Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Financial Reporting Framework Project**	**Meeting:**	201
Topic:	**Summary of the application of the Board's approach to drafting the Tier 3 Exposure Draft**	**Agenda Item:**	4.4
		Date:	20 February 2024
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		Decision-Making:	Low
		Project Status:	Developing Exposure Draft

Objective of this paper

1 The objective of this paper is to provide the Board with a **summary** of the application to drafting of the Tier 3 ED of various selected topics **for noting**. Agenda Papers 4.6 – 4.17 in the supplementary folder provide the Board with an detailed overview of how the drafted sections were derived.

Background and reasons for bringing this paper to the Board

2 The table below contains the summary of the approach to drafting the Tier 3 ED applying the approach to drafting the Tier 3 Standard as illustrated in Agenda Paper 4.1 Appendix B at this meeting, which sets out the approach to drafting the recognition and measurement requirements[1] and the disclosure requirements.[2] The table includes:

(a) the reference to the drafted section of the WIP draft of the Tier 3 ED (full document presented in paper 4.3,

(b) the respective Agenda Paper in Supplementary folder containing the drafted sections that was presented to the Subcommittee members for review; and

(c) a high-level summary in **Table 1** below of:

(i) the Tier 3 proposals;

(ii) the source/pronouncements used as a reference point to develop the Tier 3 ED; and

(iii) commentary on the process of alignment of the drafting to the Board's ED proposals.

1 Refer to Action Alert No: 222
2 Minutes of the 188th meeting of the AASB

Table 1 *High level summary of the Tier 3 proposals, the source/pronouncements as reference for developing the Tier 3 ED and process to align the drafting to the Board's ED proposals*

Section	Agenda Paper number in supplementary folder	Discussion Paper/Board's proposals	Source used as reference point for drafting	Summary of the application in the circumstances of the Board's approach to drafting
Cost as an estimate of fair value of investments in equity instruments	4.6	Consistent with the Tier 2 requirements in AASB 9 (paragraphs B5.2.3 – B5.2.6), that is, in limited circumstances, cost may be an appropriate estimate of fair value (at initial or subsequent measurement) when: • there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range; or • if there are no indicators present to suggest otherwise (e.g. a change in the economic environment in which the entity operates), and there is insufficient more recent information available to measure fair value *Refer to paragraph 5.83 of the DP*	Combination of: • guidance in paragraphs B5.2.3 – B5.2.6 of AASB 9 *Financial Instruments*; and • the *IFRS for SMEs* Accounting Standard Requirements modified to omit the "undue cost or effort" exemption from using fair value. INPAG contains limited editorial amendments.	• Paragraphs B5.2.3 B5.2.6 of AASB 9 is fully compatible with the Board's proposal; and • Using the *IFRS for SMEs* Accounting Standard requirements modified to omit the "undue cost or effort" exemption from using fair value because text included general guidance on the reliable measurement of fair value adopted by staff in drafting the section on Fair Value Measurement for the Tier 3 ED.
Impairment of assets	4.7	Impairment requirements consistent with Tier 2 requirements in AASB 136 except for the following simplification: • Only non-financial assets subsequently measured at cost or deemed cost should be subject to impairment testing whereas AASB 136 provides a NFP modification to exclude from the Standard's scope	The *IFRS for SMEs* Accounting Standard requirements	Using the *IFRS for SMEs* Accounting Standard requirements given the consistency with Tier 2 requirements except for: • the simplification noted in DP proposals; and • the following recognition and measurement requirements that are not contained in the

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		specialised assets that are not held primarily for their ability to generate net cash flows; and regularly revalued to fair value under the revaluation model in AASB 116; • Only consider whether an asset is impaired when it has been damaged physically or its service potential might have been adversely affected by a change in the entity's strategy or changes in external demands for the entity's services; • Rebuttable presumption that fair value less cost of disposal is expected to be most appropriate measure of a non-financial asset's recoverable amount; and • Tier 3 Standard will not include reporting requirements to address the reversal of previously recognised impairment losses. *Refer to paragraphs 5.159 – 5.161 of the DP*		*IFRS for SMEs* Accounting Standard requirements but are required in AASB 136: ○ the requirement to test for impairment annually, irrespective of whether there is an indication of impairment; for intangible assets with indefinite useful life; and goodwill acquired in business combination ○ indication of impairment of an asset is that its useful life has been reassessed from indefinite to finite; ○ specifically identified indications of impairment of investments in subsidiaries, joint ventures or associates; ○ identification of cash-generating units and the measurement of their recoverable amount; ○ the definition of 'corporate assets' and requirements concerning testing corporate assets for impairment as part of more than one cash-generating unit; and ○ the criterion for reversal of an impairment loss recognised in prior periods (for an asset other than goodwill) that there has been a change in the estimates used to determine the

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				asset's recoverable amount since the last impairment loss was recognised.
Inventory	4.8	Consistent with Tier 2 requirements set out in AASB 102: • except for permitting a recipient of donated inventory to initially measure such inventory at its "cost" or at its current replacement costs (subject to further considerations by the Board in Agenda Paper 4.2 at this meeting); and • including developing additional guidance regarding the calculation of any loss of service potential of inventories held for distribution. *Refer to paragraphs 5.125-5.127 of the DP*	Combination of: • the *IFRS for SMEs* Accounting Standard requirements and • Guidance from INPAG regarding the calculation of loss of service potential	• Using the *IFRS for SMEs* Accounting Standard requirements given the consistency with Tier 2 requirements except it excludes AASB 102's NFP entity modifications of IAS 2 to include the requirements referring to inventories held for distribution. The INPAG draft inventory section contains optional treatments for inventory which have not been included in the working draft of the Tier 3 ED, pending the Board's consideration in Agenda Paper 4.2 at this meeting regarding donated non-financial assets including inventory. • Using the INPAG pronouncement requirements in developing guidance and illustrative examples on the application of the concept of calculating any loss of service potential of inventories held for distribution.

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Leases	4.9	• Lease payments recognise as expenses on a straight line basis over the lease term (unless another systematic basis is more representative of time pattern of the benefits from the lese assets). Similar recognition requirements for lease receipts. Disclosure of information about outstanding lease commitments; and • Not recognise right-of-use asset nor donation income for the differences between he blew-market terms of the lease and its mark terms and conditions. *Refer to paragraphs 5.168 – 5.178 of the DP.*	The *IFRS for SMEs* Accounting Standard requirements dealing with operating leases	Using the *IFRS for SMEs* Accounting Standard requirements dealing with operating lease as starting point without requiring the identification of operating leases.
Other topics based primarily on New Zealand Tier 3 Standard	4.10	Consistent with Tier 2 requirements except for: • deferred income taxes • exclude significant aspects of the requirement for provisions (namely discounting future cash flows to their present value using a specified discount rate); and • exclude significant aspects of the requirements for foreign currency translation (namely, identifying a functional currency and accounting for foreign operations). *Refer to paragraphs 5.201 – 5.219 of the DP.*	Combination of: • NZ Tier 3 Standard; and • The *IFRS for SMEs* Accounting Standard /INPAG guidance requirements	Using NZ Tier 3 Standard as base with edits to include the *IFRS for SMEs* Accounting Standard and INPAG requirements not contained in the NZ Tier 3 Standard to align with Tier 2 requirements which include: • where financial statements were not prepared on a going concern basis; • disclosures of inability to continue operating as a going concern – to disclosure where management is aware of material uncertainties about future events or conditions arising significant doubt about the entity continuing to operate as a going concern; • offsetting allowed if required or permitted by the Tier 3 Standard; and

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				• disclosures for provisions and exchange differences.
Opting up policy, accounting policy hierarchy, Tier 2 topics and maintenance cycle	4.11	Similar to New Zealand Tier 3 and the *IFRS for SMEs* Accounting Standard requirements, that is, for: • opt up - allow entities to apply an accounting policy permitted or required by Tier 1 or Tier 2 Australian Accounting Standards that is not included in the Tier 3 Standard only where a transaction, other event or condition is not addressed by the Tier 3 Standard; • accounting policy hierarchy– in respect of transactions, other events and conditions not specifically addressed in the Tier 3 Standard, require entities preparing Tier 3 general purpose financial statements to apply judgement in developing their accounting policies by reference to the following sources, in descending order: (iv) the Tier 3 principles and reporting requirements dealing with similar and related issues; and (v) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Conceptual Framework, to the extent they do not conflict with Tier 3 reporting requirements. In making this judgement, management may also consider the requirements and guidance in Tier 2 (Australian Accounting Standards – Simplified Disclosures); In making this judgement, management may also consider the requirements and guidance in Tier 2	Combination of • NZ Tier 3 Standard; and • the *IFRS for SMEs* Accounting Standard/INPAG requirements	Using the New Zealand Tier 3 Standard as based with edits to include the *IFRS for SMEs* Accounting Standard requirements: • to only permit opting up when the Tier 3 Standard does not specifically address a transaction (disregarding implicit application of Tier 1 or Tier 2 requirements when they are reflected in Tier 3 reporting requirements); and • relating to the absence of Tier 3 requirements specifically applying to a transaction, other event or condition, which an entity's management applies judgement in developing an applying an appropriate accounting policy; and • maintenance and updating of Tier 3 requirements.

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		(Australian Accounting Standards – Simplified Disclosures); *Refer to September 2023 Board meeting minutes* • maintenance cycle – no more than once every AASB agenda consultation cycle (5 years). *Refer to paragraphs 4.24 – 4.27 of the DP.*		
Property, Plant and equipment	4.12	Consistent with Tier 2 requirements except for language *Refer to paragraphs 5.115 – 5.119 and 5.135 – 5.144 in the DP.*	The *IFRS for SMEs* Accounting Standard requirements	Using the *IFRS for SMEs* Accounting Standard requirements as the starting point given its recognition and measurement requirements are the same as Tier 2 requirements.
Fair Value Measurement				
Borrowing Cost		Consistent with the *IFRS for SMEs* Accounting Standard requirements for borrowing cost to be expensed immediately in the period incurred. *Refer to paragraphs 5.154 – 5.156 in the DP.*		Using the *IFRS for SMEs* Accounting Standard requirements as the starting point given its recognition and measurement requirements are the same as the DP proposal.
Revenue	4.13	Require entities to access whether a transaction is based on a common understanding, evidenced by the transfer provider in writing or some other form, that the entity is expected to use the inflows of resources or to act or perform in a particular way that results in outflows of resources, including: • transferring goods or services; • performing a specified activity; • incurring eligible expenditure for a specified purpose; and	New Zealand Tier 3 Standard	Using New Zealand Tier 3 Standard as the starting point given the recognition and measurement proposals are generally consistent with the New Zealand Tier 3 Standard, with the working draft text of INPAG ED being considered to the extent it is consistent with the DP proposals.

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		• using the inflows of resources in respect of a specified period. Income is recognised in the manner that most faithfully represents the amount and pattern of consumption by the entity of the resources received. All other income transactions are recognised at the earlier of receiving cash or obtaining a right to receive cash (receivables). *Refer to paragraphs 5.179 – 5.188 in the DP*		
Consolidation and separate financial statements	4.14	• Allow a free choice for parent entities not to present consolidated financial statements encompassing the entities they control. *Refer to paragraph 5.38 of the DP* • Parent entities that elect to prepare separate financial statements are required to disclose their 'notable relationships'. Notable relationships exist based on having at least significant influence over another entity by considering the factors in AASB 128 *Investments in Associates and Joint Ventures* for determining significant influence. *Refer to Action Alert of the November 2023 Board meeting*	• The *IFRS for SMEs* Accounting Standard requirements for requirements of consolidated financial statements • Disclosures of notable relationships based on AASB 1060	For requirements of consolidated financial statements, the *IFRS for SMEs* Accounting Standard requirements was used as a starting point given its recognition and measurement is fundamentally consistent with Tier 2 requirements except for: • only currently exercisable potential voting rights are considered when assessing control whereas AASB 10 paragraph B47 would consider potential voting rights even if they are not currently exercisable; • the presumption that control exists when the entity holds greater than 50% of the voting rights in an investee; • guidance on presenting combined financial statements for entities under common control; • specifying a maximum difference of 3 months between the reporting dates of parents and their subsidiaries is contained in

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				AASB 10 paragraph B93 which does not exist in the *IFRS for SMEs* Accounting Standard requirements; and • the carrying amount of the investment, when it ceases to be an investment in a subsidiary, is regarded as the cost on initial measurement of the financial assets whereas under AASB 10 paragraph 25(b) and B98, when a parent ceases to control a former subsidiary in which it retains an equity interest, the investment is measured at fair value when control is lost. For disclosures in separate financial statements, AASB 1060 given the same or similar requirements were decided by the Board for the proposed Tier 3 recognition and presentation requirements for consolidated and separate financial statements.
Investment in associates and joint ventures	4.15	Consistent with AASB 128 to allow parent entities the choice to measure their investments in associates and joint ventures either at cost or fair value, or applying the equity method. If the fair value option is chosen, changes in the fair value of these interests should be recognised in profit or loss, except that if such an interest is held for capital return and to generate income: • an entity may make an irrevocable election, upon initial recognition of a particular interest, to recognise those changes in other comprehensive income; and	The *IFRS for SMEs* Accounting Standard requirements	Using the *IFRS for SMEs* Accounting Standard requirements dealing with investments in associates and joint arrangements except; • the difference between the end of the reporting period of the associate and that of the investor to be no more than three months is contained in Tier 2 but not in the *IFRS for SMEs* Accounting Standard ; • the *IFRS for SMEs* Accounting Standard require implicit goodwill to be amortised systematically over its expected useful life

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		• any such election must be applied on a class-of-instruments basis. *Refer to Action Alert of the November 2023 Board meeting*		whereas Tier 2 specifies that implicit goodwill is not to be amortised; • If an investor loses significant influence for reasons other than a partial disposal of its investment, the investor is required to regard the carrying amount of the investment at that date as a new cost for accounting whereas the Tier 2 requirements do not have a similar requirement; and • The *IFRS for SMEs* Accounting Standard does not contain a Tier 2 requirement when an entity discontinues use of the equity method, an entity is account for all amounts previously recognised in OCI in relation to that investment on the same basis as would have been required if the investee had directly disposed of h treated assets or liabilities. The *IFRS for SMEs* Accounting Standard proposes fundamentally similar recognition and measurement requirements as the Tier 2 requirements for investments in joint arrangements except: • The accounting requirements in the *IFRS for SMEs* Accounting Standard are determined by the form of the joint venture (i.e. whether it is a jointly controlled assets/operation/entity) and permits an entity to choose on of the three different

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				models to account for investments in jointly controlled entities in its primary financial statements. Whereas the Tier 2 requirements require the accounting for joint arrangements to follow the substance of the arrangement; and • Under the equity method, implicit goodwill is systematically amortised throughout its expected useful life but Tier 2 specifies implicit goodwill not to be amortised.
Related party transactions	4.16	Consistent with Tier 2 disclosure requirements except for donations from a related party unless there is evidence that the donations could influence the entity's activities or use of resources. *Refer to Action Alert of the November 2023 Board meeting*	The *IFRS for SMEs* Accounting Standard requirements with consideration of AASB 1060	AASB 1060 disclosures are based on the *IFRS for SMEs* Accounting Standard hence the *IFRS for SMEs* Accounting Standard requirements were used as a starting point for drafting with further simplification considered by staff.
Financial Instruments	4.17	• Initial measurement of basic financial assets and liabilities measured at fair value which is consistent with Tier 2 requirements. Transaction costs and fees are expensed immediately. *Refer to paragraphs 5.83 – 5.85 of the DP* • Subsequent measurement of financial assets held to generate both income and capital return are measured at fair value through profit or loss with an option to make an irrevocable election to recognise changes in fair value through other comprehensive income, available on initial recognition of the class of financial assets.	The *IFRS for SMEs* Accounting Standard requirements	Using the *IFRS for SMEs* Accounting Standard requirements dealing with financial instruments as starting point except: • For transaction costs as the *IFRS for SMEs* Accounting Standard requirements are the same as Tier 2 which required transaction costs to be amortised over the life of the asset; • the measurement requirement for accounts receivables where transaction price would be characterised as fair value unlike *IFRS for SMEs* Accounting Requirements

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		Refer to [Action Alert](#) of the November 2023 Board meeting • Subsequent measurement of all other basic financial assets at cost less accumulated impairment losses and all basic financial instruments are subsequently measured at cost. *Refer to paragraph 5.101(a) of the DP* • The contract interest rate is applied as the discount rate for loans. *Refer to paragraphs 5.99 – 5.104 of the DP* • Any initial premium or discount on the acquisition of basic financial asset or incurrence of basic financial liability is deferred and amortised over the expected life of the financial asset or financial liability using a straight-line basis unless another systemic basis is more reflective of the period to which the premiums and discounts relate. *Refer to paragraph]h 5.101(c) of the DP* • Impairment losses for all basic financial assets measured at amortised cost determined by applying an incurred loss model. *Refer to paragraphs 5.106 – 5.108 of the DP* • Hedge accounting is prohibited. *Refer to paragraph 5.81 of the DP* • Basic financial assets are derecognised when either the contractual rights to the cash flows from the		which provides guidance on transaction price and variable consideration discussions; • the proposal to use undiscounted cash flows for current liabilities is not included in the Tier 3 ED; • the discount rate which the *IFRS for SMEs* Accounting Standard requires generally the application of the effective interest rate; • hedge accounting is permitted in the *IFRS for SMEs* Accounting Standard; • further simplification suggested by staff on derecognition criteria for financial assets; and • modifications of the terms of a financial liability or an exchange of a debt instrument for a different instrument.

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		financial assets expire or settled or the entity otherwise loses control of the asset. *Refer to paragraph 5.110 of the DP* • A basic financial liability is derecognised when the obligation is discharged, cancelled or expires. *Refer to paragraphs 5.113 – 5.114 of the DP*		