Audit New Zealand
Mana Arotake Aotearoa

28 February 2019

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

Dear Warren

NZASB Exposure Draft 2018-5 – PBE IPSAS 41 Financial Instruments and NZASB Exposure Draft 2018-6

We appreciate the opportunity to provide comments to the New Zealand Accounting Standards Board on ED 2018-5 and ED 2018-6.

We set out our views in the attached document, which also provides our responses to the specific questions posed by the NZASB.

If you would like to discuss any of our comments, please phone me on 021 222 6247 or email me at brett.story@auditnz.govt.nz.

Yours sincerely

B. Story

Brett Story
Associate Director, Technical
Audit New Zealand

Our responses to the questions in the Invitation to Comment

ED 2018-5 PBE IPSAS 41 *Financial Instruments*

1. **Do you agree that the proposed requirements in ED 2018-5 are appropriate for a new PBE Standard? If you disagree, please explain why not and outline any alternative proposals.**

   We agree.

2. **Do you agree with the proposal to locate dividend and interest revenue requirements in PBE IPSAS 41 rather than PBE IPSAS 9? If not, please explain why not.**

   We agree that these requirements should only be located within PBE IPSAS 41. This will also avoid possible different interpretations arising between the previous requirements in PBE IPSAS 9 and the requirements in PBE IPSAS 41.

   We encourage the NZASB to bring to the IPSASB's attention the duplicate dividend and interest revenue requirements in IPSAS 9 and IPSAS 41 with a view to amending IPSAS 9.

3. **Do you agree with the proposed RDR concessions? If you disagree, please provide reasons and indicate what concessions you consider would be appropriate.**

   We agree.

4. **For entities moving from PBE IFRS 9, do you agree with the proposed transition provisions? If not, please explain why not and identify what you think would be more appropriate.**

   We agree.

5. **Do you agree with the proposed effective date for PBE IPSAS 41 (being 1 January 2022)? If not, please explain why not and identify what you think would be more appropriate.**

   We agree. This provides entities that choose not to early adopt sufficient time to prepare and implement the new standard.

6. **Do you have any other comments on ED 2018-5?**

   We recommend that a transition relief provision be added to PBE IPSAS 41 in relation to the measurement of financial guarantee contracts issued in a non-exchange transaction whose fair value could not previously be reliably measured at initial recognition.

   Under PBE IPSAS 29 paragraph AG97, an entity would apply PBE IPSAS 19 at initial recognition when the fair value of a financial guarantee issued in a non-exchange transaction could not be reliably measured.

   > *AG97.* ***If no reliable measure of fair value can be determined, either by direct observation of an active market or through another valuation technique, an entity is required to apply the principles of PBE IPSAS 19 to the financial guarantee contract at initial recognition****. The entity assesses whether a present obligation has arisen as a result of a past event related to a financial guarantee contract whether it is probable that such a present obligation will result in a cash outflow in accordance with the terms of the contract and whether a reliable estimate can be made of the outflow. It is possible that a present obligation related to a financial guarantee contract will arise at initial recognition where, for example, an entity enters into a*

financial guarantee contact to guarantee loans to a large number of small enterprises and, based on past experience, is aware that a proportion of these enterprises will default.

If at initial recognition it was not probable a loss under the contract would occur, this would result in the financial guarantee contract being initially recognised at nil. Under the subsequent measurement requirements of PBE IPSAS 29, the entity would continue to measure the financial guarantee by reference to PBE IPSAS 19.

Under PBE IPSAS 41 paragraph AG136, if the fair value of a financial guarantee contract issued in a non-exchange transaction cannot be reliably determined at initial recognition it is measured based on application of the expected credit loss model.

AG136. If no reliable measure of fair value can be determined, either by direct observation of an active market or through another valuation technique, an entity is required to measure the financial guarantee contract at the amount of the loss allowance determined in accordance with paragraphs 73 to 93.

The different measurement requirements between PBE IPSAS 29 and PBE IPSAS 41 for financial guarantee contracts are shown below:

PBE IPSAS 29	**PBE IPSAS 41**
Initial measurement	
Fair value *(*Measure in accordance with PBE IPSAS 19 if fair value cannot be reliably measured)	Fair value *(*Measure in accordance with expected credit loss model if fair value cannot be reliably measured)
Subsequent measurement	
Measure it at the higher of: (i) The amount determined in accordance with PBE IPSAS 19; and (ii) The amount initially recognised (see paragraph 45) less, when appropriate, cumulative amortisation recognised in accordance with PBE IPSAS 9.	Measure it at the higher of: (i) The amount of the loss allowance determined in accordance with paragraphs 73–93; and (ii) The amount initially recognised (see paragraph 57) less, when appropriate, the cumulative amount of amortisation income recognised in accordance with the principles of PBE IPSAS 9.

There is no transition relief in PBE IPSAS 41 for an entity that previously applied paragraph AG97 of PBE IPSAS 29. This means on transition to PBE IPSAS 41, an entity would need to retrospectively apply para AG136 of PBE IPSAS 41 and determine the expected credit losses for the financial guarantee contract when it was first issued. The entity would then need to determine the expected credit losses of the contract at the date of transition to determine the amount of the liability on transition to PBE IPSAS 41 (the highest amount would be recognised).

There could be undue cost or effort in applying the expected credit loss model retrospectively for non-exchange financial guarantee contracts to determine what the initial amount of the liability was if the entity had applied PBE IPSAS 41 paragraph AG136.

We consider a transition concession should be provided so entities do not need to calculate the expected credit loss for a financial guarantee at initial recognition for non-exchange financial guarantee contracts whose fair value could not be reliably measured under PBE IPSAS 29. A possible concession would be for an entity to measure the financial guarantee at the higher of the amount previously recognised under PBE IPSAS 29 and the amount calculated by applying the expected credit loss model at the date of transition to the standard (either the start of the comparative year or start of the current year, depending on whether the entity has elected to restate comparatives on transition to PBE IPSAS 41).

ED 2018-6 *Effective Date of PBE IFRS 9*

7. Do you agree with the proposal to defer the effective date of PBE IFRS 9 to 1 January 2022 (so that PBE IFRS 9 does not become mandatorily effective before PBE IPSAS 41)?

We agree.

8. Do you agree with the proposal to limit the ability of entities to early adopt PBE IFRS 9 once PBE IPSAS 41 has been issued (a six-month period is proposed)?

We agree.

9. Do you have any other comments on ED 2018-6?

No.