IN SUMMARY

PBE Financial Instruments

November 2018

Updating financial instrument requirements for PBEs

This document summarises the proposals in NZASB ED 2018-5 PBE IPSAS 41 Financial Instruments. *It also discusses the withdrawal of PBE IFRS 9* Financial Instruments.	**Project objective**	To develop a PBE Standard (applicable to Tier 1 and 2 PBEs) based on IPSAS 41 *Financial Instruments*. PBE IPSAS 41 will supersede most of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* (apart from the hedging requirements). PBE IPSAS 41 will also supersede PBE IFRS 9 *Financial Instruments.*
	Project stage	The NZASB is seeking comments on the proposed PBE IPSAS 41 *Financial Instruments* and the proposals for the withdrawal of PBE IFRS 9. These proposals are set out in: • Exposure Draft 2018-5 PBE IPSAS 41 *Financial Instruments*; and • Exposure Draft 2018-6 *Effective Date of PBE IFRS 9.*
	Next steps	The NZASB will consider comments before finalising the standards.
	Comment deadline	28 February 2019

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Why is the NZASB undertaking this project?

To update the requirements in PBE Standards in line with more recent IPSAS and NZ IFRS.	The IPSASB has updated its requirements for financial instruments – it issued IPSAS 41 *Financial Instruments* in August 2018. IPSAS 41 is closely based on IFRS 9 (2014) *Financial Instruments*. It introduces new classification, measurement and impairment requirements for financial assets and new hedging requirements. This update is expected to lead to higher quality financial reporting and, in some cases, better cost-benefit relationships. For example, the new hedging requirements are less restrictive than the requirements in PBE IPSAS 29 and allow an entity to better reflect the impact of its hedging activities on its financial performance. The update will not only lead to better alignment with IPSAS. It will also lead to better alignment with NZ IFRS 9 *Financial Instruments* (which should assist "mixed groups" that contain both PBEs and for-profit entities). Mixed group issues were partially addressed by PBE IFRS 9 *Financial Instruments*, which was issued in January 2017 as an interim measure, pending the development of IPSAS 41. However, the proposed PBE IPSAS 41 represents a more comprehensive solution to mixed group issues and is more aligned with current NZ IFRS.

What is new compared to PBE IPSAS 29?

	PBE IPSAS 29	Proposed PBE IPSAS 41
Financial assets classifications	Selection of classification and measurement categories is based on a range of factors. The categories are: • Fair value through surplus or deficit. • Held-to-maturity investments. • Loans and receivables. • Available-for-sale financial assets.	Selection of classification and measurement categories depends on the entity's management model and nature of the contractual cash flows. The categories are: • Amortised cost. • Fair value through other comprehensive revenue or expense (for certain debt instruments). • Fair value through other comprehensive revenue or expense (for certain equity instruments). • Fair value through surplus or deficit.
Financial liability classifications	• Amortised cost. • Fair value through surplus or deficit.	• Amortised cost. • Fair value through surplus or deficit (if a liability is designated as this category, change in the entity's own credit risk is presented in other comprehensive revenue and expense).
Impairment	• Incurred loss model.	• Expected credit loss model.

Hedge accounting	• More restrictive than IFRS 9.
	• For example, PBE IPSAS 29 allows components of financial items to be hedged, but not components of non-financial items (except for foreign currency risk).
		• Entities can continue to apply the hedge accounting requirements in PBE IPSAS 29 if they wish.
		• The new requirements in PBE IPSAS 41 are:
		  ○ based on IFRS 9 (and aligned more closely with an entity's risk management).
		  ○ allow more hedging instruments and hedged items to qualify for hedge accounting.

Amendments to other standards (see Appendix D of ED 2018-5)

Aligning references and requirements	As part of this project the NZASB is amending other PBE Standards to add references to PBE IPSAS 41 and to refer to the relevant requirements in PBE IPSAS 41. In addition, the project better aligns PBE Standards with NZ IFRS by picking up a number of narrow scope amendments that had not previously been included in PBE Standards. The most affected standards are PBE IPSAS 28, PBE IPSAS 29 and PBE IPSAS 30.
PBE IPSAS 28	There is now more guidance about whether an entity has a legally enforceable right of set-off.
PBE IPSAS 29	Most of this Standard is being deleted because its requirements are superseded by PBE IPSAS 41. The hedging requirements are not deleted – entities have the option of continuing to use these requirements pending further work by international standard setters on broader hedging proposals.
PBE IPSAS 30	For entities transitioning from PBE IPSAS 29 there are additional disclosure requirements, including disclosures about the impairment of financial assets, hedge accounting, offsetting financial instruments and transfers of financial assets. Certain disclosures are required on transition. For entities transitioning from PBE IFRS 9 there are new disclosure requirements on offsetting financial instruments and transfers of financial assets.

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Withdrawal of PBE IFRS 9

Why was PBE IFRS 9 issued?	PBE IFRS 9 was issued as an interim measure to address mixed group issues in the lead up to NZ IFRS 9 becoming effective (1 January 2018).
Why is PBE IFRS 9 being withdrawn?	The PBE IFRS 9 project was a narrow scope project pending the development of IPSAS 41. That project did not consider a number of narrow scope amendments and other issues considered by the IPSASB in developing IPSAS 41.
Why is the effective date of PBE IFRS 9 being deferred?	The effective date is being deferred by one year (to 1 January 2022) so that PBE IFRS 9 does not become mandatorily effective before PBE IPSAS 41.
What if an entity has early adopted PBE IFRS 9 (or is planning to do so)?	There are separate transition provisions for entities that have early adopted PBE IFRS 9. These provisions aim to keep the transition process as simple as possible. PBE IPSAS 41 will withdraw PBE IFRS 9 – but entities will be able to early adopt PBE IFRS 9 for six months after PBE IPSAS 41 is issued.
Where are the differences between PBE IFRS 9 and PBE IPSAS 41 explained?	The ITC highlights the main differences – Appendix 1 of the ITC has more detail. The marked-up version of ED 2018-5 contains shading and comments that help identify differences.

Effective date and transition

Early application permitted *Retrospective application (with certain exceptions)* *Restatement of comparatives generally not required* *Specific provisions for early adopters of PBE IFRS 9*	The proposed effective date of PBE IPSAS 41 is 1 January 2022. Earlier application is permitted. Requirements depend on whether the entity is transitioning from PBE IPSAS 29 or PBE IFRS 9: <u>Transition from PBE IPSAS 29</u>: • Retrospective application is required, with certain exceptions. For example, hedge accounting requirements are generally applied prospectively. • Restatement of comparatives is generally not required. Restatement is permitted only if it is possible without hindsight. • There are specific transitional provisions for certain classifications and designations. <u>Transition from PBE IFRS 9:</u> • Except as expressly permitted by PBE IPSAS 41, entities must continue to classify, recognise and measure financial instruments in the same way as before transition. • There are specific transitional provisions for some requirements that differ from PBE IFRS 9 (for example, the designation of financial instruments in accordance with the new requirements about prepayment features with negative compensation). • An entity may choose to apply the hedge accounting requirements in PBE IPSAS 41 on adoption of PBE IPSAS 41, even if they did not pick up the new hedge accounting requirements on adoption of PBE IFRS 9. In this case, the hedge accounting requirements of PBE IPSAS 41 must be applied prospectively, with certain exceptions. However, any entities that picked up the new hedge accounting requirements on adoption of PBE IFRS 9 may not revert to the hedge accounting requirements in PBE IPSAS 29.

Next steps

Comments are due by 28 February 2019 *We plan to hold a webinar – watch out for details*	**Commenting on the proposals** Respondents may choose to answer all or some of the questions in the Invitation to Comment. The NZASB would like to know why you agree or disagree with any proposals and welcomes comments on any other matters you think are important. Comments can be formal or informal. Comments letters and emails will generally be posted on the XRB website. Further information is available on the website at www.xrb.govt.nz After the consultation period ends we will consider submissions received and, subject to the comments in those submissions, expect to finalise and issue PBE IPSAS 41. We will also issue an amending standard to defer the effective date of PBE IFRS 9.