Australian Government
Australian Accounting Standards Board

Cover Memo

Project:	**Not-for-Profit Private Sector Financial Reporting Framework**	**Meeting:**	M188
Topic:	**Project overview**	**Agenda Item:**	12.1
		Date:	6 May 2022
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Objective of this agenda item

1 The objective of this agenda item is, for the purposes of the Not-for-Profit Financial Reporting Framework (NFP FRF) Discussion Paper, for the Board to:

(a) **receive** a project update, including interaction with cross-cutting projects and the timeline (this Agenda Paper);

(b) **decide** its preliminary views on Tier 3 accounting requirements for:

(i) financial instruments (Agenda Papers 12.2.1.0, 12.2.1.1, 12.2.2, 12.2.3 and 12.2.4); and

(ii) the disclosure approach for topics covered in Tier 3 requirements and applying the disclosure approach to key topics included in the DP (Agenda Papers 12.3.1 and 12.3.2).

Attachments

2 Papers for this agenda item are:

(a)	Agenda paper 12.2.1	Tier 3 – Financial Instruments
(b)	Agenda paper 12.2.1.1	Supporting document: Tier 3 – Financial instruments background previously presented in May 2022 (in supplementary folder)
(c)	Agenda paper 12.2.2	Tier 3 – Financial Instruments: Measurement
(d)	Agenda paper 12.2.3	Tier 3 – Financial Instruments: Hedge accounting and Embedded derivatives
(e)	Agenda paper 12.2.4	Financial Instruments: Derecognition[1]

[1] Agenda Paper 12.2.4 will be included as part of the second mail out to the Board.

(f)	Agenda paper 12.3.1	Tier 3 – Approach to developing disclosure requirements
(g)	Agenda paper 12.3.2	Tier 3 – Application of the recommended disclosure approach to transactions covered in the Tier 3 Standard
(h)	Agenda paper 12.4	Final Minutes of the NFP Advisory Panel meeting held on 17 May 2022 (in Board-only supplementary folder)
(i)	Agenda paper 12.5	High-level summary of the population of NFP entities from ATO (in Board-only supplementary folder)
(j)	Agenda paper 12.6	Research study – Accountability via Financial Disclosures: An Exploration of the Public's Perceptions (in Board-only supplementary folder)

Background

3 At its 20 – 21 February 2021 meeting, the Board agreed to develop a further reporting Tier (Tier 3) for application by not-for-profit (NFP) private sector entities. Staff presented a number of papers, including the approach to simplification agreed by the Board at its 4 August 2021 Board meeting (Minutes of the 182nd meeting of the AASB) as presented in Appendix A – Approach to simplification agreed by the Board at its 4 August 2021 Board meeting. The Board has made a number of tentative decisions to date in developing the Tier 3 accounting requirements. These decisions are summarised in *The Not-for-Profit Private Sector Financial Reporting Framework Project Summary*.

Tier 3 Financial Instruments (Agenda Papers 12.2.1, 12.2.1.1, 12.2.2, 12.2.3 and 12.2.4)

4 Agenda Paper 12.2.1 provides the Board with the staff analysis and recommendations on the list of possible simplification from Tier 1 reporting requirements and seeks the Board's views for which financial instruments specific Tier 3 reporting requirements should be developed.

5 Agenda Paper 12.2.1.1 is a supporting document that was previously presented to the Board at its May 2022 Board meeting. This paper provides the Board with the background including stakeholder feedback and findings from research and other literature review on financial instruments.

6 Agenda Paper 12.2.2 provides the Board with staff analysis and recommendations on the Tier 3 reporting requirements for financial instrument including measurement of interest income and interest expenses, impairment of financial assets and estimating fair value.

7 Agenda Paper 12.2.3 provides the Board with staff analysis and recommendations on Tier 3 reporting requirements for hedge accounting and embedded derivatives.

8 Agenda Paper 12.2.4 provides the Board with staff analysis and recommendation on Tier 3 reporting requirements for derecognition of financial assets and financial liabilities.

Tier 3 Approach to developing disclosure requirements (Agenda Papers 12.3.1 and 12.3.2)

9 Agenda Paper 12.3.1 provides the Board with the staff analysis and recommendations on the approach to developing Tier 3 disclosure requirements.

10 Agenda Paper 12.3.3 provides the Board with staff analysis and recommendations on the draft disclosure requirements, applying the disclosure approach staff recommended in Agenda Paper 12.3.1, to three topics (investment property and property, plant and equipment, leases and change in accounting policies and correction of errors). Staff will also ask the Board to consider the staff suggested approach to developing disclosure requirements for other key topics

previously discussed to be included in the DP based on the approach recommended in Agenda Paper 12.3.1.

Project update

Stakeholder outreach update

11 The AASB NFP Project Advisory Panel met on 17 March 2022 (refer to meeting minutes in Agenda item 12.4). At that meeting, staff sought to obtain Panel members' input into initial staff considerations on the disclosure approach for key topics that staff plan to discuss with the Board at its June 2022 meeting, as referenced in Agenda Paper 12.3.1, paragraph 17. Staff have incorporated the feedback into the respective staff analysis. Staff will continue to seek feedback from the NFP Project Advisory Panel throughout the project.

12 The table below provides an update on the interactions with regulators and other cross-cutting projects.

Project environmental update, including interaction with cross-cutting projects

Project and other updates	Update
Regulators update	Staff further engaged with regulators, provided an update and specifically discussed the interaction of the respective requirements in their jurisdiction. A summary of the discussion is as follows: Australian Taxation Office (ATO) • *Taxation Administration (Private Ancillary Fund) Guidelines 2019* and *Taxation Administration (Public Ancillary Fund) Guidelines 2022* requires all ancillary funds, regardless of size, to prepare financial statements in accordance with Australian Accounting Standards. • Whilst Australian Accounting Standards may not specify reporting thresholds, the Guidelines note that ancillary funds will meet legislative requirements if they have prepared financial reports in accordance with the ACNC reporting requirements as meeting the legislative requirements for ancillary funds. • AASB will work with ATO to leverage ATO's engagement with their NFP stakeholders for future communications on the NFP FRF project. ATO has also provided AASB with some relevant data on the NFP sector for the project (see Agenda Paper 12.5) Department of Education, Skills and Employment (DESE) • DESE regulates a variety of NFP entities including non-governments schools (~5% of which are non-charity NFP entities), higher education institutions, vocational education and training organisations and early childcare providers. • DESE requires these entities to prepare financial statements in accordance with the Australian Accounting Standards, as such they noted that the AASB's proposal to develop a possible third tier of GPFS would impact the NFP entities they regulate as well as their regulatory functions under their legislative requirements. • Specifically for non-government schools, DESE is required to consider the financial viability under section 27 of the Australian Education Regulation 2013 and considered the statement of cash flows and financial information presented in the statement of profit or loss and statement of financial position provides information to support DESE when assessing financial viability of these entities. DESE staff considers that disclosures such as related party transactions, related party loans, key management personnel information is useful when administering their regulatory functions. Any proposed changes to the Australian Accounting Standards that would otherwise not enable or reduce their ability to carry out the function under their legislative requirements would impact DESE. • While DESE staff considers service performance reporting is useful, they considered it as supplementary information to support the financial information of the NFP entity. • AASB staff noted that tentative decisions to date would appear to align with DESE use of the financial statements. The outreach on the Board's proposals that will be contained in

Project and other updates	Update
	the DP will provide opportunity to further consult whether any of the proposals would negatively impact DESE to effectively perform its function. Australian Charities and Not-for-profits Commission ACNC has published guidance on related party transactions as part of the ACNC Legislative Review Reform recommendations to be applied in the 2023 Annual Information Statement and onwards. While related party disclosure will not be a topic discussed in the DP, staff will consider the guidance when assessing stakeholder feedback from the DP outreach.
NZASB's post-implementation review (PIR) of Tier 3 and Tier 4	At its Board meeting in May 2022, the NZASB Board considered and provided feedback on a communication plan for the NZ Tiers 3 and 4 PBE exposure draft for not-for-profit and public sector entities. Staff will consider NZASB's communication plan when developing the communication strategy for the DP.
Second comprehensive review of the *IFRS for SMEs* Standard	IASB is currently in the process of assessing whether to align the *IFRS for SMEs* Standard with IFRS Standards and is working towards publishing an exposure draft proposing amendments to the *IFRS for SMEs* Standard for new requirements that are in the scope of the review. The IASB met in April 2022 and tentatively decided to propose amendments to 16 sections of the current Standard based on the application of the principles it had agreed in March 2022 for updating disclosure requirements in the *IFRS for SMEs* Standard. In particular, amendments are proposed for: • Section 3 and 8: Financial Statement Presentation and notes to the financial statements – align changes arising from the *Disclosure Initiative*, and primarily to refer to 'material' accounting policy information rather than 'significant accounting policies'; • Section 6: Statement of Changes in Equity and Statement of Income and Retained Earnings – to require disclosure of dividends by class of share; • Section 7: Statement of Cash Flows – to require reconciliation of opening and closing liabilities from financing activities; • Section 9: Consolidated and Separate Financial Statements – align disclosures based on comparable disclosures in the ED to reflect recognition and measurement changes for step disposals, where there is a loss of control of subsidiary, but the holder retains an investment; • New section, Fair Value Measurement – aligning disclosure requirements with IFRS 13 *Fair Value Measurement* excluding accounting policy options not available in the Standard; • Section 11: Financial Instruments – for impairment losses on financial assets measured at amortised cost (other than trade receivables and contract assets in scope of Section 23 Revenue), using an expected credit loss model and to align with the simplified approach in IFRS 9 *Financial Instruments* with further reduction reflecting the fact that the amendments to the *IFRS for SMEs* are aligned with the simplified approach in IFRS 9 and do not incorporate the general approach in IFRS 9. No amendments were proposed where no changes were made to recognition and measurement (i.e. hedge accounting and IBOR reform). • Section 14 Investment in Associates and Section 15 Interest in Joint Arrangements – minor editorial changes and revised requirements relating to disclosure of an entity's commitments relating to jointly controlled entities; • Section 16 Investment Property and Section 17 Property, Plant and Equipment– align changes to new section on fair value measurement; • Section 19: Business Combinations and Goodwill – additional disclosures relating to contingent considerations and additional disclosures for an undue cost or effort exemption; • Section 23: Revenue – this section is expected to align with IFRS 15 *Revenue from Contracts with Customers*, however IASB staff noted that, if necessary, adding disclosures where the simplifications in Section 23 affect the disclosures; • Section 27: Impairment of Assets – align language in respect of jointly controlled entities; • Section 28: Employee Benefits – editorial amendments and removing corresponding disclosure from removing the simplification for measurement of a defined benefit obligation; • Section 34 Specialised Assets – exploration and evaluation expenditure, no specific disclosure requirements except referring preparers to the relevant section for disclosure requirements.

Project and other updates	Update
	No amendments were proposed for sections where there were no disclosure requirements or where no recognition and measurement changes were made including: statement of financial position; statement of comprehensive income and income statement; accounting policies; estimates and errors; inventories; intangible assets other than goodwill; leases; provisions and contingencies; liabilities and equity; government grants; borrowing costs; share-based payment; income tax; foreign currency translation; hyperinflation; events after the end of the reporting period; and transition to the IFRS for SMEs. Staff have included consideration in staff analysis in paragraph 15 of Agenda Paper 12.3.1.
IFR4NPO	Exposure Draft will be released in three tranches with Tranche 1 due to be published in late 2022 relating to the framing of the Guidance following the format of the *IFRS for SMEs* Standard relating to Preface, Non-Profit Organisations, and the Concepts and Pervasive Principles. The Guidance will be the same as *IFRS for SMEs* except where NPO-specific financial reporting guidance is required. At its latest meeting in April and May 2022, the Technical Accounting Group (TAG) considered the areas as part of the ED Tranche 1 Guidance including the use of concepts and principles from the IFRS Conceptual Framework and IPSASB's Public Sector Conceptual Framework when developing financial reporting guidance for NPOs on issues not covered within the existing *IFRS for SMEs* Standard. They also discussed other areas including: • The definition of the Reporting NPO will include guidance on the description of the reporting NPO, the parent NPO, subsidiaries, and consolidated and unconsolidated financial statements including guidance on branches; • The elements which provide definitions of the key components of financial statements will be consistent with the IASB Conceptual Framework but take account of IPSAS 35 *Consolidated Financial Statements* to reflect the fact that returns may be non-financial rather than financial. Guidance will be developed for identification of the reporting NPO where difficulties exist, proposing a two-step process also inspired by the guidance from NZ (Explanatory Guide A8 *Financial Reporting by Not-for-Profit Entities: The Reporting Entity* (EG A8)) and Australia (Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity*). Guidance will be provided for accounting for branches based on the guidance from the UK Charities SORP and NZ. • Consultation response relating to the presentation of financial statements and narrative reporting The Donor Reference Group also met in October 2021 and April 2022 to discuss donors as users of financial statements and their use of cash versus accrual basis information. This stakeholder group confirmed that they are users of general purpose financial statements for a variety of reasons including to ensure accountability by confirming how grantees have used the donated funds and assess the health of the organisation, noting the limitations that GPFR does not capture project specific information. However, they noted that many donors may require reports of grant utilisation to be submitted on a cash basis, as such a supplementary Donor statement within the GPFR may be useful for this stakeholder group. Donors also confirmed their financial information needs include the accountability of funds (such as restricted funding and spending of cash) and associated achievement of project goals, as well as forecast and pragmatic cash flow to allow a donor to assess risk and to detect potential misuse of cash. However, they expressed the desire for GPFR to become a main tool for reporting. The group also noted some challenges currently with GPFR including inconsistent reporting between countries, inaccurate or incomplete financial statements to provide information that may be useful and challenges with user understanding of terms and lack of expertise in reading financial reports. Some strategies suggested to overcome the challenges include staff training (e.g. checklist for readers) to improve financial literacy, prescribe the use of a specific framework for preparation of NFP's GPFR and using accredited firms for audit of NFP's GPFR. Staff noted that the IFR4NPO will develop their guidance for all NFOs using the *IFRS for SMEs* Standard. However, staff consider the Approach to Simplification in Appendix A continues to be appropriate which considers pronouncements from other jurisdictions including *IFRS for SMEs*, when developing simplification options for smaller NPF entities within the Tier 3-size.

Project and other updates	Update
Updates to FRS 102 and FRS 105	In October 2020, FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* was amended to require entities to recognise changes in operating lease payments that occur as a direct consequence of the COVID-19 pandemic, and meet specified conditions, on a systematic basis over the periods that the change in lease payments is intended to compensate. The treatment was considered to reflect the economic substance of the intended benefit of these concessions and their temporary nature and improve the consistency of reporting for users of financial statements. Similar amendments were made to FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*. Staff considered these changes do not impact the tentative decision the Board made in November 2021 relating to the Tier 3 reporting requirements for leases.

Research update

13 A paper by Barker (2022),[2] made recommendations to the amend the New Zealand Charities Act including the following financial reporting-related recommendations:

(a) remove sections enabling affiliated or closely related entities to be treated as a single entity for the purpose of charitable registration where this would align with financial reporting requirements where registered charities that “control” other charities are required to prepare consolidated accounts;

(b) financial reporting requirements for charities to be comprehensively reviewed to ensure balance is struck between visibility and accountability, and not undermining small charities’ ability to deliver on their charitable purposes;

(c) design of an online financial reporting tool for charities that would reduce duplication and facilitate data collection and to consider extending use of annual information be widely used by government agencies and other funders;

(d) look beyond outputs and outcomes to identify measures and report on impact generated by charities; and

(e) include analysis of the concept of fund accounting (as adopted in the UK Charities SORP).

14 A study by Ghoorah (2019) looked at the general public’s perceptions of the relative importance of specific financial disclosures which the public believes social economy sector (SES) organisations should publish as part of their provision of accountability. [3] The study was conducted using a survey questionnaire administered to a sample of 400 Australian individuals. The study suggests that the public perceives financial disclosures related to the source of fund inflows, mission-related expenses, and financial sustainability to be relatively important disclosures for NFP entities. In particular, respondents of the survey were asked to rank the importance of specific financial disclosures for information relating to revenue, expenses and other financial disclosures. Respondent results suggested that:

(a) For revenue disclosure items – ‘revenue earned from donations’ and ‘total revenue earned by the organisation’ highest in importance, while less importance was given to the ‘breakdown of revenue sources of the organisation’;

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2 Baker, S (2022), *Focus on purpose – What Does a World-Leading Framework of Charities Law Looks Like?,* report prepared for the New Zealand Law Foundation Accessed online via https://www.lawfoundation.org.nz/wp-content/uploads/2022/04/Charities-Law-Reform-Report-April-2022.pdf, date 23 May 2022

3 Ghoorah, U (2019) ‘Chapter 2 Accountability via Financial Disclosures: An Exploration of the Public’s Perceptions’, *Modernization and Accountability in the Social Economy Sector, A volume in the Advance in Finance*, Accounting and Economics (AFAE) Book Series, Hershey, PA.

(b) For expenses disclosure items – ‘salaries of senior staff’, ‘fundraising expenses’ and ‘administrative expenses’ were ranked the most important. Most respondents also perceived financial disclosures associated with ‘the amount spent on the social mission of an SES organisation’ to be relatively important; and

(c) Other financial disclosure items – ‘ability to pay debts when they fall due’ and ‘any surplus made by the organisation’ and ‘cash inflows and cash outflows’ of the organisation were ranked highest in importance. Respondents also ranked disclosures of ‘money owed to creditors’ as an important other financial disclosure. While respondents ranked ‘transactions with related parties’ least important amongst other financial disclosures, they still considered the disclosure information to be of interest to users.

The author recommended that SES organisations should cater the financial disclosures to the user needs as a way of improving their accountability. Staff have incorporated the research findings to the analysis and recommendation for developing the disclosure approach. (refer to paragraph 21 of Agenda Paper 12.3.1).

15 Staff consider these research reports support the objective of the NFP FRF project to develop simplified reporting requirements for financial reporting for common transactions that is proportionate to smaller NFP entities and provide information that is useful to users. It also highlights the importance for NFP entities to report on the impact generated as part of service performance reporting and exploring the concept of fund accounting. The Board will be considering the feedback from its Agenda Consultation, including service performance reporting, at its June Board meeting.

16 Staff are looking at further research to help inform the Board in its proposals to develop Tier 3 reporting requirements addressing common transactions of Tier 3-sized NFP private sector entities. This will be considered in Agenda Paper 7.1 (refer Research Update paper).

Project timeline and milestones

17 There have been no changes to the project timeline and milestones since the May 2022 meeting.

TIMELINE	PROJECT MILESTONES	TOPIC
AUG 2022	Board to review final draft DP and outreach plan, and appoint a subcommittee to finalise the DP out of session	• Consider draft of DP (including disclosure requirements of other key topics) • Consider any outstanding matters, including sweep issues • Consider outreach plan
SEP 2022	DP exposed for public comment	
SEP 2022 – MAR 2023	Outreach	
Q2 2023	Staff to consider feedback	

Question to the Board

Do Board members have any comments or questions on the project update?

Appendix A – Approach to simplification agreed by the Board at its 4 August 2021 Board meeting