Plan for its NFP Conceptual Framework project, and agreed with the proposal (on page 6) that Stage 2 of the project would include considering the potential need for further NFP modifications of the RCF arising from the outcome of research into user needs—including, for example, a recent research paper suggesting that accountability should be given greater prominence to better reflect the needs of the NFP sector. That paper, by R. Kober, J. Lee and J. Ng, was entitled *Australian not-for-profit sector views on the conceptual framework, accounting standards and accounting information* (Accounting & Finance, 2020, 10.1111/acfi.12605):

(https://research.monash.edu/en/publications/australian-not-for-profit-sector-views-on-the-conceptual-framewor)

34. Compared with the existing *Framework for the Preparation and Presentation of Financial Statements*, the RCF added references to accountability (using the phrase "management's stewardship of the entity's economic resources") in eight paragraphs relating to the objective of general purpose financial reporting (paragraphs 1.3, 1.13, 1.15, 1.16, 1.18, 1.20, 1.22 and 3.2).
35. Agenda Paper 10.3 sets out the following staff draft Aus paragraphs for the revised RCF that enlarge on the RCF's coverage of accountability/stewardship (see also the discussion of Issues 2 and 37 in Agenda Paper 10.2):
    (a) AusSP1.5.1 (paralleling for-profit-oriented paragraph SP1.5 on the role of the Conceptual Framework);
    (b) Aus1.3.1 (linking stewardship to the information needs of users of financial reports of NFP entities);
    (c) Aus1.16.1 (mentioning that information about stewardship helps NFP users make predictions); and
    (d) Aus1.18.1 (noting that information about stewardship is an ingredient in assessing whether the entity's income is sufficient to recover the cost of the goods or services a NFP entity provides).
36. The references to accountability/stewardship in the staff draft of the RCF (Agenda paper 10.3) do not address the extent to which additional information might be needed in NFP entities' general purpose financial reports to satisfy management's accountability/stewardship. Considering that topic would take more time to complete than is feasible within Stage 1 of this project. Instead, it has been flagged for consideration in Stage 2, consistent with the Board's decision on the Project Plan mentioned in paragraph 33 above.
37. **Panel feedback:** *With regard to the issue in paragraph 36, a Panel member expressed the view that the implications of accountability/stewardship for NFP entity reporting should be examined more closely, but that this important task can wait until Stage 2 of the project.*

Question 9 to the Board:

Do Board members agree with the staff recommendation that the paragraphs on accountability/stewardship referred to in paragraphs 34-35 are sufficient as an interim step until more detailed consideration can be given to accountability/stewardship in Stage 2 of the project? If not, which suggestions do Board members have for wording or themes to add to the attached draft version of a RCF for adoption by NFP entities?

Service Performance Reporting

38. The Board's Financial Reporting Framework for NFP Private Sector Entities project considers (consistent with the New Zealand reporting model for NFP entities) possible requirements to report information useful for assessing service performance of NFP private sector entities. In light of those considerations, Panel members were asked whether they consider that the NFP Revised Conceptual Framework should address the reporting of information about service performance more explicitly than currently addressed in the RCF.
39. **Panel feedback:** *One Panel member expressed support for linking service performance reporting with the Revised Conceptual Framework because it reflects NFP users' information needs. In separate discussion of the Board's project on its NFP Private Sector Financial Reporting Framework, Panel*

members expressed mixed views regarding whether NFP entities should be required to include service performance information in their general purpose financial reports[1].

40. Staff consider that, if service performance reporting is to be part of Australian Accounting Standards for NFP entities, it is important to give explicit recognition to it in Stage 1 of this project. However, in view of the depth of research necessary for this topic, a complete conceptual coverage of it would seem infeasible before Stage 2. Therefore, staff recommend that:

    (a) in Stage 1 of the project, the NFP RCF includes explicit acknowledgement of the relevance of information about service performance to users of general purpose financial reports of NFP entities and the reasons why it is relevant, without elaborating further; and

    (b) in Stage 2 of the project, the updated NFP RCF sets out concepts for reporting information about service performance, including conceptual guidance on applying the qualitative characteristics to that reporting.

Question 10 to the Board:

Do Board members agree with the staff recommendations that the Revised Conceptual Framework should give explicit conceptual recognition to the relevance of service performance reporting, and that this should be achieved by taking the following steps in Stages 1 and 2:

(1) in Stage 1 of the project, including in the NFP RCF explicit acknowledgement of the relevance of information about service performance to users of general purpose financial reports of NFP entities and the reasons why it is relevant, without elaborating further; and

(2) in Stage 2, in the updated NFP RCF, setting out concepts for reporting information about service performance, including conceptual guidance on applying the qualitative characteristics to that reporting? *(See also the discussion in Issue 3 of Agenda Paper 10.2.)*

Other NFP Issues for Stage 2

41. Agenda paper 10.2, which is a comparison of the Revised Conceptual Framework with the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, identifies a number of potential NFP issues that staff recommend addressing in Stage 2 of the project.

42. **Panel feedback:** *No Panel members expressed disagreement with the Board's decision that this project should proceed in two stages (with Stage 1 limited to amending the AASB's RCF to enable its adoption by NFP entities as an interim measure), although some said it was unclear exactly which topics would be dealt with in Stage 1, Stage 2 or a combination of both.*

Question 11 to the Board:

At this stage, are there any important issues that should be considered in Stage 1 of the project in addition to those identified in this paper (including, for example, any issues in Agenda Paper 10.2 where you disagree with the staff recommendation to either consider them in Stage 2 or exclude them from consideration or where the issue warrants further discussion whether to be included in Phase 1 or not)?

Question 12 to the Board:

Do Board members have any initial feedback on the issues in Agenda paper 10.2 that staff recommend to be considered in Stage 2?

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[1] Because that project will proceed parallel with the NFP Conceptual Framework project, the Board's consideration of service performance reporting would simultaneously inform the drafting of due process documents for both projects.

SUGGESTED NEXT STEPS AND TIMELINE

43. Staff propose the following timeline, based on the Board's decision to progress this project in two stages:

Task	Timing
Staff to commence drafting an Exposure Draft for Stage 1 of the project	4^{th} quarter of 2020
Staff to commence research on clear-cut Stage 2 issues	4^{th} quarter of 2020
Board to consider agenda paper(s) on: • staff's implementation of Board decisions at the September 2020 Board meeting; • issues identified by staff in the process of drafting a Stage 1 Exposure Draft; and • staff's follow-up of Panel member comments noted in this paper.	11-12 November 2020
Hold second Panel meeting to discuss: • Any significant issues relating to Stage 1 not yet discussed fully with the Panel (e.g. additional issues raised by the Board or Stage 1 issues raised by Panel at its 21 August 2020 meeting) • Final confirmation of issues for Stage 2 of the project and initial feedback by Panel members on those issues	4^{th} quarter of 2020 or 1^{st} quarter of 2021

Question 13 to the Board:

Do Board members agree with the suggested next steps and timeline? If not, what do members suggest?

APPENDIX A: ELABORATION OF KEY CHANGE PROPOSED TO THE FRAMEWORK

Chapter 6 – Measurement

A1. Paragraphs 6.55 – 6.56 of the Revised Conceptual Framework state that: "When a business activity of an entity involves the use of several economic resources that produce cash flows indirectly, by being used in combination to produce and market goods or services to customers, historical cost or current cost is likely to provide relevant information about that activity. For example, property, plant and equipment is typically used in combination with an entity's other economic resources. … For assets and liabilities that produce cash flows directly, such as assets that can be sold independently and without a significant economic penalty (for example, without significant business disruption), the measurement basis that provides the most relevant information is likely to be a current value that incorporates current estimates of the amount, timing and uncertainty of the future cash flows."

A2. Thus, paragraphs 6.55 – 6.56 of the Revised Conceptual Framework indicate that the comparative relevance of different measurement bases for a non-financial asset[2] (or a non-financial liability, eg provision for restoration, that arose in connection with the use of that asset[3])—in particular, historical cost or current cost versus fair value or value in use—depends to a large extent on whether the asset (or liability) produces cash flows directly or indirectly. Views might be held that the business focus of paragraphs 6.54 – 6.57 might not be as appropriate for some types of NFP entities. Staff consider that applying paragraphs 6.55 – 6.56 (in particular[4]) without a NFP modification would be a significant potential concern because, for many non-financial assets of not-for-profit entities, whether they produce cash flows directly, or indirectly, has no bearing on the relevance of different measurement bases to them. This is because many non-financial assets of not-for-profit entities are held primarily for their service potential rather than their ability to generate net cash inflows. Consider, for example, the classification (and resulting measurement basis implications) of two asset types of a community centre: a mini-bus hired without charge by special needs clients, and the furniture and equipment composing a computer learning centre accessed free-of-charge. Under the guidance in paragraphs 6.55 – 6.56:

- the mini-bus would seem likely to be classified as producing cash flows directly because, although its funding is at a whole-of-entity level rather than through user charges[5], it typically is not used in combination with the entity's other economic resources to provide services[6]; and it

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2 The measurement of financial assets and financial liabilities is discussed separately in paragraph 6.57 of the Revised Conceptual Framework.

3 Liabilities are mentioned only in passing in connection with this issue, in paragraphs 6.54 and 6.56. From the discussion of financial assets and financial liabilities in paragraph 6.57, it can reasonably be construed that the liabilities discussed in paragraphs 6.55 – 6.56 are non-financial liabilities. The example of a non-financial liability in this parenthetical comment was provided by staff, and is not mentioned in the Revised Conceptual Framework. Non-financial liabilities are not discussed further in this section (except for being mentioned in the staff recommendation), because they seem to generate similar issues to non-financial assets in this regard. (Staff noted the implication that historical cost might be a relevant measure of some non-financial liabilities, such as provisions (as paragraph 6.55 seems to do), while IAS 37 requires provisions to be measured at current values. However, this does not affect NFP entities differently from for-profit entities, as therefore is not discussed further—particularly in light of the staff view that, in any event, such liabilities should be excluded from the scope of the Revised Conceptual Framework that would be applicable to not-for-profit entities.)

4 See the discussion of paragraph 6.57 in paragraph A23 below.

5 The guidance in paragraphs 6.55 – 6.56 on how cash flows are produced seems to focus on how assets are used, and whether they can be sold independently, rather than on whether they generate user charges.

6 This tentative interpretation disregards the use of the entity's administration resources to safeguard custody of, and maintain accounting records for, the mini-bus. This is because taking such resources into account would appear to cause all non-financial assets of an entity to be classified as producing cash flows indirectly, which would seem to defeat the purpose of the guidance on the direct/indirect cash flows distinction.

can be sold independently and without a significant economic penalty (for example, the community centre could sell the mini-bus and replace it with a newer model); and

- the non-financial assets composing the computer learning centre would seem likely to be classified as producing cash flows indirectly, because each of them is used in combination with other assets to produce services, and because each of them could not be sold independently without disruption the production of services by the other computer learning centre assets.

It is not apparent why the comparative relevance of historical cost or current cost, on one hand, and fair value or value-in-use on the other, should differ for the mini-bus and the non-financial assets composing the computer learning centre.

A3. The abovementioned significant potential concern with paragraphs 6.55 – 6.56 might be ameliorated to some degree by the fact that those paragraphs do not imply the use *only* of historical cost when an asset 'produces cash flows indirectly' (ie those paragraphs also accommodate using current cost, which arguably is a highly relevant measurement basis for assets of NFP entities, particularly the many assets they hold primarily for their service potential rather than to generate net cash inflows). The greatest potential concerns surrounding paragraphs 6.55 – 6.56 are that they lack relevance in a NFP environment, might cause NFP entities to incur cost and effort in applying the classification scheme in paragraphs 6.55 – 6.56 for little apparent purpose, and seem unlikely to assist the AASB in making decisions about measurement bases in Standards-level projects.

A4. Staff consider these potential concerns about paragraphs 6.55 – 6.56 cannot be remedied simply by broadening the reference to cash flows (eg by replacing that term with 'resource flows'). The potential concern stems mainly from the direct/indirect criterion rather than the reference to cash flows. This is because, even if particular non-financial assets could generate *non-cash resources* independently through exchange with other non-financial assets, this would not make the direct nature of the inflow any more relevant to the selection of a measurement basis than the potential of that asset to generate cash independently of other assets.

A5. AASB staff consider the development of alternative concepts for addressing this issue would take more time than the timetable for Stage 1 of this project would allow.

A6. Options for addressing this concern are:

- Adopting the Revised Conceptual Framework without a NFP modification for this issue in Stage 1 of the project, and addressing the issue in Stage 2;
- Adding NFP guidance that excludes NFP entities from the scope of paragraphs 6.55 – 6.56 (this option includes two sub-options) but otherwise applies the Measurement chapter (Chapter 6);
- Excluding NFP entities from the scope of the entire Measurement chapter; and
- Deferring adoption of the Revised Conceptual Framework by NFP entities until Stage 2 of the project is completed.

These options are discussed below.

<u>Option (a): Adopting the Revised Conceptual Framework without a NFP modification for this issue</u>

A7. The main argument in favour of this option is that, despite the arguably significant potential concern about paragraphs 6.55 – 6.56 from a NFP perspective, the potential concern is unlikely to affect preparers and auditors in advance of thoroughly addressing the issue (ie consider whether to develop replacement wording and what that wording, if any, should be) in Stage 2. This is because most measurement issues are dealt with in Australian Accounting Standards—in this sense, the AASB is the primary user of the Measurement concepts.

A8. The main arguments against this option are that:

- the potential concern about paragraph 6.55 – 6.56 is so significant that issuing those paragraphs without a scope exclusion or other NFP modification would potentially create significant difficulties for preparers and auditors of financial statements of NFP entities. This is because not-for-profit entities would need to take into account how non-financial assets produce cash flows despite draft paragraph Aus4.16.1 (which transfers, with minimal amendment, the text of paragraph Aus54.2 from the existing NFP Conceptual Framework) stating that the provision of goods or services may not result in net cash inflows; and

- it is unnecessary to wait until Stage 2 of this project to address the potential concern: even if developing replacement text cannot be performed until Stage 2, it would be preferable to provide a scope exclusion for NFP entities instead of retaining those paragraphs without modification.

A9. Staff prefer the arguments in paragraph A8 to that in paragraph A7, and therefore do not recommend adopting Option (a).

<u>Option (b): Adding NFP guidance that excludes NFP entities from the scope of paragraphs 6.55 – 6.56</u>

A10. Adopting the views in paragraphs A8 – A9 would imply that NFP entities should be excluded from the scope of paragraphs 6.55 – 6.56 in Stage 1 of the project, even though there would appear to be insufficient time in Stage 1 to develop replacement concepts for those excluded paragraphs. This paper identifies the following two possible sub-options to this approach:

- Option (b)(i): Exclude from the scope of paragraphs 6.55 – 6.56 all non-financial assets of NFP entities; and
- Option (b)(ii): Exclude from the scope of paragraphs 6.55 – 6.56 all non-financial assets of NFP entities held primarily for their service potential (ie not primarily to generate net cash inflows).

A11. Preferring Option (b)(i) could be argued on the view that the distinction between direct and indirect cash inflows is irrelevant to the way not-for-profit entities are managed.

A12. Preferring Option (b)(ii) could be argued on the view that non-financial assets of not-for-profit entities held primarily to generate net cash inflows (and cross-subsidise their service delivery activities) have substantially the same characteristics regardless of whether held by a for-profit or not-for-profit entity. Consequently, it could be argued, applying the AASB's Not-for-Profit Entity Standard-Setting Framework (NFP Standard-Setting Framework) does not support modifying the application of the Revised Conceptual Framework to such non-financial assets of not-for-profit entities. Specifically, it could be argued that such a modification would not meet the criteria for such a modification in paragraph 28 of the NFP Standard-Setting Framework.

A13. At this stage (pending further consideration), staff prefer Option (b)(ii) to Option (b)(i), for the reasons in paragraph A12. However, staff consider that stakeholders' views should be sought on whether applying paragraphs 6.55 – 6.56 would be likely to give rise to undue cost and effort (as referred to in paragraph 28(d) of the NFP Standard-Setting Framework) specifically for not-for-profit entities because of the way the other assets of not-for-profit entities are managed.

<u>Option (c): Excluding NFP entities from the scope of the entire Measurement chapter</u>

A14. A possible response to the significant potential concern about paragraphs 6.55 – 6.56 would be to exclude not-for-profit entities from the scope of the entire Measurement chapter in Stage 1, and retain the section on Measurement in the existing NFP Conceptual Framework (which, together with the related section on Concepts of Capital and Capital Maintenance, is paragraphs 99 - 110 thereof).

A15. Arguments in favour of this option are that:

- removing any important components of a chapter can affect the overall application of the chapter. Therefore, such a change should not be made until the AASB fully develops its alternative views on the chapter (ie considers whether to develop replacement wording and what that wording, if any, should be); and

- the chapter should not be issued for application by not-for-profit entities until the AASB considers the outcome of the IPSASB's current project on Measurement (the IPSASB plans to approve an exposure draft in December 2020).

A16. Staff observe that the second argument in paragraph A15 relates to a broader issue than how to respond to paragraphs 6.55 – 6.56 of the Revised Conceptual Framework. That issue is discussed in paragraphs 23 – 27 of the Staff Paper. Therefore, it is excluded from this analysis of paragraphs 6.55 – 6.56.

A17. Arguments against Option (c) are that:

- the section on Measurement in the existing NFP Conceptual Framework (paragraphs 99 – 101) provides very limited guidance on measurement. It essentially is limited to a description of four measurement basis—none of which is fair value—without discussing the information value of adopting different measurement bases or identifying factors to consider when selecting a measurement basis. This contrast starkly with Chapter 6 of the Revised Conceptual Framework, which covers both those aspects in discussion spanning 58 paragraphs. Therefore, deferring adoption of Chapter 6 would exclude not-for-profit entities from considering its considerable additional material, including its discussion of fair value; and
- omitting to adopt an entire chapter of the Revised Conceptual Framework because of two (or three: see paragraph A23) paragraphs that are potentially irrelevant in the NFP environment would be unnecessary, because the other discussion of Measurement in Chapter 6 is not dependent on paragraphs 6.55 – 6.56.

A18. Staff prefer the arguments in paragraph A17 to the first argument in paragraph A15, and therefore recommend not to adopt Option (c).

<u>Option (d): Deferring adoption of the Revised Conceptual Framework by NFP entities until Stage 2 of the project is completed</u>

A19. Option (d) is essentially an extension of Option (c), and is based on the conclusion that a logical consequence of excluding not-for-profit entities from the scope of the entire Measurement chapter would be to defer adoption of the Revised Conceptual Framework by not-for-profit entities in its entirety. This conclusion reflects the view that the Measurement chapter is so important to the Revised Conceptual Framework that adopting the remainder of the Revised Conceptual Framework for not-for-profit entities without that Chapter would provide an incoherent set of concepts. Consequently, retaining the section on Measurement in the existing NFP Conceptual Framework would be inappropriate.

A20. Because Option (d) is essentially an extension of Option (c)—which the staff does not support—staff recommend not to adopt Option (d).

<u>Staff recommendations</u>

A21. The discussion in paragraphs A6 – A20 indicates staff do not support any of Options (a), (c) or (d). As noted in paragraph A13, staff prefer Option (b)(ii) to Option (b)(i)—therefore, Option (b)(ii) is the option recommended by staff.

A22. Accordingly, the working draft Revised NFP Framework (Agenda Paper 10.3) includes draft paragraph Aus6.56.1, which excludes from the scope of paragraphs 6.55 – 6.56 all non-financial assets of NFP entities held primarily for their service potential (ie not primarily to generate net cash inflows) and all related non-financial liabilities. Paragraph Aus6.56.1 does not have a counterpart in the existing NFP Conceptual Framework, because it pertains to 'new' paragraphs 6.55-6.56 (which do not have a counterpart in the existing NFP Conceptual Framework).

A23. Staff do not propose to exclude not-for-profit entities from the scope of paragraph 6.57, because the service potential/potential to generate economic benefits of financial assets (and the claims on that potential that financial liabilities represent) is dependent on their direct cash inflows (and direct cash outflows). Staff consider that concessionary loans for public policy purposes do not contradict that view, because they regard such loans as comprising two elements, namely, a claim and a donation. This view is consistent with the AASB not including in AASB 9 *Financial Instruments* a NFP modification for concessionary loan receivables (ie their carrying amount is not increased to reflect their public policy purpose)—similarly, the IPSASB states that, under IPSAS 29 *Financial Instruments: Recognition and Measurement*, “the issuer of a concessionary loan accounts for the off-market portion of the loan as an expense in the year the loan is issued” and “the initial granting of the loan results in the commitment of resources, in the form of a loan and a subsidy, on day one” (Basis for Conclusions on IPSAS 29, paragraphs BC11 and BC15). Despite being different from most loans[7] made by for-profit entities, their service potential/potential to generate economic benefits is nonetheless dependent on their direct cash inflows.

[7] Note that concessionary loans are sometimes offered by for-profit entities to enhance customer relationships or facilitate sales.