

6 October 2016

Mr Warren Allen  
Chief Executive,  
External Reporting Board,  
PO Box 11250,  
Manners Street Central,  
Wellington 6142

Dear Warren

## EXPOSURE DRAFT: PBE IPSAS 9 Financial Instruments

The Treasury welcomes the opportunity to provide comments to the New Zealand Accounting Standards Board on the Exposure Draft: PBE IPSAS 9 Financial Instruments.

NZASB is to be commended for its efforts in tackling this project in a way that addresses the significant mixed model issues that could arise with inconsistent timing in introducing new financial reporting requirements for financial instruments. We applaud the NZASB for its general approach to this standard.


We have attached our responses to the specified matters for comment, and provided further information on the major issue arising for the Government from the proposed standard.

Yours sincerely



Nicola Haslam  
Manager, Fiscal Reporting

ANNEX 1: Responses to Specified Matters for Comment  
ANNEX 2: Student Loans in New Zealand



1 The Terrace  
PO Box 3724  
Wellington 6140  
New Zealand

tel. 64-4-472-2733  
fax. 64-4-473-0982

[www.treasury.govt.nz](http://www.treasury.govt.nz)



## ANNEX 1

- 1. Do you support the NZASB's proposal to issue a PBE Standard based on IFRS 9 in advance of the IPSASB completing its project on financial instruments, taking into account the factors discussed in the PBE Policy Approach? If not, please explain why not and indicate any alternative course of action that you think would be more appropriate.**

Treasury supports the NZASB's proposal to issue a PBE Standard based on IFRS 9 in advance of the IPSASB completing its project on financial instruments. We support the proposal because we agree that:

- the new requirements in IFRS 9 are expected to lead to higher quality financial reporting and, in some cases, to improve the cost-benefit aspects of accounting for financial instruments,
- the differences between NZ IFRS 9 and PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* are likely to result in significant differences between NZ IFRS and PBE Standards, unless a similar change is made to PBE Standards,
- these differences are likely to result in additional compliance costs for "mixed groups", such as the Consolidated Government Reporting Entity, because of the different timing of the introduction of NZ IFRS 9 and any replacement for PBE IPSAS 29 – rather than differences that are necessary to reflect differences in user information needs

Therefore the requirements of the "*Policy Approach to Developing the Suite of PBE Standards*" have in our view been met and we consider it is appropriate for the NZASB to take action to remedy this issue.

Further we consider that:

- The risk that IPSASB will come to a significantly different result for public sector reporting on financial instruments is relatively low, and therefore the cost of changes that **may** be necessary when the IPSAS harmonised standard is finalised, is very unlikely to outweigh the costs associated with dual reporting processes in the interim.
- The intelligence that New Zealand will gather as a consequence of this project is likely to be useful and influential with the IPSASB.

- 2. If a PBE Standard based on IFRS 9 were to be issued by the end of 2016, and you are the head of a mixed group or a member of a mixed group:**
  - (a) do you think it is likely that you or any PBEs within the mixed group would wish to early-adopt PBE IFRS 9; and**
  - (b) if so, do you think that the expected issue date of late 2016 would provide sufficient lead-in time for a PBE within a mixed group to voluntarily adopt the proposed PBE Standard?**

Treasury has consulted the Accident Compensation Corporation, the Reserve Bank of New Zealand, the Debt Management Office and the Ministry of Education (responsible for the student



debt portfolio) in forming a view as to the likely timing of adoption of the new reporting requirements should the NZASB proceed in accordance with its proposed deadline.

If the final standard PBE IFRS 9 is issued before the end of the first quarter of 2017, the Government reporting entity would have the necessary lead time to understand the impacts and update systems in time for the beginning of the 2018/19 financial year. The Government reporting entity would also aim to adopt PBE IFRS 9 requirements in the economic and fiscal update (covering a five year period) which is published in May 2018 as part of Budget 2018.

In making that decision we note:

- That timing enables a synchronised adoption of the IFRS 9 throughout the government reporting entity – this is a key benefit of the proposed approach
- Much of the information on the value of the Government's investment portfolios is provided by external investment managers, who will be using IFRS 9 as the basis for their reporting – this is a key benefit in making the change at that date

We are however conscious of two key risks:

- That the NZASB will not be able to finalise the standard in time – we therefore urge that this issue is given priority
- Notwithstanding that the move to an expected loss model for impairment more accurately describes our approach to measuring the student loan portfolio, the current proposed PBE IFRS is likely to create avoidable problems in adopting the new standard – we therefore urge that our proposals in the second annex to this paper be adopted.

**3. Do you agree with the modifications made by the NZASB in developing the proposed PBE Standard? If not, please explain why not and identify what you think would be more appropriate. Respondents may find it helpful to consider the matters outlined in Tables 2-4.**

We agree with the modifications made by the NZASB in developing the proposed PBE Standard, with the exception of one issue.

The proposed standard does not include relevant guidance for classifying and subsequently measuring the Government's concessionary loans (particularly student loans). It also makes a number of presumptions in applying impairment provisions that do not apply to concessionary loans such as student loans. Without relevant interpretation guidance, it may be difficult for preparers to appropriately classify concessionary loans and apply the impairment requirements. Essentially this is because:

- Without relevant guidance, it is open to interpretation in the proposed standard if concessionary loans could be classified and subsequently measured at amortised cost because of the new cash flow characteristics test. which requires financial assets at amortised costs to have contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding
- The proposed standard presumes that an assessment of credit risk is made or is possible on the origination of the loan. The student loan scheme provides resources to individuals that would not otherwise have access to them. The lack of creditworthiness

at origination is compensated for, and made less relevant, by the use of the tax system to call on future earnings to provide assurance the loan will be repaid.

- The proposed standard presumes a set of contracted cash flows that will be different to expected cash flows to determine an expected credit loss. However the income contingent nature of the cash flows for most of the student loan portfolio, means that these two concepts become confused because contractual cash flows are the same as expected cash flows in practice.
- The proposed standard presumes that a loan can be classified as performing, at risk of non-performance and non-performing based on repayment experience. This is not the case for student loans where often extended periods of non-repayment are fully in accordance with the terms of the student loan contract.

The IPSASB will no doubt be examining these issues in depth. In the meantime we propose some minor clarifications in the proposed NZASB standard to ensure the current approach of classifying concessional loans at amortised cost can continue, and to allow the current approach to “recognise the cumulative changes in lifetime expected credit losses since initial recognition” (PBE IFRS 9, para 5.5.14) to be applied. By directing the impairment requirements for concessional loans to that paragraph, the problems arising in applying the usual impairment requirements based on inapplicable presumptions do not arise.

Treasury considers that this will ensure the intent of the standard is fulfilled. Importantly however, it avoids the risk that accounting policies for concessional loans such as student loans will be required to be changed twice in a short period

More detail on this issue is provided in the Annex 2.

**4. Do you agree with the proposed RDR concessions in relation to PBE IPSAS 30 (refer Appendix D of the Exposure Draft)? If you disagree, please provide reasons and indicate what concessions you consider would be appropriate.**

Treasury agrees with this requirement.

**5. Do you agree with the proposal that the effective date of the proposed PBE IFRS 9 be 1 January 2021, with early adoption permitted (bearing in mind the NZASB’s intention to defer the effective date of PBE IFRS 9 until a future IPSAS based on IFRS 9 is effective)?**

Bearing in mind the issues that PBE entities that are not part of mixed-groups will face Treasury agrees with this proposal

**6. Do you have any other comments on the Exposure Draft?**

No other comments.



## ANNEX 2

### Student Loans in New Zealand

1. In New Zealand a student loan can be advanced for course fees, course-related costs and living costs. At 30 June 2015 there were approximately 728,000 borrowers with a student loan. In nominal terms as at 30 June 2015 there was \$11.7 billion New Zealand-based and \$3.1 billion overseas-based loans. The total impaired value, based on expected future repayments was \$8.9 billion.
2. To get a student loan, borrowers usually have to be:
  - enrolled in a tertiary course
  - studying full-time or limited full-time, or meet StudyLink's requirements for part-time study
  - a New Zealand citizen, or meet residency requirements for minimum of three years under 55 when the course starts, for course-related costs and living costs borrowing – there's no upper age limit for course fees borrowing.
3. There are two main concessions associated with student loans:
  - A principal concession – borrowers are not assessed for credit risk, nor are they required to provide security for the loans. Repayment of the loan is income-contingent (borrowers based in New Zealand only need to make payments if they earn over a threshold income (e.g. \$19,084 per annum or \$367 per week), and payment is based on a percentage of their income (e.g. 12 cents in the dollar)
  - An interest concession – no interest charged for borrowers based in New Zealand
4. We believe other countries have income-contingent student loan schemes although the policies differ, including Australia, England, Wales, South Africa, South Korea, United States, Netherlands, Hungary, and Malaysia.
5. If a New Zealand borrower subsequently moves overseas (away for six months or more) then there is a fixed annual repayment obligation of either \$1000, \$2000, \$3000, \$4000 or \$5000 payable in two instalments, depending on the nominal loan balance when the borrower left New Zealand. (In contrast, under the British and Australian student loan schemes, the loans stay income contingent when people leave home soil).
6. There are some borrowers who do not make their required repayments under the New Zealand scheme. These tend to be borrowers based overseas who have annual repayment obligations, rather than income contingent repayment obligations. Enforcement of these loans is improving over time, and is usually rectified on the borrowers return to New Zealand. Borrowers based in New Zealand have relatively high collection rates, because repayments are deducted before salary and wages are paid and collected via the tax system.

7. The only time a student loan is written off is in the event of death or bankruptcy. In 2015, \$35 million was written off the nominal loan book of \$14.8 billion. (2014 \$25 million written off a nominal loan book of \$14.2 billion).

### **Developing Accounting Policy for Student Loans to date**

8. Since the creation of the student loans scheme, firstly IAS 39, and subsequently NZ IAS 39 and PBE IPSAS 29 have been applied in determining the measurement of student loans for financial reporting purposes. For ease of reference, this paper refers to those prior standards as the existing standards and PBE IFRS 9 as the proposed standard.
9. In compliance with the existing standards, student loans are initially measured at fair value, subsequently measured at amortised cost using the effective interest rate (EIR) method and subject to impairment testing.
10. In developing the accounting policy it was acknowledged that the transaction price of a student loan could not represent the initial fair value because the loan is not earning a market rate of return and the repayments are largely income contingent.
11. As the consideration given in providing student loans is not the return on the financial instrument, the fair value of student loans is estimated as the present value of future cash receipts discounted using the prevailing market rate of interest for a similar instrument with a similar credit rating.
12. At the point student loans are drawn down the EIR is the rate at which the discounted expected cash flows equals the initial fair value write down. The difference between the amount lent and the initial fair value write down is an expense. This expense will be unwound over the life of the loan using the EIR, where it is estimated that the loan will be recovered through expected cash flows. With student loans, the EIR is used to allocate notional interest income to the surplus/deficit over the period of the loan. The EIR can also be described as the rate at which the initial fair value, less emerging repayments, must be compounded so that at the end of the contract the value is zero.
13. Once determined, the EIR is locked in for that year's tranche of student loans until repayment. This means that future changes in the reported value of the student loan portfolio should reflect changes in expected cash flows only.
14. Applying the existing standard's requirements to the student loan portfolio requires a number of judgments and assumptions. These include determining the profile of future cash flows by modelling borrower behaviour and income levels. This requires detailed analysis of past borrower behaviour and applying a variety of economic assumptions such as CPI and general wage inflation. It also requires determining when borrowing is "new" or an extension of existing borrowing. Complex models have been developed using a number of datasets to estimate the future cash flows.



15. To calculate the present value of future cash flows judgments are also required to determine appropriate discount rates including related risk premiums at the time the loan is drawn down. While future cash flows are continually reviewed at future reporting periods, the original discount rate at the point of lending is not.
16. For more information on the accounting for student loans under the existing standards refer to Chapter 4 *Costs of the Scheme* and Chapter 5 *Financial Schedules* in the Student Loans Annual Report 2015

<https://www.educationcounts.govt.nz/publications/80898/student-loan-scheme-annual-report-2015>

### **Classification of loans under the proposed standard**

17. We observe that under the proposed new standard there is a new approach to classification of financial assets in the proposed standard which is more principle-based; using a two-step test looking at an entity's business model and the nature of cash flows of a financial asset. Under the existing standard which is more rules based, loans and receivables are required to be classified and subsequently measured at amortised cost using the effective interest method.

18. We have looked at the two tests in the proposed standard to determine how student loans might be classified and measured subsequently. The proposed standard states:

*A financial asset shall be measured at amortised cost if both of the following conditions are met:*

- (a) *The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and*
  - (b) *The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.*
- [IFRS 9.4.1.2]*

19. In looking firstly at the business model, we note that the government's current policy is to hold and collect cash flows related to student loans. The intention test seems a fairly straight forward one to apply to the student loan portfolio and we would conclude the first condition is met.
20. The second test involves making a more difficult assessment of the contractual cash flow characteristics in relation to student loans. This involves determining whether the contractual cash flows are solely payments of principal and interest (SPPI). For contractual cash flows to be SPPI, they must include returns consistent with a basic lending arrangement comprising a return for the time value of money and credit risk at a minimum.
21. The second test involves making a more difficult set of judgements involving determining whether the contractual cash flows are:



- on specified dates, which requires a view that because tax payment dates are specified, it can be argued that this condition is met
  - for principal and interest only, which requires a view that the cash flows represent repayment of principal (being fair value) and interest (being the EIR calculation).
22. However, we are concerned that it could equally be an interpretation that because repayment dates are income contingent they are not specified, and because the cash flows are repayments of the nominal principal value they are not solely principal and interest payments.
23. The original approach that IASB was pursuing was that amortised cost should only be used for loans with basic loan features. The criteria for allowing the amortised cost approach was then amended because respondents demanded guidance on how the “basic loan features” should be assessed. The underlying question in relation to concessionary loans remains however. Concessionary loans such as student loans may be regarded as basic (because there is no interest) or non-basic (because of the difficulty in calculating the concession). Treasury understands this issue is being considered by the IPSASB, and from our reading of the IASB literature, we believe this will be the first time the issue has been addressed by standard setters.
24. We therefore urge the NZASB to clarify that the current status-quo for accounting for concessionary loans continues until the IPSASB has addressed the issue.

### **Challenges with determining promised (or contractual) cash flows**

25. The purpose of the discussion below is to provide background on the challenges in determining contractual cash flows and isolating expected default loss in the student loan portfolio. This provides context for our suggestion in the following section, that the simplified approach in the proposed standard should be applied to the impairment requirements to concessionary loans (assuming they can be classified and subsequently measured at amortised cost under the proposals).
26. In determining the initial fair value of student loans under existing standards, we have been challenged by the fact that cash flows are not contracted as such. Prior to 2008 we calculated initial fair value twice by:
- a) Present valuing estimated expected cash flows using a current discount rate (built up from a risk-free rate and a risk adjustment proxy to reflect the uncertainty in the cash flows) – this is the initial fair value amount on Day 1, and
  - b) Present valuing estimated promised (or contractual) cash flows
27. The estimated promised (or contractual) cash flows were greater than expected cash flows because they were not reduced by the following two items:

- deaths and bankruptcies, and
  - where those who are “contractually” required to make repayments because they have income over the threshold, but chose not to make them (mainly arises in the oversea borrower cohort). For example, back in 2008 expected repayments were estimated to be lower than promised repayments by about \$150m pa.
28. While we knew the fair value amount from the calculation described above in bullet 26(a), to determine the appropriate effective interest rate and identify the Expected Default Loss (EDL), we took the promised cash flows, compared them to the initial fair value from bullet 26(a), and were able derive another EIR including an EDL. As a result we had two fair value amounts that were the same on initial recognition, but they were expressed differently as follows:
- a) Present value of the estimated expected cash flows using a current discount rate (built up from a risk-free rate and a risk adjustment proxy)
  - b) Present value of the estimated promised cash flows using a current discount rate (built up from a risk-free rate, a risk adjustment and an EDL proxy)
29. At the time, it was considered important to separately identify the EDL (to reflect death, bankruptcies and where people should have been making repayment, but chose not to) under an “incurred loss model”. All subsequent impairment was modelled based on present valuing estimated promised cash flows using the EIR established on initial origination (which included an EDL proxy)
30. This approach to measuring student loans was problematic for a number of reasons:
- It was confusing: to preparers, auditors, Ministers and other users of financial reports. Few understood the difference between contracted, expected and promised cash flows from student loans.
  - Using the updated promised cash flows at each subsequent reporting period for the impairment calculation, but an EDL proxy fixed within the EIR when the loan was initially advanced, meant there was a risk that the EDL proxy was not aligned with emerging experience.
  - It was cumbersome and onerous in requiring two sets of cash flows to be prepared.
  - It led to a value which was inconsistent with well understood and largely predictable processes.

***The current approach based on ‘expected cash flows’***

31. In 2008, when we formally adopted NZ IAS 39, we simplified the process by making the initial fair value write down and subsequent impairment testing all based on “expected cash flows” (as described in bullet 26(a) above), rather than doing a second calculation for “promised cash flows”. We felt it could be argued this would be reflected in any “exit price” of student loans, and it made the subsequent impairment testing consistent and easy to communicate. Importantly, the actual result for the impaired value was a better reflection of what value was expected to be recovered at each reporting date.



32. Making the change to having all valuations based on estimated expected cash flows has been helpful in communicating to stakeholders and Ministers. Since 2008 we no longer need to justify to stakeholders (and confuse them) why there are two different future cash flows and two different EIR in our disclosures. We also avoid the additional costs and complexity of estimating both promised and expected cash flows from the same actuarial model and data analysis.
33. Even with simplifying all valuation calculation to expected cash flows, we have however continued to face challenges with the requirement to follow an “incurred loss” approach, when we are estimating future cash flows. An impaired value under an “incurred loss” approach would generally not allow for assumption changes that have not been based on observable data or which cannot be related to an evidence based event (such as a change in Inland Revenue collection procedures). For example if the data showed bankruptcies at 1.0% but management believed a rate of 1.5% was appropriate as they believed the rate of bankruptcies would increase in the future this should not be taken into account as the 0.5% is effectively building in a “future impairment” and it is not based on observable data.
34. Challenges in operating an incurred loss model also arise with economic assumptions. Borrower income levels and therefore future repayments are mainly based on past payment history, but should also be assessed taking into account the latest economic forecast data which is forward looking. Therefore, there is a challenge in using a mixture of lag and lead indicators in the current valuation to get the best estimate.
35. Given the nature of the Student Loan Scheme and current valuation model we support the “incurred loss” approach being replaced with an “expected loss” approach for student loans.

### **Going forward with accounting for student loans**

36. In our view, assuming student loans could be classified and measured using amortised cost under the proposals, impairment of student loans should primarily be based around evidence of reduced expectations of future cash flows since initial recognition. Any adverse (or positive) change in the original assumptions applied to calculate the initial fair value of student loans is an impairment (or a negative impairment i.e. a gain).
37. The proposed standard requires an entity to recognise a loss allowance for expected credit losses for most financial assets. However, for loans for purchased or originated credit-impaired financial assets, the standard requires an entity to recognise changes in the cumulative changes in lifetime expected credit losses as an impairment gain or loss.
38. We have explored both of these approaches below

### ***Recognising a loss allowance for expected credit losses***

39. The standard IFRS 9 model focuses on an assessment of the credit risk for a loan (or group of loans), and estimating 12 month expected credit losses (on initial recognition and life time



expected credit losses if there is an increase in credit risk since initial recognition). The emphasis in the language in the standard is on ensuring the carrying value of the portfolio reflects the latest estimated future cash flows of the portfolio.

40. Credit losses in IFRS 9 are defined as:

*the difference between all the contractual cash flows that are due to an entity and the cash flows that it actually expects to receive ("cash shortfalls") This difference is discounted at the original effective interest rate (or credit adjusted effective interest rate for purchased or originated credit-impaired financial instruments).*

41. As discussed above, the concept of contractual cash flows for student loans is problematic. Cash flows are not contracted directly, rather they are contingent on borrowers' income and therefore need to be estimated. Because estimation techniques need to be used both to underlie the "contractual cash flows" and the "cash flows that are actually expected to receive" the difference between these measures is confounded, and the value of the disclosure of the difference is limited.

42. Unsurprisingly therefore the approach outlined in the proposed standard for determining credit losses to create an allowance is also confounded. The standard expects that an assessment of significant increases in credit risk is possible and is required in a two-step approach. It requires a differentiation to be made between performing (stage one) and under-performing (stage two) loans from a credit-risk perspective in the student loan portfolio, and loss adjustments determined from that differentiation

43. This creates three problems:

- The nature of the student loans scheme is that there is no credit assessment of borrowers at initial advancement. In fact we expect most loans on origination would not have the security or current income to justify the loan in market terms, but we compensate for this lack of initial creditworthiness through the use of the tax system to call on future earnings. We thus have no base for determining if credit risk is decreasing or increasing from some unknown point in the terms of the standard.
- It is difficult to differentiate loans between loans that are "performing" and "non-performing". The standard expects that payment history, and the borrower's performance in meeting contractual obligations would be a guide to whether the loan is performing or not. However with student loans it is perfectly acceptable for a student loan to be "performing" within the contract even if no repayments are currently being made. The meeting of "contractual" repayment obligations on the other hand is more an issue of the efficacy of the tax system than it is the performance of the borrower.
- Most reassessments of the value of student loans are due to revised expectations as to the timing and amount of repayments. Using a 'credit loss' approach is an imperfect

way of capturing this reality, which is more commonly thought of as a liquidity rather than a credit risk.

44. Our conclusion from this analysis is that while we can measure and remeasure the expected cash flows from the student loan portfolio, we cannot measure the expected credit losses in the way the proposed standard demands, unless we put a fairly arbitrary value on “promised cash flows” to create a difference that we can call the loss allowance. Our experience with attempting this approach prior to 2008 is that it creates confusion and misunderstanding rather than useful information.

### ***Recognising cumulative changes in lifetime expected credit losses***

45. The proposed standard in paragraphs 5.5.13 to 5.5.14 states that an entity shall only recognise the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit impaired financial instruments. This approach looks practically achievable, as the total estimated cash flows from the student loan portfolio is calculated each year to be used as the basis for the measurement of the portfolio, and the difference from the previously estimated cash flows will represent the impact that year on cumulative credit losses. In essence, it is a more direct way of achieving the same desired result.

46. There would however, need to be acceptance that “lifetime expected credit losses” in these paragraphs had a broader meaning when applying it to the student loan scheme. This is because some of the difference arising each year from comparing the carrying value to the re-measurement of estimated cash flows would not be attributed to “pure credit losses” but from revised (probably better) assumptions about the timing of future incomes and repayments.

47. However, the NZASB has added a footnote to paragraph 5.5.13:

*A purchased or originated credit-impaired financial asset is distinguished from a concessionary loan (see B5.1.1A to B5.1.2G).*

48. This footnote is unhelpful in the student loan case as it suggests that being concessionary, we could not apply the impairment requirements described in paragraph 5.5.13 and 5.5.14. If this is the case, we would be required to apply the first option above and need to continually assess loans as performing, underperforming or non-performing.

49. We also note that this direct impairment approach is available for receivables (including receivables resulting from transactions within the scope of IPSAS 23 *Revenue from Non-exchange Transactions*) and lease receivables. However, we have assumed that student loans don't meet the definition of a receivable for the purpose of this simplification.



## A clearer, less problematic approach for loans with principal concessions

50. Our suggestion to fix the problem, so we are not faced with the problems of the first approach, is to allow student loans to apply the direct approach by using lifetime expected credit losses at each reporting date. This could be done in the following ways:

Option 1) Insert “may be distinguished” from a concessionary loan in the footnote (This would provide some flexibility in interpretation, but could still leave considerable judgment and debate between preparers and auditors when this may apply).

Option 2) Provide additional guidance that concessionary loans where a concession is provided on the principal as well as interest could be reported in the same way as loans that are credit-impaired at origination. The NZASB may also want to consider the definition of principal concessions and interest concessions as described in paragraph 3. Note this could be done in the BC supporting the footnote, or in the standard replacing the footnote

Option 3) Rather than equate concessionary loans with loans that are credit-impaired on origination, add a third direct option in IFRS 9 for certain public sector loans (where credit risk is not a consideration in the decision to lend) that set out a similar approach to impairment as credit-impaired loans on origination. This option has the advantage of not having to decide if student loans are non-performing at origination (especially when from an education policy perspective the government is investing in the future of New Zealand, and the ‘credit-impaired’ label may imply these loans are “bad investments”).

51. Options 2 is recommended. While in fact Treasury is relatively agnostic between the second and third options, we believe the second option is simpler, and therefore preferable.

52. Regardless of where the NZASB lands on concessionary loan guidance or simplifications, we think there is an inconsistency within the proposed standard. Under the definitions:

*A credit-impaired financial asset* is a financial asset that is credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:

- (a) significant financial difficulty of the issuer or the borrower;
- (b) a breach of contract, such as a default or past due event;
- (c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower’s financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
- (d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

53. A concessionary loan is clearly contemplated as a credit-impaired financial asset under part (c) of this definition. However this is in conflict with the footnote to paragraph 5.5.1.3 which states:



*A purchased or originated credit-impaired financial asset is distinguished from a concessionary loan (see B5.1.1A to B5.1.2G).*

54. We are unsure why the NZASB has inserted this footnote in the impairment section of PBE IFRS 9. For example, PBE IFRS 9 B5.1.2 clarifies the accounting for initially measuring concessionary loans and how the concession (or non-exchange component) should be treated so the footnote has no consequence for initial measurement. On subsequent measurement, it is possible that the remaining "exchange component" of a concessionary loan is also credit-impaired on origination, so we are perplexed as to what purpose the footnote serves.
55. We think this conflict either needs to be removed or an explanation provided in the guidance about the distinction between loans that are credit-impaired on origination and concessionary loans and what accounting consequences are being addressed with the footnote being inserted.

## Conclusion

56. To effect the recommendations in the above paper (for the NZASB to clarify that the current status-quo continues until the IPSASB has addressed the relevant issues), we propose the following amendments to the proposed PBE IFRS 9.
57. **Amend** paragraph B5.1.2.A (Guidance currently sourced from IPSAS 29) as follows to clarify that concessions can be interest or principal related:
- B5.1.2A Concessionary loans are granted to or received by an entity at below market terms. *Below market terms may arise from an interest concession (e.g. an interest free loan) and/or a principal concession (e.g. concessionary principal repayment terms).* Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education and housing loans granted to low income families. Entities may receive concessionary loans, for example, from development agencies and other government entities.
58. **Add** paragraph to clarify that concessional loan repayments may be regarded as solely payments of principal and interest
- B4.1.7AA Contractual cash flows under a concessionary loan arrangement (see B5.1.1A – B5.1.2G) are not disqualified from being considered a basic loan arrangement solely because of the concession. Neither an interest concession nor a principal concession impacts on whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding,
59. **Add** paragraph to more clearly allow the recognition of the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for concessionary loans.

5.5.14A Where concessionary loans (see B5.1.1A – B5.1.2G) have similar characteristics to originated credit-impaired financial assets, entities may recognise the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance.

60. **Delete** Footnote 6