



Project:	Not-for-Profit Private Sector Financial Reporting Framework	Meeting:	M182
Topic:	Primary objective in setting Tier 3 proposals	Agenda Item:	4.2
		Date:	26 July 2021
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		Decision-Making:	High
		Project Status:	Initial deliberations

Objective of this paper

- 1 The objective of this staff paper is for the Board to **reconfirm** its objective in forming the Tier 3 proposals for not-for-profit (NFP) private sector entities, including to:
 - (a) **consider** whether the primary objective of Tier 3 reporting requirements should be to simplify accounting requirements or to facilitate comparability; and
 - (b) **discuss** the approaches to simplification that can be applied when developing simplified reporting requirements

Background and reasons for bringing this paper to the Board

- 2 The Board, when beginning its financial reporting framework for NFP private sector entities in Australia project (NFP FRF project), determined that its primary objective in undertaking the project was to develop a simple, proportionate, consistent and transparent financial reporting framework for application by NFP private sector entities.¹ Subsequently, at its 20-21 April 2021 meeting, the Board determined the following tentative set of principles by which it will develop its preliminary views on Tier 3 reporting requirements for inclusion in a Discussion Paper (DP):
 - (a) the development of Tier 3 reporting requirements is subject to the AASB Not-for-Profit Entity Standard-Setting Framework;
 - (b) Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of the financial statements;
 - (c) consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable, but might not always be warranted, since Tier 3 requirements are being developed as a proportionate response to the costs incurred by certain entities whilst still meeting the needs of users of the financial statements for this cohort of entities. For example, opportunities for deviation from

1 [AASB November 2019 minutes, AASB Agenda Paper 5.1 Australian Financial Reporting Framework – NFP Private Sector Project Plan](#)

Tier 2 accounting principles that could give a similar outcome to users while reflecting an appropriate cost/benefit balance could include disclosure requirements instead of a Tier 2 measurement requirement or an approach of specifying minimum 'prescriptive' disclosures;

- (d) where possible within the context of its conceptual framework, user needs and cost/benefit considerations, in developing accounting requirements the aim is to maximise leveraging information that management uses to make decisions about the entity's operations; and
- (e) accounting requirements do not impose disproportionate costs on preparers, when compared to benefits of the information.

In forming its views on Tier 3 reporting requirements, the Board decided it would consider, and be informed by, reporting requirements of other jurisdictions applying to similar-sized NFP private sector entities, including New Zealand.

- 3 At its 21-22 June 2021 meeting, the Board discussed whether the primary objective of Tier 3 reporting requirements should be to simplify accounting requirements or to facilitate comparability between Tier 3 NFP private sector entities, and the interaction of this primary objective with the Board's principles for developing the proposed Tier 3 requirements. The Board did not form a view and directed staff to perform further work in this regard.
- 4 The purpose of this paper is to provide the Board with the staff analysis of the primary objective of Tier 3 reporting requirements, with a view to applying the agreed principles to the subsequent analysis of accounting requirements in developing the proposed DP.

Proposed primary objective of Tier 3 reporting requirements

- 5 A key issue identified during deliberations at its 21-22 June 2021 Board meeting was whether the primary objective of Tier 3 reporting requirements should be to simplify the accounting requirements or, alternatively, to facilitate comparability. In response, staff have reviewed the primary overall project objective as outlined in the [NFP FRF private sector project plan](#)² which was to develop a simple, proportionate, consistent and transparent financial reporting framework for application by NFP private sector entities.
- 6 The overall project objective indicates that simplicity is only one of the objectives of the NFP financial reporting framework, and other contributing objectives including consistency and transparency must also be considered.

Comparability

- 7 Staff acknowledge the importance of consistency/comparability as part of standard setting process for the following reasons:
 - (a) comparability is an enhancing qualitative characteristic of useful financial information as financial information about an entity is more useful if it can be:
 - (i) compared with similar information about other entities and with,
 - (ii) similar information about the same entity for another period or another date.³

2 The NFP FRF Project Plan for private sector entities was approved by the Board at its 21 November 2019 .

3 Research has also indicated the "...importance of comparability and the need to devote special attention to, and perhaps additional disclosure requirements for, the types of entities that solicit contributions from people who will not

- (b) consistency, which is part of the Board’s NFP FRF project outcome, helps achieve comparability. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities, while comparability enables users to identify and understand similarities in, and differences among, items.
- (c) the benefits of comparability within and across sectors to facilitate movement of professionals across sectors.⁴

Simplicity

- 8 However, one of the key drivers for the Board to undertake this project was to respond to stakeholder concerns that existing reporting requirements of the Australian Accounting Standards were, for some entities, too complex to apply.⁵ Feedback from various AASB outreach activities on a potential revised differential framework supported a demand for one or more tiers of simpler reporting requirements.⁶ The AASB also commissioned a series of research activities which indicated support for simplifying the financial reporting requirements for certain NFP private sector entities, and to provide a proportionate response for private sector entities that may no longer be able to present special purpose financial statements.⁷
- 9 In addition, research findings indicate that the public would benefit from financial disclosures by NFPs, and users would benefit from less complex (simplified) reporting to help improve understandability.⁸

Staff analysis and recommendation

- 10 Considering the feedback and research findings discussed above, which focuses on developing simplified and proportionate financial reporting requirements for some NFP private sector entities, staff recommend the following primary objective for Tier 3 reporting requirements:

To develop simplified requirements for financial reporting to meet the needs of users for smaller NFP entities.

- 11 In addition, staff note the importance of comparability considerations for developing the simplified reporting requirements for Tier 3. To help clarify this, staff recommend capturing the comparability considerations within the tentative principles as outlined in paragraph 2(d) as follows:

directly or indirectly benefit from their gifts...” ([Research Report 16 Financial Reporting by Non-Corporate or Smaller Entities](#), page 36). This indicates that there is a need to consider comparability of information and information disclosures for NFP entities

- 4 Para 18 of the [NFP Standard Setting Framework](#)
- 5 In November 2014, the FRC’s Financial Reporting Taskforce published a report [Financial Reporting – Issues, Recommendations and Summary of Observations](#) showing that the current financial reporting requirements for all sectors are complex. [Feedback from AASB Roundtable Financial Reporting Framework \(January 2016\) – Not-for-profit Private Sector Entities](#) suggested that “...the existing financial reporting requirements might be too complex for many NFP private sector entities preparing general purpose financial statements, with the result that financial statements nominally prepared in accordance with Tier 1 or Tier 2 Australian Accounting Standards were not necessarily comparable across NFP private sector entities...”
- 6 [Summary of outreach feedback](#) received from the November 2017 outreach sessions for [Discussion Paper – Improving the financial reporting framework for Australian Charities](#)
- 7 Research report 5 October 2017: [Financial Reporting Requirements Applicable to Charities](#) further indicated the complexity of reporting requirements in the charities sector with limited number of Tiers of GPFs available, which might be too onerous for some charities. AASB Research report 16 [Financial Reporting by Non Corporate or Small Entities](#) showed that financial statements would be better served by simplified (rather than traditional) audited financial statements. This indicates that there is support for simplified financial reporting requirements for smaller entities which, in turn, helps user understanding of those financial statements.
- 8 Research article: *Donors’ perceptions of financial disclosures and links to donations intentions*, Ushi Ghoorah, A K M Mominul Haque Talukder & Aila Khan, 27 Jan 2021 (Agenda Paper 4.4)

- (d) where possible, leverage the information management uses to make decisions about the entity’s operations. The ability to leverage the information management uses is made within the context of the not-for-profit conceptual framework, user needs and cost/benefit considerations and the aim for comparability within Tier 3 reporting requirements.

Question 1 to Board members

- (a) Does the Board agree that the proposed primary objective in forming Tier 3 reporting requirements is to develop **simplified requirements of financial reporting** to meet the needs of users for **smaller NFP entities**?
- (b) Does the Board agree to revise the principle as recommended by staff in paragraph 11 above to specifically refer to the aim for comparability within Tier 3 reporting requirements, where possible?

Simplified reporting requirements: Approaches to simplification

- 12 If the Board agrees with the staff recommendation that the primary objective is to develop simplified accounting requirements for smaller NFP entities, the Board will need to agree on how simplification can be applied when developing simplified reporting requirements as discussed in paragraphs 13 - 15.
- 13 To assist the Board in applying its primary objective of developing simplified financial reporting requirements, staff have identified the following different approaches to simplification that could be reflected within Tier 3 reporting requirements:
- (a) explanation
 - (b) recognition criteria
 - (c) measurement criteria
 - (d) disclosure criteria
 - (e) interpretation
 - (f) understandability
- 14 Each of these potential approaches simplification are explained further in the table below:

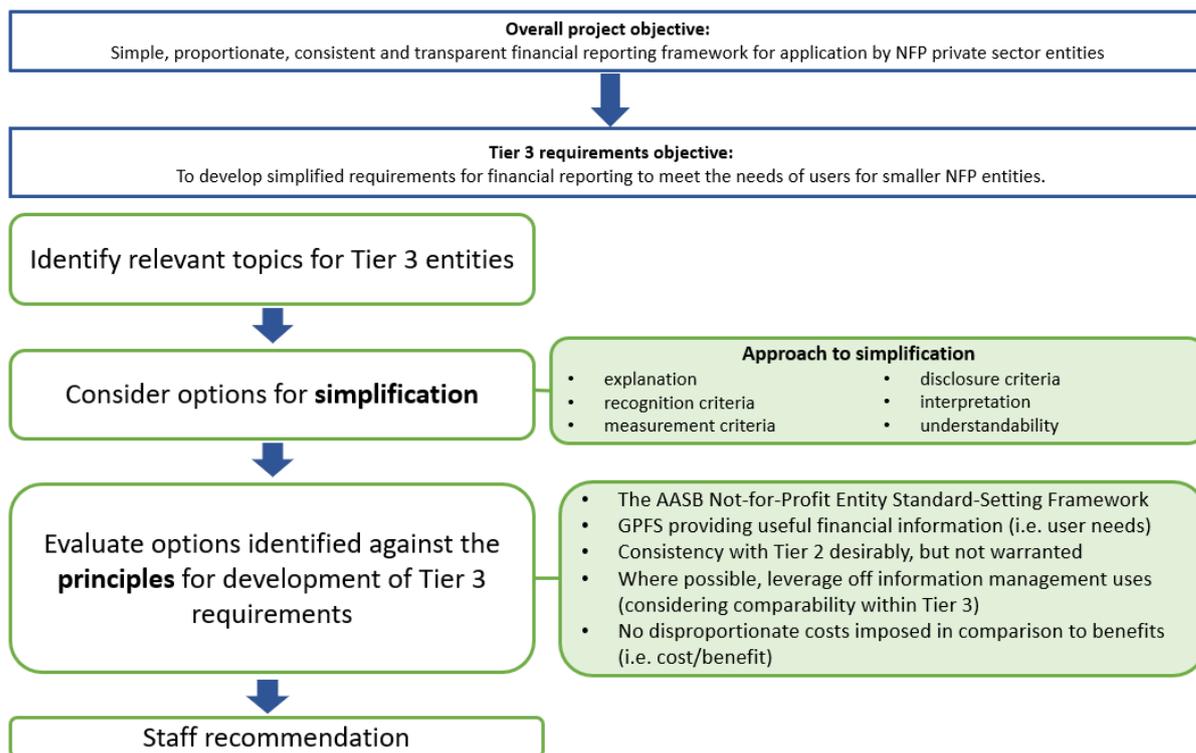
Approach to simplification⁹	Description
Explanation	Tier 3 accounting requirements are presented in a form that is more easily understood by preparers who are not (or could reasonably expected not to be) ‘financial reporting experts’. That is, preparers are not expected to have extended familiarity with or reason to actively consider detailed requirements of Australian Accounting Standards. This simplified explanation may include consideration of the structure of the

9 Staff note that the simplification techniques described above are approaches the Board might employ to develop ‘simplified’ Tier 3 accounting requirements for application by preparers (and aid understanding of the resultant financial statements by users). However, the application of the available techniques would still be a matter for the Board’s judgement in considering the requirements of any particular topic.

	requirements, further use of diagrams and flowcharts, and simplification of language used.
Recognition criteria	The recognition criteria for elements of financial statements are less subject to preparers' judgement and/or require simpler conditions to be met.
Measurement criteria	The measurement criteria for elements of financial statements are less subject to preparers' judgement (e.g. fewer estimates required) and/or less complex to apply.
Disclosure criteria	The disclosure requirements for Tier 3 accounting requirements are made simpler and/or less complex than Tier 2, such as specifying minimum 'prescriptive' disclosures that are less subject to preparers' judgement.
Interpretation	The application/applicability of an accounting requirement is made easier to interpret by reducing managerial discretion, such that the requirement can be applied without further interpretation or need for significant judgement.
Understandability	Tier 3 accounting requirements result in reporting outcomes that can be easily understood or explained to users of the financial statements.

- 15 Staff also note that the Board's simplification and comparability decisions are made within the boundaries of its tentative principles for forming its preliminary views on Tier 3 reporting requirements, and having regard to possible user demands for information of entities in the size threshold contemplated by the Board.¹⁰ The flow chart below outlines the interrelationship between the primary objective of simplifying the accounting requirements and the agreed principles when forming the staff recommendation on the Tier 3 reporting requirements.

¹⁰ The Board tentatively agreed at its [20-21 April Board meeting](#) to develop proposals on Tier 3 accounting requirements having regard to balances and transactions commonly undertaken by NFP private sector entities with revenues between \$500,000 and \$3 million. This size indication provides the Board with an indicative boundary for identifying common transactions and forming views on requirements applying to Tier 3 financial statements.



Question 2 to Board members

- Does the Board agree with the approaches to simplification identified in paragraph 14 above?
- Does the Board agree with how simplification is applied when developing Tier 3 requirements of financial reporting as shown in the flowchart in paragraph 15 above?

Relationship between simplicity and comparability

- Having regard to the approaches to simplification discussed, staff think that the application of simplicity and comparability are not necessarily mutually exclusive concepts leading to different Board decisions. For example, providing simpler reporting requirements for less complex and straightforward transactions with no accounting policy option achieves both simplicity and comparability objectives.
- Staff further note that, in some circumstances, the ability to simplify may be limited due to factors such as:
 - known challenges to interpretations due to the judgement required to interpret certain terms. Consequently, it might not be possible to use a term in Tier 3 reporting requirements without defining it or providing more guidance about its interpretation. For example, 'material' and 'significant' are terms that involve judgement and may require guidance to be included within Tier 3 reporting requirements to help NFP Tier 3 private sector entities to interpret and apply these terms consistently. There is also a lack of consistency in definitions of NFP expenses such as program costs, fundraising expenses and marketing costs,¹¹ which may require guidance to be developed to assist the interpretation for Tier 3 entities.

¹¹ Research article: *Donors' perceptions of financial disclosures and links to donations intentions*, Ushi Ghoorah, A K M Mominul Haque Talukder & Aila Khan, 27 Jan 2021 (Agenda Paper 4.4)

- (b) need to include guidance or illustrative examples of application to different NFP entity scenarios, and perspectives which can lead to expansion and perceived complexity of the Tier 3 accounting requirements. For example, the need to incorporate illustrative examples, application and implementation guidance, as well as flow charts will ultimately expand the length of the Tier 3 reporting requirements.
- (c) the potential need to provide for accounting options, in line with recognising diversity in the sector and in keeping with the Board decision at its 21-22 June 2021 meeting to develop a standalone standard with minimal cross-reference to guidance contained within existing Australian Accounting Standards.
- (d) discussing phenomena that is inherently complex and cannot be made easy to understand. For example, assessing whether an arrangement is, or contains, a lease and understanding clauses in lease contracts (e.g. lease terms) is inherently complex and could affect measurement of the lease liability or lease commitments.

Question 3 to Board members

Does the Board have any further comments or concerns in relation to the interaction of simplification and comparability in developing Tier 3 reporting requirement?