PBE Financial Instruments – new proposals

ED 2018-5 PBE IPSAS 41 *Financial Instruments*
ED 2018-6 *Effective Date of PBE IFRS 9*

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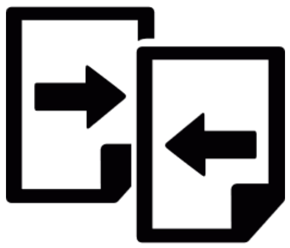
Contents

- Why develop a new standard?
- What's new?
- Moving from PBE IPSAS 29 to PBE IPSAS 41
- Moving from PBE IFRS 9 to PBE IPSAS 41
- Next steps

Why develop a new standard?



- International alignment
  - IFRS 9 *Financial Instruments*
  - IPSAS 41 *Financial Instruments*
- PBE IPSAS 41 is based on IPSAS 41 and therefore substantially aligned with IPSAS 41, IFRS 9 and NZ IFRS 9
- Currently two standards available
  - PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*
  - PBE IFRS 9 *Financial Instruments*

What’s new compared to PBE IPSAS 29?

- Key differences
  - Financial assets: New classification and measurement model
  - Impairment: New “expected credit loss” model – more forward-looking
  - Hedge accounting: New, more flexible requirements
  - Additional disclosure requirements, e.g. for impairment and hedge accounting

What's new for charities?

(and other entities with relatively few financial instruments applying PBE IPSAS 29)

- What if the only financial instruments are cash, deposits, receivables and payables? Will anything change?
  - Classification and measurement likely to remain at amortised cost, but need to re-assess impairment
- What if the charity has granted concessionary loans?
  - Some types of concessions could affect classification and measurement
  - Consider new impairment requirements
- What if the charity has investments in bonds and notes?
  - Might need to re-assess classification and measurement
  - Consider new impairment requirements

What’s new compared to PBE IFRS 9?

- There is more…
  - More up to date
  - More PBE-specific modifications
  - More disclosures
  - More examples and guidance
- New transitional provisions
- Detailed differences—check out the ITC and marked-up ED

Moving from

PBE IPSAS 29 to PBE IPSAS 41

Financial assets classification

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- Old classification categories under PBE IPSAS 29

Loans and receivables

(amortised cost)

Held-to-maturity

(amortised cost)

Financial assets

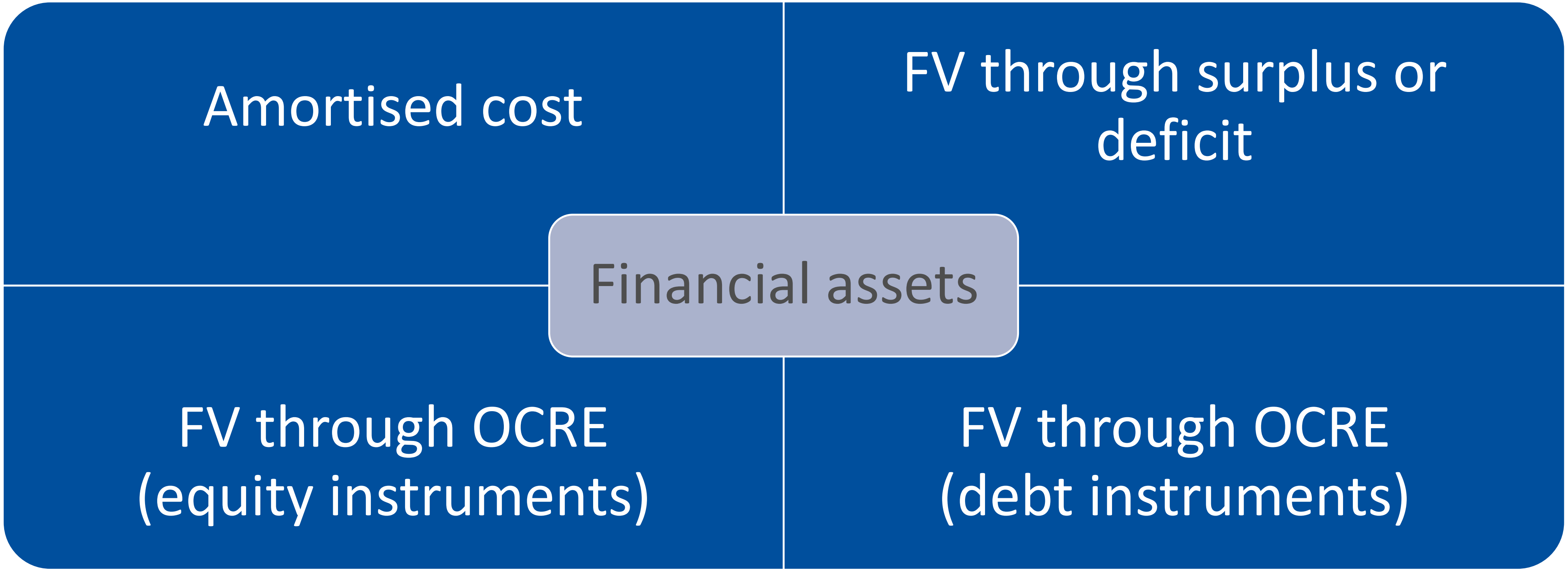
Available-for-sale

(FV through OCRE)

FV through surplus or deficit

Financial assets classification

- New classification categories under PBE IPSAS 41



Financial assets classification

- Classification and measurement depends on two criteria

The nature of the asset's contractual cash flows	+	The entity's management model
Are the cash flows "solely payments of principal and interest" (SPPI)?		Holding assets to collect contractual cash flows, or to both collect cash flows and sell, or under another model?

Financial assets classification

- Classification of debt instruments (receivables, deposits, loans, bonds, etc.)

Nature of contractual cash flows	**Management model**	**PBE IPSAS 41 classification**
SPPI	Hold to collect contractual cash flows	Amortised cost *Interest and impairment through surplus/deficit*
SPPI	Hold to collect contractual cash flows and sell	FV through OCRE (debt instrument) *Impairment, interest and "recycling" on derecognition through surplus/deficit*
SPPI	Any other model (hold to sell, manage on fair value basis, etc.)	FV through surplus or deficit
Not SPPI	Any model	FV through surplus or deficit

Financial assets classification

- Classification of debt instruments – common examples

Asset (debt instrument)	PBE IPSAS 41 classification
Receivables (from exchange or non-exchange transactions)	Likely amortised cost *Note: Interest for purpose of SPPI test may be 0%*
Deposits	Likely amortised cost
Loans to others (including concessionary loans)	Likely amortised cost – but concessionary loans may need special attention
Bonds	“Plain vanilla” bond held to collect contractual cash flows: Amortised cost Other bonds: Likely FV through surplus or deficit *(unless conditions for FV through OCRE (debt instruments) are met)*

Financial assets classification

- Classification of equity instruments (e.g. shares)

	PBE IPSAS 41 classification
Held for trading	FV through surplus or deficit
Not held for trading	FV through surplus or deficit -OR- FV through OCRE (equity instruments), if elected *Note: Different to FV through OCRE (debt instruments)*

- Classification of derivatives (e.g. FX forwards, interest rate swaps)

	PBE IPSAS 41 classification
No hedge accounting	FV through surplus or deficit
Hedge accounting applied	See the slides on hedge accounting

Financial liabilities classification

- Financial liability categories same as under PBE IPSAS 29

Amortised cost	Fair value through surplus or deficit
Default classification for financial liabilities, unless required or permitted otherwise.	Mandatory for specific financial liabilities (e.g. derivatives). Can be elected in certain circumstances.

- For liabilities that an entity elects to designate as FV through surplus or deficit, there is change in presentation of FV movements
  - FV movements that relate to own credit risk are presented in other comprehensive revenue and expense

Impairment of financial assets

- PBE IPSAS 41 introduces “expected credit loss” (ECL) model
    - More forward looking than the “incurred loss” model in PBE IPSAS 29
    - Recognise impairment for expected future defaults (discounted, probability-weighted)
    - Impairment applies to financial assets measured at amortised cost (and debt instruments at FV through OCRE)

Impairment of financial assets

- PBE IPSAS 41: Two approaches to impairment

Receivables
(and lease receivables, if elected)

Simplified approach

Impairment based on lifetime ECL

Under the simplified approach, no need to keep track of whether credit risk deteriorated significantly or not

All other financial assets subject to impairment (most deposits, loans, etc.)

General approach

Did credit risk deteriorate significantly since asset acquisition?

No

Impairment based on 12-months ECL

Yes

Impairment based on lifetime ECL

Impairment of financial assets

- Impairment of receivables: provisioning matrix
  - Group receivables in way that reflects credit risk – e.g. by age and/or customer type, product/service type etc.
  - Determine loss rate to apply to each group – based on historical experience of defaults, adjusted for current and future forecast information

Receivables age	ECL rate	Gross receivables	Impairment allowance
Current	0.3%	15,000	45
1-30 days past due	1.6%	7,500	120
31-60 days past due	3.6%	4,000	144
61-90 days past due	6.6%	2,500	165
90+ days past due	10.6%	1,000	106
		30,000	**850**

Impairment of financial assets

- Expected impact
  - Some financial assets may be impaired earlier than under PBE IPSAS 29
  - More judgement is required about future events
  - May need to upgrade systems and processes to gather additional information (e.g. actual and estimated defaults for different groups of receivables)
  - Additional disclosures (see proposed amendments to PBE IPSAS 30)
- Size of impact depends on type of asset, past experience of losses and future expectations

Hedge accounting

- PBE IPSAS 41 introduces new hedge accounting requirements that better reflect entities' risk management activities
- Less restrictive than PBE IPSAS 29
  - More risk management strategies qualify for hedge accounting
  - No "bright line" effectiveness threshold to qualify for hedge accounting (whereas PBE IPSAS 29 requires hedge effectiveness of 80-125%)
- However, entities can continue to apply the old hedge accounting requirements in PBE IPSAS 29

Hedge accounting

- Criteria to qualify for hedge accounting under PBE IPSAS 41
  - Formal documentation of hedge relationship
  - Economic relationship exists between hedging instruments and hedged item
  - Fair value movements not dominated by credit risk
  - "Hedge ratio" is the same as ratio between the hedging instrument and hedged item for risk management purposes
- Types of hedges are the same as under PBE IPSAS 29:
  Cash flow hedge, FV hedge, hedge of net investment
- Additional disclosures (proposed amendments to PBE IPSAS 30)

Hedge accounting

- Why an entity might want to apply hedge accounting
  - Reflect effect of risk management strategies in the financial statements
  - Example: Use an AUD/NZD forward contract to mitigate risk of currency fluctuation on an up-coming (highly probable) purchase in AUD

Without hedge accounting	
FV gains/losses on forward contract	XXX
Net surplus/deficit	**XXX**

Fluctuations

With hedge accounting (CF hedge)	
Net surplus/deficit	**Limited impact** (ineffective portion only)
Other comprehensive revenue and expense	
FV gains/losses on forward contract	XXX (effective portion)

Transition from PBE IPSAS 29

- PBE IPSAS 41 is effective for periods beginning 1 January 2022
- Early application is allowed
- Retrospective application generally required, with some exceptions (e.g. hedge accounting is generally applied prospectively)
- Restatement of comparatives not required
  - If comparatives not restated, adjustments from retrospective application are recognised in opening accumulated comprehensive revenue and expense of the year of initial application (e.g. as at 1 July 2022 for a June year-end)

Moving from

PBE IFRS 9 to PBE IPSAS 41

What’s different to PBE IFRS 9?

- More up to date (i.e. more narrow-scope amendments)
  - Offsetting of financial instruments (including disclosure requirements)
  - Disclosures on transfers of financial assets
  - Treatment of financial assets that have prepayment features with negative compensation
  - Treatment of long-term interests in associates and joint ventures
- Includes illustrative examples and guidance
- Impairment of receivables: simplified approach mandated
- RDR concessions – aligned with NZ IFRS 7

What’s different to PBE IFRS 9?

- In addition, there are a number of detailed differences
  - Invitation to Comment (see the Appendix)
  - marked-up version of the ED (see shading and comments)

Transition from PBE IFRS 9

- Classification and measurement remains the same, unless PBE IPSAS 41 requires or permits otherwise
- Where the requirements differ from PBE IFRS 9, there are specific transitional provisions – for example:
  - New requirements on prepayments with negative compensation applied retrospectively, but restatement of comparatives is not required
  - New requirements on offsetting and relevant disclosures apply to current and prior periods (but not before the date of application of PBE IFRS 9)
  - New disclosure on transferred assets required only from current period

Transition from PBE IFRS 9

- Hedge accounting

Has the entity applied the new hedge accounting requirements in PBE IFRS 9?

YES

On adoption of PBE IPSAS 41, an entity must apply the hedge accounting requirements in PBE IPSAS 41

NO

On adoption of PBE IPSAS 41, an entity has a choice:

- adopt the new requirements in PBE IPSAS 41, or
- continue to apply the requirements in PBE IPSAS 29

Deferral of the effective date of PBE IFRS 9

Deferral of effective date of PBE IFRS 9

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- PBE IPSAS 41 – proposed effective date is 1 January 2022
- PBE IFRS 9 – effective date is 1 January 2021
- Proposal to defer the effective date of PBE IFRS 9 by one year
- See NZASB ED 2018-6 *Effective Date of PBE IFRS 9*

ED 2018-6
Effective Date of
PBE IFRS 9

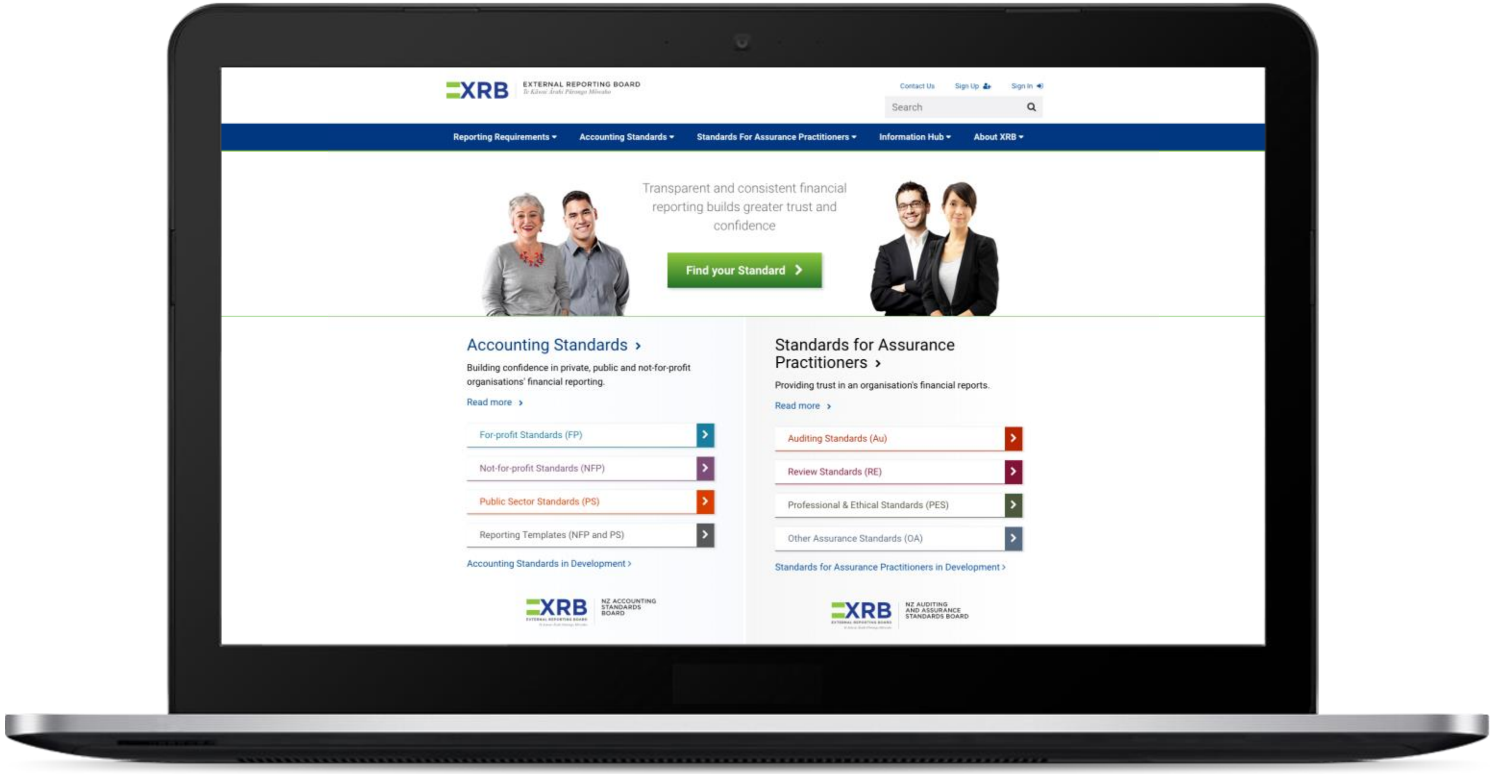
Next steps

Next steps

- Comments due to NZASB by 28 February 2019
- Documents available on XRB website
  - In Summary
  - Invitation to Comment
  - NZASB ED 2018-5 PBE IPSAS 41 *Financial Instruments* (and a marked-up copy)
  - NZASB ED 2018-6 *Effective Date of PBE IFRS 9*
  - IPSAS 41 *Financial Instruments*
- Send comments to submissions@xrb.govt.nz

Information

See “Accounting Standards in Development” section.



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