Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Private Sector Financial Reporting Framework**	**Meeting:**	M213
Topic:	**Redeliberation on certain Category B topics**	**Agenda Item:**	5.2
		Date:	17 June 2025
Contact(s):	Maggie Man mman@aasb.gov.au Jim Paul jpaul@aasb.gov.au	**Project Priority:**	High
		Decision-Making:	High
		Project Status:	Project redeliberations

Objective of this paper

1 The objective of this staff paper is for the Board to **decide** how to finalise the proposed requirements exposed in ED 335 *General Purpose Financial Statements – Not-for-Profit Private Sector Tier 3 Entities*, regarding:

(a) Section 9: Accounting Policies, Estimates and Errors;

(b) Section 11: Fair Value Measurement; and

(c) Section 18: Leases.

Structure of this paper

2 This paper is structured as follows:

(a) Summary of staff recommendations (paragraph 3);

(b) Background and reasons for bringing this paper to the Board (paragraphs 4 – 6);

(c) Staff analysis and recommendation on:

(i) SMC 15 for Section 9 (paragraphs 7 – 17);

(ii) SMC 19 for Section 11 (paragraphs 18 – 22); and

(iii) SMC 26 for Section 18 (paragraphs 25 – 29).

Summary of staff recommendations

3 Staff recommend the Board to finalise a Tier 3 Standard based on ED 335:

(a) that a full retrospective approach is required for the correction of prior period errors;

(b) that a modified retrospective approach is required for voluntary changes in accounting policies and prospective approach is required for changes in accounting estimates as exposed in Section 9;

(c) for requirements for fair value measurement as exposed in Section 11, except for removing “in general” from the beginning of the second sentence of paragraph 11.7; and

(d) for requirements for leases as exposed in Section 18, except to include an exemption in paragraph 18.2 from separating costs of services such as insurance and maintenance from lease payments where separating them is impracticable.

Background and reasons for bringing this paper to the Board

4 The Board decided at its May 2025 meeting to proceed with developing a Tier 3 Accounting Standard with simplified recognition, measurement, presentation and disclosure requirements for smaller not-for-profit (NFP) private sector entities, and commence redeliberations of the proposals in ED 335.[1]

5 At its May 2025 meeting, the Board considered the summarised feedback on ED 335 and the staff categorisation of the extent of the Board's redeliberation efforts in Agenda Paper 4.2. This paper presents the staff analysis and recommendations for several Category B topics identified in that Agenda Paper. The Category B topics are proposals on which mixed feedback was received or stakeholders expressed substantial concerns on one or more particular aspects.

6 The primary objective of this paper is for the Board to, in respect of the topics covered, decide whether to make any substantial change to the proposals exposed in ED 335. Staff have not included any revised drafting. Staff plan to present the revised drafting collectively in November 2025, as per the project timeline outlined in Agenda Paper 5.0. This approach allows the Board to first make all decisions on matters of principle, ensuring a comprehensive view of the overall draft Standard.

Staff Analysis of Stakeholder's Feedback and Recommendations

7 Staff recommendations for modifying the text of ED 355 for the Tier 3 requirements in response to stakeholder comments analysed in the tables below are:

(a) set out in the staff analysis column of each affected table; and

(b) repeated in a staff recommendation paragraph below each affected table, for easy reference by Board members.

SMC 15 – Section 9: Accounting Policies, Estimates and Errors

8 SMC 15 sought stakeholder views of the Board's proposed Tier 3 recognition and disclosure requirements for Section 9: Accounting Policies, Estimates and Errors. At a high level, Section 9 specifies that:

(a) if the Tier 3 Standard does not specifically address a transaction, other event or condition, management applies a 'hierarchy approach' and uses its judgement to develop and apply accounting policies by considering, in descending order:

(i) the principles and other reporting requirements in the Tier 3 Standard dealing with similar and related issues; and

(ii) the definition, 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.

Management may also consider the requirements and guidance in Tier 2 dealing with similar and related issues.

(b) an entity can apply Tier 2 recognition and measurement requirements only where the topic is not directly addressed in Tier 3 reporting requirements, and the entity applies the

1 Refer to Agenda Paper 2.2 for the May 2025 Board meeting draft minutes.

hierarchy approach to develop its accounting policy. Otherwise, an entity can opt up to apply Tier 1 or Tier 2 accounting requirements in their entirety;

(c) voluntary changes in accounting policies and corrections of prior period errors are treated largely consistently with Tier 2 requirements, except that entities apply a modified retrospective approach whereby adjustments are made to the opening balances of the current reporting period for the cumulative effect of the change, and comparative information is not amended. To align with the modified retrospective approach, the Tier 3 Standard require disclosure of the description of the error, how it was corrected and the amounts of adjustments or corrections to the opening balances of assets, liabilities and items of equity for the current period; and

(d) accounting estimates are treated consistently with Tier 2 requirements.

9 The Board decided its proposals in the ED per para. BC25 – BC31 and BC57 – BC63, as summarised below:

(a) for the hierarchy approach in paragraph 8(a) with the aim of developing a stand-alone Standard. In line with this view, the Board considered a stand-alone standard should limit the need for an entity to apply Tier 2 requirements. Therefore, the Board proposed to allow an entity to develop an accounting policy by first referring to the principles and requirements in the Tier 3 Standard dealing with a similar or related issue, rather than its preliminary view posed in the Discussion Paper which required entities to first apply the classification, recognition, measurement and disclosure requirements specified by Tier 2 requirements;

(b) to ensure consistency and comparability for entities applying the Tier 3 Standard, an entity would apply Tier 1 or Tier 2 requirements only as specified in paragraph 8(b), rather than allowing a free choice to do so, which may have led to issues similar to those arising under the special purpose financial statement regime;

(c) to require a modified retrospective application for voluntary changes in accounting policies, as the Board considered this approach would strike an appropriate cost-benefit balance for Tier 3 entities and is compatible with AASB 108, which caters for a modified retrospective approach in transitional provisions of various new and amended Standards. A similar approach was proposed for the correction for prior period errors because, among other reasons listed in para. BC60, it would ensure that the cumulative effects of prior period errors do not distort income and expenses for the current period. The Board also noted that a similar approach was adopted in the New Zealand Tier 3 Standard, and no adverse feedback was received during that Standard's post-implementation review regarding the application of a modified retrospective approach to the correction of prior period errors.

10 As per Agenda Paper 4.3 at the May 2025 Board meeting, of the 18 comment letters that responded directly to ED 335 and the total participants who attended a virtual/in-person outreach session, 10 and 23 respondents, respectively, provided a response to SMC 15. Table 1 provides an overview of the responses received on SMC 15.

Table 1 SMC 15 responses

	Agreed	**Agreed with exception**	**Disagreed**	**Unsure**
Out of 10 comment letters that commented on SMC 15	1 (10%)	9 (90%)	-	-
Out of 23 participants who attended a virtual/in-person outreach session and commented on SMC 15	14 (61%)	-	4 (17%)	5 (22%)

Staff analysis of stakeholders' comments on Section 9

11 As per Table 1, many stakeholders, primarily preparers, agreed with the Board's proposals presented in Section 9, including applying a modified retrospective approach, noting that some errors might affect multiple line items, and that updating comparative period information can be costly. Some stakeholders also commented that users generally value the accuracy of current period amounts more than comparative period information and one stakeholder (regulator) considered the proposed disclosures will maintain public trust in the charity sector while reducing 'red tape'. Notwithstanding their support for the majority of the proposals in Section 9, many other stakeholders, mainly auditors and advisors (including participants in virtual/in-person outreach sessions that disagreed or were unsure) from written submissions mainly expressed concerns with the Board's proposals to neither require nor permit corrections of prior period errors to be reflected in comparative information presented for prior periods. Table 4 provides the comments from stakeholders that agreed with exception, or disagreed, and the Board's rationale for the proposed requirements and staff analysis and recommendation of their concerns:

Table 2 SMC 15: Stakeholder comments from those who agreed with exception or disagreed and staff analysis

Comments from those who agreed with exceptions or disagreed	Staff analysis and recommendation
Comments relating to the proposed hierarchy approach in developing an accounting policy when the Tier 3 Standard does not specifically address a transaction, other event or condition.	
A stakeholder noted that entities typically apply the hierarchy approach to develop accounting policies only in occasional exceptions where Tier 3 reporting requirements do not provide specific guidance, and these cases usually involve more complex transactions. As such, the stakeholder argued that the hierarchy approach should require entities to first refer to Tier 1 or Tier 2 requirements, rather than first considering the principles and related requirements within the Tier 3 Standard. They expressed concern that allowing entities to look to Tier 3 guidance first could lead to inconsistencies in developing their accounting policies, and that auditors and advisors would likely default to the existing Tier 1 and Tier 2 requirements regardless.	As noted in para. BC25 – BC28 of ED 335, the Board previously considered similar feedback on its Discussion Paper proposals where the Board's preliminary view was to require an entity to first apply the classification, recognition, measurement and disclosure requirements specified by the Tier 2 requirements when develop an appropriate accounting policy when the Tier 3 Standard does not provide guidance. However, some stakeholders expressed concerns about directing entities to apply Tier 2 requirements because they considered a stand-alone Standard should avoid the need for an entity to apply Tier 2 requirements. In response to the feedback, the Board decided to propose in the ED that entities can apply judgment in developing an accounting policy by first referring to the Tier 3 reporting requirements for similar and related issues when an issue is not specifically addressed in the Tier 3 Standard. The Board also proposed that an entity may consider Tier 2 requirements and guidance in developing their accounting policy. As such, staff think that the stakeholder concerns raised do not provide evidence (for example, evidence of pervasiveness in practice or a new argument against) that should cause the Board to revise its exposed proposal. Furthermore, all other stakeholders supported the Board's proposals. Accordingly, **staff recommend** no changes to the requirement that, when the Tier 3 Standard does not specifically address a transaction, other event or condition, entities should first refer to the principles and other reporting requirements within the Tier 3 Standard dealing with similar and related issues when developing an accounting policy.

<table>
<tr><th>Comments from those who agreed with exceptions or disagreed</th><th>Staff analysis and recommendation</th></tr>
<tr><td colspan="2">Comments relating to the modified retrospective application of corrections of prior period errors</td></tr>
<tr><td>Many stakeholders, consisting of professional services firms and professional service bodies, disagreed with the proposal to require application of a modified retrospective approach to correct a material prior period error, i.e. without restating comparative information. Staff consider their concerns can be categorised into the following three themes:

<u>Information not useful to users</u>
• Not correcting comparative information for material prior period errors would contradict the objective of the proposed Standard (i.e. para 1.1 states that the objective is to require the reporting of useful, consistent and transparent information”. The Conceptual Framework also gives emphasis to stewardship/accountability, which would mean that restating prior period information provides users with information regarding stewardship and management requiring a fully retrospective approach to correcting prior period errors.
• The proposed disclosures alone arguably would (including as argued by one stakeholder that considered an auditor’s emphasis of matter would be necessary) be insufficient to meet users’ needs.

<u>Risk and/or potential impact on auditors</u>
• The proposal could pose ethical challenges for auditors signing financial statements, where they may have concerns that prior period information has been intentionally misstated.
• Auditors from external meetings or who attended virtual/in-person outreach considered that some prior period errors may be identified upon taking over an assurance engagement. They also considered that an emphasis of matter may be required if comparative information is not adjusted for known errors.

<u>Benefit outweighs cost</u>
• There is little cost or simplification benefit of a modified retrospective approach compared to correcting the comparative information as well as the opening balances for the current period, given the cumulative catch-up adjustment to correct the error is required to be quantified and corrected as an opening adjustment and disclosure of the nature of the error is required;</td><td>As per paras. BC59 – B60 of ED 335, staff note that the Board has previously heard similar feedback on two of the themes (i.e. information not useful to users and risk and/or potential impact on auditors), when developing its proposals in the Exposure Draft. However, the Board considered, amongst other reasons, that its proposals would still require an identified prior period error to be corrected and the nature of the error to be disclosed, which would address the concern of possible risk of management manipulating financial reporting and heightening the auditor’s responsibility relating to fraud in an audit of a financial report. The Board also considered that if the applicable financial reporting framework allows comparative information not to be restated for correction of prior period errors, an auditor would provide assurance against the applicable framework, including assuring that comparative information is not restated.

Staff note similar audit concerns were raised following the removal of special purpose financial statements (SPFS) through AASB 2020-2, which permitted entities transitioning early to Tier 2 requirements not to restate comparative information. This approach is discussed in the <u>AUASB Bulletin</u>, which outlines the auditors’ responsibilities regarding comparative information in the year of transition. Noting those concerns that the information may mislead users and therefore not be useful to users, the Board proposed additional disclosures in ED 335 to signal to users that adjustments to the opening balances for the current period are not reflected in the comparative information presented in prior periods.

Regarding whether the benefits outweigh the cost, staff note that the Board’s proposal was developed with consideration of the fact that the benefits of restating comparative information presented for prior periods might not exceed the related costs, since these adjustments are generally one-off in nature. This aligns with some stakeholders’ views in para. 11 that users of Tier 3 entity financial statements might not regard such restatements as crucial. However, comments received from stakeholders may indicate that there is little cost saving from not correcting the prior period information since an entity would still need to determine the cumulative catch-up adjustments needed in the current period opening balances, and disclosures of the nature and the quantification of the correction to the opening balances of asset/liabilities/equity. Because of the benefit of full retrospective correction of prior period errors providing better information to users (e.g. to identify trends over time), preparers are inclined to correct prior period comparative information in practice. Therefore, staff think there is sufficient new evidence to indicate that the Board should consider alternative approaches to its proposal in ED 335 in relating to the correction of errors, to address the</td></tr>
</table>

Comments from those who agreed with exceptions or disagreed	Staff analysis and recommendation
• The benefits of comparability and better information to users arguably outweigh the cost of correcting the comparative period information, depending on whether the nature of the error and the comparative adjustment are straightforward. Despite the costs associated with correcting comparative period information, some stakeholders were generally inclined to correct that information. Furthermore, at virtual/in-person outreach, some stakeholders noted that fully retrospective corrections of prior period errors usually affect only a small number of line items.	stakeholder feedback. Staff have presented two alternative options in paragraphs 12—14.
A stakeholder noted that the proposed disclosures of a change in accounting policy does not include additional disclosures for when the relief under para. 9.12 is utilised (i.e. when it is impracticable to determine the cumulative effect of the new policy) and suggested additional disclosures be included such as the reason(s) why it is impractical for the entity to determine the cumulative effect and how (i.e. what assessment) the entity has undertaken for the determination. They also provided some editorial suggestions.	Staff note that, in developing its proposals to the Exposure Draft, the Board had previously decided not to require entities to disclose an explanation when it is impracticable to determine the amounts of adjustments to the opening balances for the current period.[2] This decision was made to further simplify requirements in a way that is proportionate, particularly since users of Tier 3 entities' financial statements may generally lack the expertise to assess the validity of such explanations. Since only one stakeholder suggested this additional disclosure, **staff recommend** not making changes to provide further disclosures in response to the stakeholder comment (i.e. why it is impractical for the entity to determine the cumulative effect and how the entity has undertaken for the determination).

Alternative approach to the correction of comparative period information for prior period errors

12 Based on stakeholder feedback on the Exposure Draft, staff identified two alternative options for correcting comparative period information for prior period accounting errors, which are evaluated in paragraphs 13 – 14.

(a) **Option 1**: Align with Tier 2 requirements – this approach requires the retrospective approach to correction of prior period errors except to the extent it is impracticable to determine the periods-specific effects or the cumulative effect of the error. The disclosure requirements will be based on AASB 1060, which requires an entity to disclose the nature of the error and, to the extent practicable, the amount of correction for each financial line item affected and the amount of correction at the beginning of the earliest prior period presented. Otherwise, an explanation why it is impracticable to determine the amounts is to be disclosed; and

(b) **Option 2:** Permit but not require the correction of comparative information for prior period errors.

2 Refer to Agenda Paper 3.3 at the September 2024 Board meeting,

13 **Option 1** – align with Tier 2 requirements for the correction of prior period accounting errors.

Staff note that the Board previously considered this approach in Agenda Paper 5.3 at the November 2023 Board meeting when developing its proposals for ED 335. During previous targeted outreach, members of the NFP Project Advisory Panel, consisting of the representatives of professional services firms and professional service bodies that provided a written submission on the Exposure Draft, supported aligning with Tier 2 requirements by requiring a full retrospective approach, as it provides users with more faithful information about prior period events. Additionally, as presented in Table 4 above, some professional services firms consider that providing the proposed compensating disclosures may not be straightforward and that it could be more efficient for preparers to correct the error (including updating comparative information). This approach would also promote consistency across all tiers, including amongst Tier 3 entities. However, as noted in paragraph 11, many preparers consider that some errors can be complex to correct and that the cost of correcting prior-period errors through full retrospective application may outweigh the benefit for users who place greater value on the accuracy of current-period information. Additionally, the Board may need to consider whether changes to its proposal to require a full retrospective approach to error correction would require the Board to expose the changes to its proposals.

14 **Option 2** – permit but not require the correction of comparative information for prior period errors

The Board has not previously considered this option. A few stakeholders suggested Option 2 as an alternative, proposing that entities be permitted to correct prior period comparative information. This approach recognises that some stakeholders consider the benefits of full retrospective application to correct prior period errors would outweigh the costs, and that the uncorrected comparative information is less useful to their users. It would also allow preparers to continue their current practice of correcting prior period comparative information. At the same time, it acknowledges concerns, mainly from preparers, that correcting comparative period information can be costly, especially for complex errors that affect multiple line items, as noted in paragraph 11. However, the choice in Option 2 may reduce consistency between Tier 3 entities, and some stakeholders have expressed concern that the Tier 3 Standard already provides too many options, which can increase the need for judgement and add to overall complexity of the requirements. Similarly to Option 1, the Board may need to consider whether changes to its proposal to require instead an optional full retrospective approach to correction of errors would require the Board to expose the changes to its proposals.

Staff recommendations

15 Staff **recommend** Option 1, that is, that the Board finalises the Tier 3 requirements to require a full retrospective approach to correction of prior period errors. This staff recommendation is based on the consideration that the proposal to apply a modified retrospective application to correct prior period errors received the most adverse stakeholder feedback, with many expressing concerns that it offers little cost savings for preparers. This is because the proposed disclosures still require errors to be quantified, corrected as an opening cumulative catch-up adjustment, and the nature of the error to be disclosed.

16 As per the analysis in paragraph 11, staff also **recommend** that the Board finalises the Tier 3 requirements as exposed in Section 9 of ED 335, to apply a modified retrospective approach for voluntary changes in accounting policies and, consistent with the Tier 2 requirements, a prospective approach for changes in accounting estimates. This recommendation is based on almost all stakeholders supporting the Board's proposals in ED 335.

17 Staff reviewed the third edition of the IFRS for SMEs Accounting Standard (issued in February 2025) and determined that it contains no substantive changes from the Exposure Draft on which

Section 9 of ED 335 was based that would warrant further consideration by the Board in finalising the Tier 3 Standard. However, in the course of reviewing Section 9, staff identified some editorial changes of clarification in nature. As such, subject to the Board agreeing with the staff recommendations in, (1) paragraph 15 to require a full retrospective approach to the correction of prior period errors; and (2) paragraph 16 to apply a modified retrospective approach for voluntary changes in accounting policies and changes in accounting estimates in finalising a Tier 3 Standard, staff will draft these and other editorial changes for the Board to consider at a future meeting (expected November 2025).

Question 1 for Board members

Do Board members agree with the staff recommendations in paragraphs 15 and 16 that the Board finalises the Tier 3 requirements to require:

(a) a full retrospective approach for the correction of prior period errors?

If not, what do Board members suggest?

(b) a modified retrospective approach for voluntary changes in accounting policies and a prospective approach for changes in accounting estimates, as exposed in Section 9 of ED 335?

If not, what do Board members suggest?

SMC 19 – Section 11: Fair Value Measurement

18 SMC 19 sought stakeholder views of the Board's proposal that its Tier 3 requirements for Section 11: *Fair Value Measurement*, including the definition of fair value, should be consistent with Tier 2 reporting requirements. However, the Board decided to simplify the requirements not to include a fair value hierarchy and provide a practical expedient for identifying when a higher and better use of a non-financial asset than its current use would exist, and simpler disclosures.

19 The decision to keep the requirements for fair value measurement largely consistent with Tier 2 requirements is to avoid cost of misinterpretation and retraining that would potentially be incurred if another source of guidance on fair value measurement were specified for Tier 3 entities. In addition, the Board noted that the proposed Tier 3 reporting requirements would not require application of a revaluation model to non-financial assets. To achieve the simplification objectives of the Tier 3 Standard, the Board proposed in ED 335:

(a) guidance in paragraph 11.7 clarifying (and limiting) the circumstances in which the presumption that an asset's current use is its highest and best use may be rebutted; and

(b) to exclude the fair value hierarchy because the guidance would only be necessary if disclosure were required of the levels of the fair value hierarchy at which the fair values of assets are measured. Since AASB 1060 does not include any such disclosures, the Board did not propose any disclosures for the Tier 3 Standard. The Board also noted that applying the fair value hierarchy might involve significant judgements and be costly for Tier 3 entities to apply, without significant apparent benefits to users of financial statements of those entities.

20 As noted in Agenda Paper 4.3 for the May 2025 Board meeting, staff did not ask this question at the outreach session. As such, the feedback was obtained only from written submissions. Of the 18 comment letters that responded directly to ED 335, 8 respondents provided a response to SMC 19. Table 3 provides an overview of the responses received on SMC 19.

Table 3 SMC 19 responses

	Agree	Agree with exception	Disagree	Unsure
Out of 8 comment letters that commented on SMC 19	5 (63%)	3 (37%)	-	-

Staff analysis of stakeholders' comments on Section 19

21 As per Table 3, all stakeholders agreed, or agreed with exceptions, with the Board's proposals for the requirements in Section 11. Those stakeholders that agreed with the Board's proposal as drafted agreed with aligning the definition of fair value with Tier 2 reporting requirements because they consider fair value measurement is a fundamental concept. They considered diverging from a known fair value concept would make financial statements harder to understand and confuse users. Some written submitters agreed, but with the limited exceptions noted in Table 4 below (which includes staff analysis and recommendation).

Table 4 SMC 19: Stakeholder comments from those that agreed with exception and staff analysis

Comments from those that agreed with exceptions	Staff analysis and recommendation
A few stakeholders suggested additional simplification as follows: • Two professional service bodies suggested removing para. 11.4 referencing prohibition of adjusting the market price for transaction costs, as these stakeholders did not believe transaction costs would be likely to significantly impact the market price for fair value measurement purposes for Tier 3 entities; • The same professional service bodies suggested removing para. 11.5 relating to transport costs unless further guidance is included on the circumstances in which transport costs may be relevant; • The same professional service bodies suggested to provide further guidance on applying the 'cost approach' in para. 11.9(b) and 11.10 and the concept of economic obsolescence for non-financial assets held by Tier 3 entities, using simplified guidance based on the Australian implementation guidance for NFP public sector entities in para. F8-F15 and F16-F19,	• In regard to the first dot point, staff note that para. 11.4 is consistent with Tier 1 and Tier 2 requirements and the IFRS for SMEs, which specifies that transaction costs are specific to a transaction and therefore not considered a characteristic of the fair value of an asset or a liability itself. Transaction costs are amounts paid to third parties for services such as legal fees, commissions, and brokerage fees. Staff note that transaction costs are pervasive to market exchanges for many assets and liabilities, regardless of the entity's reporting tier, and often are material. Staff think continuing to exclude transaction cost ensures consistency with Tier 1 and Tier 2 requirements, which most other stakeholders agree is a fundamental concept, and diverging from the fair value concept would make financial statements harder for users to understand. Additionally, including transaction costs could reduce comparability between entities and transactions. For example, different entities may incur different transaction costs for the same asset, leading to inconsistent valuations and less comparable financial statements. Transaction costs should be recognised as expenses when incurred, rather than being included in the measurement of the asset or liability. This view is consistent with the approach the Board took, as per para. 10.5, to expense all transaction costs incurred for the initial measurement of a financial asset or financial liability. For the reasons noted above, and given that all other stakeholders supported the Board's proposals, **staff recommend** not removing para. 11.4 referencing prohibition of adjusting the market price for transaction costs. • Regarding the second dot point, similar to the arguments above, staff consider removing transport costs from being adjusted for the asset's market price, where location is a characteristic of the asset, would be inconsistent with Tier 1 and Tier 2 requirements. As noted in BC62 of IFRS 13, transport costs are different from transaction costs, and are costs that would be incurred to transport the asset from its current location to its principal (or most advantageous) market. Unlike transaction costs, which arise from a transaction and do not change the characteristics of the asset or liability, transport costs arise from an event (transport) that does change a characteristic of an asset (its location). IFRS 13 states that if location is a characteristic of an asset,

Comments from those that agreed with exceptions	Staff analysis and recommendation
respectively, of Appendix F to AASB 13 *Fair Value Measurement*; and • One stakeholder suggested the Board clarifies the rationale for including a one-year period for the 'highest and best use' exception from current use in para. 11.7 (referred to in para. 19(a) above).	the price in the principal (or most advantageous) market should be adjusted for the costs that would be incurred to transport the asset from its current location to that market. That is consistent with the fair value measurement guidance already in IFRSs. For example, IAS 41 requires an entity to deduct transport costs when measuring the fair value of a biological asset or agricultural produce. Staff note the Board's approach not to simplify or develop additional guidance on identifying the control concept in AASB 10 *Consolidated Financial Statements,* as per BC46 of ED 335, because it might have unintended implications for Tier 2 NFP entities applying AASB 10. Additionally, Tier 3 entities have an accounting policy choice to prepare consolidated financial statements or separate financial statements. Staff consider that essentially the same argument would apply to not deviating from guidance supporting the definition of fair value in AASB 13 since the Board proposed in many instances for an accounting policy choice to measure non-financial assets. Accordingly, **staff recommend** not to remove para. 11.5 relating to transport costs. Staff will consider developing some education guidance on the circumstances in which transport costs may be relevant to address the stakeholder feedback. • Regarding the third dot point, while additional guidance could assist preparers on how to apply the cost approach, staff are mindful that including such guidance would lengthen the Standard. Simplifying the language to suit Tier 3 requirements also risks unintentionally altering the substance of the guidance. Additionally, as per BC 17 of ED 335, the Board acknowledged that a stand-alone Tier 3 Standard cannot address the whole breadth of transactions, other events and conditions addressed by Tier 1 and Tier 2 Australian Accounting Standards. Staff note that the Board's hierarchy approach would already enable management to consider the requirements and guidance in Tier 2 dealing with similar and related issues (refer to paragraph 8(a)). As such, staff consider that entities could refer to implementation guidance in Australian Accounting Standards where there is no significant recognition and measurement difference between Tier 2 and Tier 3 requirements (e.g. NFP implementation guidance in AASB 10 *Consolidated Financial Statement,* AASB 11 *Joint Arrangements*, AASB 13) if entities consider that guidance useful when applying the Tier 3 Standard. Since most other stakeholders did not request this additional guidance, staff **recommend** not developing guidance based on the Australian implementation guidance in AASB 13. • Regarding the final dot point, staff noted that the Board had considered including in its proposal the practical expedient in AASB 13 made available to public sector NFP entities via AASB 2022-10 *Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* (specifically, paras. Aus29.1 and Aus29.2) as being appropriate and useful for Tier 3 entities. As explained in BC41 of AASB 13, these relate to an asset's highest and best use and are designed to reduce the cost and effort of a NFP public sector entity resulting from unnecessarily searching for possible alternative uses of an asset not held primarily for its ability to generate net cash flows. In light of a stakeholder's request for greater clarity, **staff recommend** stating in the Basis for Conclusions the rationale for the one-year

Comments from those that agreed with exceptions	Staff analysis and recommendation
	period applied to the 'highest and best use' exception, drawing on the reasoning provided in AASB 2022-10.
A stakeholder suggested whether additional guidance can be provided on determining fair value for heritage assets (including artwork).	Staff consider the guidance is not only relevant to Tier 3 entities but also for Tier 2 and Tier 1 entities. In addition, staff consider that heritage assets would generally be uncommon for Tier 3 NFP entities, and it is doubtful that adding guidance on measuring their fair value would be proportionate for a simplified Tier 3 Standard. As such, **staff recommend** not to develop guidance specifically for Tier 3 entities, but to consider whether NFP specific guidance should be developed as part of its next agenda consultation.
A stakeholder disagreed with the provisions in relation to the current use under para. 11.7, that is, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that it is highly probable a different use by market participants would maximise the value of the asset. This requirement would require an entity to consider market participants, contrary to recent changes to AASB 13 for the public sector that current use should be the default.	Para. 11.7 of ED 335 states: "An entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that it is highly probable that a different use by market participants would maximise the value of the asset. In general, this exception would occur only when it is highly probable that, within one year of the asset's measurement date, the asset will either be sold to a buyer who would use the asset for a different use or be redeployed by the entity." Para. 11.7 is a modified version of para. 29 of AASB 13. As stated in Agenda Paper 10.2.1 for the Board's June 2023 meeting (Meeting 196), pages 42 – 43, para. 11.7 is a condensed version of the practical expedient provided in para. Aus29.1 – Aus29.2 of AASB 2022-10 (now AASB 13) for public sector NFP entities. A subtle difference between para. Aus29.1 – Aus29.2 of AASB 13 and para. 11.7 of ED 335 is that para. Aus29.1 – Aus29.2 effectively replace para. 29 of AASB 13 for public sector NFP entities, which refers to considering the use to which market participants would put the asset, whereas the second sentence of para. 11.7 (quoted above) uses "in general" in relation to the practical expedient (i.e. not entirely eliminating the need to consider market participants' intentions). The intention in para. 11.7 was to retain the general principle that fair value reflects the assessments of market participants. However, in view of the stakeholder's concern, which relates to the limited expertise of Tier 3 NFP preparers in identifying market participants' assumptions, **staff recommend**: • retaining the reference to market participants in the first sentence of para. 11.7; but • removing "in general" from the beginning of the second sentence of para. 11.7, so that, after applying the practical expedient in that sentence, there is no uncertainty about whether market participants' assumptions still need to be estimated.

22 Staff have reviewed the third edition of the IFRS for SMEs Accounting Standard in comparison with the IFRS for SMEs ED on which Section 11 of ED 335 was based. The review identified the changes made were editorial in nature, focusing on improvements in expression rather than substantive amendments to the requirements.[3] Staff will assess these editorial refinements and incorporate them into the final drafting where they enhance clarity or simplify the language, without altering the intended meaning of the requirements.

3 For example, the IFRS for SMEs ED proposed in paragraph 12.8 that: "The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs…". In the final IFRS for SMEs Accounting Standard, paragraph 12.8 was expressed as: "An entity shall ignore transaction costs when using the price in the principal (or most advantageous) market to measure the fair value of the asset or liability…".

23 As per staff analysis in paragraphs 21 and 22, staff **recommend** that the Board finalises the Tier 3 requirements for fair value measurement as exposed in Section 11 of ED 335, except for removing "in general" from the beginning of the second sentence of paragraph 11.7.

24 Staff have also identified further editorial changes of clarification in nature and will bring them and other changes identified in Table 4 for the Board to consider at a future meeting (expected November 2025).

Question 2 for Board members

Do Board members agree with the staff recommendation in paragraph 23, to finalise the Tier 3 requirements for fair value measurement as exposed in Section 11 of ED 335, except for removing "in general" from the beginning of the second sentence of para. 11.7?

If not, what do Board members suggest?

SMC 26 – Section 18: Leases

25 SMC 26 sought stakeholder views on the Board's proposal on its Tier 3 recognition, measurement and disclosure requirement for Section 18: *Leases*. At a high level, under Section 18 a lessee (lessor) recognises the lease payments (income) associated with the lease arrangement (including concessionary leases) as an expense (income) on a straight-line basis over the term of the agreement unless another systematic basis is more representative of the time pattern of the consumption by the entity of the asset's benefit. There is no requirement for accounting for sale and leaseback arrangements.

26 The Board's decisions regarding the proposed requirements in Section 18 were based on the consideration that applying AASB 16 *Leases* to account for leases would likely impose proportionately greater costs on Tier 3 entities. While the proposed approach provides less information to users about the entity's underlying financial position, the Board considered that the disclosures of an entity's lease commitments could provide users of these financial statements with sufficient, understandable, and hence useful, information. Additionally, to further simplify the requirement, the Board decided not to include guidance on sale-and-leaseback arrangements, as stakeholders did not indicate these arrangements are common for Tier 3 NFP entities.

27 As per Agenda Paper 4.3 at the May 2025 Board meeting, of the 18 comment letters that responded directly to ED 335 and the total participants who attended a virtual/in-person outreach session, 10 and 18 respondents, respectively, provided a response on SMC 26. Table 5 provides an overview of the responses received on SMC 26.

Table 5 SMC 26 responses

	Agreed	Agreed with exception	Disagreed	Unsure
Out of 10 comment letters that commented on SMC 26	5 (50%)	5 (50%)	-	-
Out of 18 participants who attended a virtual/in-person outreach session that commented on SMC 26	15 (83%)	-	1 (6%)	2 (11%)

<u>Staff analysis of stakeholders' comments on Section 18</u>

28 As per Table 5, almost all stakeholders generally agreed with the Board's proposals for the requirements in Section 18. Notwithstanding the support for the proposals, some written submitters and those who attended a virtual/in-person outreach and disagreed or were unsure,

and either suggested further simplifications or expressed the limited concerns presented in Table 6 below (which includes staff analysis and recommendation).

Table 6 SMC 26: Stakeholder comments from those that agreed with exception, or disagreed, and staff analysis

Comments from those who agreed with exceptions or disagreed	Staff analysis and recommendation
Many stakeholders (including the stakeholders that disagreed or were unsure at the virtual/in-person outreach) suggested further simplification for lease accounting by matching the recognition of lease incentives/discounts with the timing of lease cash payments, supported by disclosures about lease rent-free periods/discounts to supplement the suggested further simplification. Another stakeholder noted that the requirement to include initial direct costs for the acquisition of leases in the lease expenses recognised over the lease term contrasts with the treatment for financing obtained. They considered the requirement may not be proportionate because such costs typically are not material to the entity, and requiring a straight-line method would increase the cost of assurance due to the ongoing requirement to demonstrate that the income statement is not materially misstated due to cumulative error. As such, these stakeholders considered allowing entities to record lease payments based on the timing and amount of actual cash payments and allowing or requiring initial direct costs of the lessee to be recognised as an expense as incurred would further simplify the proposed requirements, which require lease income/expenses to be recognised on a straight-line basis over the lease term.	Staff note that the Board proposed in the ED the same proposals as those in its Discussion Paper, that is, to require lease payments (income) to be recognised on a straight-line basis over the lease term, which is the accounting requirement for operating leases adopted in several other jurisdictions.[4] Staff also note that when the Board was considering the measurement criteria in developing the Discussion Paper proposal, it had regard to an alternative approach of measuring lease expense/income at the amount of the periodic payment made to the lessor. The Board recognised that this approach is simpler to apply (e.g. it results in no lease assets or liabilities being recognised), would reduce the cost of preparing financial statements and arguably would provide users with relevant information, such as benefits of a rental holiday or other lease incentive reflected in the period in which the benefit is provided. However, the Board ultimately rejected the alternative approach because the timing of lease payments may not necessarily represent the time pattern of the lessee's consumption of the value of the leased asset. While some stakeholders preferred aligning the recognition of lease incentives or discounts with the timing of lease cash payments –complemented by disclosures about rent-free periods or discounts to further simplify reporting – staff note that other stakeholders supported the Board's approach as an appropriate balance between simplification and adherence to accrual accounting principles. This is particularly relevant given the Board has not proposed a cash basis for other topics, such as general expenses. Therefore, **staff recommend** no changes to the requirement that lease income and expenses, including lease incentives and direct costs to the lessee, be recognised on a straight-line basis over the lease term.
One stakeholder noted that where leases contain an annual increase similar to expected inflation, straight-line calculations may not account for those amounts either	The Board previously received feedback on its Discussion Paper proposal regarding how lessees would apply the 'straight-line basis' to recognise lease payments as an expense in the context of

4 As per Agenda Paper 7.3 at the November 2021 Board meeting, IFRS for SMEs Accounting Standard, UK FRS 102, UK FRS 105 , UK Charities SORP, Singapore CAS, HK SME-FRF & SME-FRS do not require the lessee in an operating lease to recognise a lease asset and lease liability. The lessee recognises its lease payments as an expense over the lease term on a straight-line basis, unless another systematic basis is more representative of the pattern of the lessee's benefit. Any incentives are similarly recognised over the lease term. Initial direct costs are treated in the same manner as under AASB 16, that is, those costs are added to the carrying amount of the underlying asset and recognised as an expense over the lease term on the same basis as the lease income.

Comments from those who agreed with exceptions or disagreed	Staff analysis and recommendation
because they are immaterial or preparers are not aware of the requirements. Another stakeholder noted concerns with requiring a fixed increase in minimum lease payments but not including a CPI increase, despite increases operating for similar economic reasons. They may also be concerned as to how fixed increases are dealt with when there are market reviews.	fixed vs variable rents and rents with periodic increases based on an inflation index or otherwise.[5] At the time of drafting the requirements for the ED, staff noted that para. 20.15 of the IFRS for SMEs Accounting Standard requires lease payments under operating leases to be recognised as an expense over the lease term on a straight-line basis unless: a) another systemic basis is representative of the time pattern of the user's benefit even if the payments are not on that basis; or b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then the condition (b) is not met. The IFRS for SMEs Accounting Standard also includes an example of applying subparagraph 20.15(b). Staff observed that the example involving rent escalation clauses in leases assumes published information is available regarding a consensus view of what future rent increases tied to a consumer price index would be. Staff consider testing this assumption is likely to be complex for Tier 3 NFP entities, as it presumes they can easily access such data. Staff maintain their view that the Tier 3 requirements should not include detailed guidance on leases with rent increases tied to inflation or similar indices. This position aligns with the Board's broader approach for measuring provisions and employee benefits (as discussed in Agenda Paper 5.5), which excludes expected future expenditure like pay rises when calculating the present obligations on an undiscounted basis. As no new evidence or arguments have been presented regarding the prevalence of this issue in practice, **staff recommend** no changes to the Board's exposed position to address the scenarios in the left-hand column.
A stakeholder noted a lack of guidance on the method of separating the cost of insurance and maintenance as part of the lease from the underlying lease payments (as required by para. 18.2 of ED 335 for lessees) where commonly, these payments are pre-negotiated and included in a single fee. They recommended that the Board include:	The Tier 3 requirements for leases were developed based on Section 20 of IFRS for SMEs Accounting Standard for operating leases. The IFRS for SMEs Accounting Standard does not provide any guidance on the method of separating the cost of insurance and maintenance from lease payments. Staff note that AASB 16 *Leases* provides guidance on separating lease from non-lease component in para. B32-B33 which involves identifying distinct components and allocating consideration accordingly.[6]

5 Refer to Agenda Paper 4.9 at the March 2024 Board meeting

6 Para. B32 and B33 of AASB 16 state:

The right to use an underlying asset is a separate lease component if both:

(a) The lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transaction or event); and

Comments from those who agreed with exceptions or disagreed	Staff analysis and recommendation
• an exception where it is not practicable for a lease payment that is pre-determined and not subject to variability for changes in the cost of services, to permit inclusion of such services in the lease payments subject to the straight-line basis treatment; and • a specific method of measurement be described within the Standard to ensure consistency of approach for allocating/separating the costs.	The Board could consider developing similar guidance to AASB 16 on how to separate the lease component from the non-lease component to be included in the Tier 3 requirements. However, staff consider adding such guidance would make the requirements unduly complex and add length to the Tier 3 Standard. However, noting the stakeholder comment that it may be a common occurrence for lease payments to be pre-negotiated and included in a single fee, staff think it would be practical to include an exemption, as suggested by the stakeholder, for situations in which it is not feasible to separate pre-determined, non-variable lease payments for services. The exemption would permit the inclusion of such costs in the lease payments where it may be impracticable for entities to separate the cost of services from the underlying lease payments, which will further simplify the requirements. Staff also observe that another possible alternative is to develop a practical expedient that allows the lessee to choose, by class of leased asset, to either include or exclude the costs of services in lease payments. This approach is similar to that contained in AASB 16 *Leases* para. 15, which provides a practical expedient that allows lessees to choose, by class of underlying asset, not to separate non-lease components from lease components and instead account for all components as a single lease component. However, staff have not further analysed this approach because of stakeholder feedback on ED 335 indicating that accounting policy choices may increase judgment and, consequently, create additional costs for smaller entities. On balance, **staff recommend** including an exemption from separating components of costs from the underlying lease payments in paragraph 18.2– for example: "If it is impracticable to separate the cost of services such as insurance and maintenance from the underlying lease payments, the lessee is permitted to include such services in the lease payments." Staff note that para. 18.5 of ED 335 requires a lessor to record lease income (excluding amounts for services such as insurance and maintenance) in profit or loss over the lease term. Staff do not consider that an equivalent exemption is needed for lessors, since it would be expected that lessors would be able to obtain the

(b) The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying asset in the contract. For example, the fact that a lessee could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets.

A contract may include an amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee. For example, a lessor may include in the total amount payable a charge for administrative tasks, or other costs it incurs associated with the lease, that do not transfer a good or service to the lessee. Such amounts payable do not give rise to a separate component of the contract, but are considered to be part of the total consideration that is allocated to the separately identified components of the contract.

Comments from those who agreed with exceptions or disagreed	Staff analysis and recommendation
	amounts for services such as insurance and maintenance charged to them from third parties separately from the lease income.

29 Staff reviewed the third edition of the IFRS for SMEs Accounting Standard and determined that it contains no substantive changes from the Exposure Draft on which Section 18 of ED 335 was based that would warrant further consideration by the Board in finalising the Tier 3 Standard.

30 As per the analysis in paragraphs 28 and 29, staff **recommend** that the Board finalises the Tier 3 requirements for leases as exposed in Section 18 of ED 335, except to include an exemption in paragraph 18.2 from separating costs of services such as insurance and maintenance from lease payments where separating them is impracticable.

31 Staff have also identified further editorial changes of clarification in nature and will bring them for the Board to consider at a future meeting.

Question 3 for Board members

Do Board members agree with the staff recommendation in paragraph 30 to finalise the Tier 3 requirements for leases as exposed in Section 18 of ED 335, except to include an exemption in paragraph 18.2 from separating costs of services such as insurance and maintenance from lease payments where separating them is impracticable?

If not, what do Board members suggest?