



29 March 2019

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Dear Warren

EXPOSURE DRAFT 2018 AMENDMENTS TO XRB A1 APPENDIX A

We appreciate the opportunity to comment on the *Exposure Draft 2018 Amendments to XRB A1 Appendix A*.

In our view, it is important to have the right guidance to help entities determine the accounting standards they should use to prepare their financial statements. We acknowledge that guidance will not eliminate the need for judgement to be applied to the circumstances of particular entities.

Overall, we are of the view that the amendments are an improvement to XRB A1 Appendix A. In particular, it is useful to have introduced an indicator regarding the purpose and use of assets.

We comment on a few matters below where we think further clarity could be provided.

The term “equity holders” does not easily fit all situations

The purpose and use of assets (paragraph 32) notes that the reason an entity acquires and/or holds an asset may indicate whether it is a public benefit entity. This paragraph further elaborates that for-profit entities hold assets mainly for sale or for generating a financial benefit for equity holders.

However, there are non-company structures such as trusts which do not have “equity holders”, in a traditional sense, and where financial benefits are being generated.

For example, licensing trusts operate in a commercial manner to maximise financial returns. However, they are community organisations in the sense that any surplus profits must be used for community or philanthropic purposes.

We recommend that the paragraphs regarding purpose and use of assets could be enhanced by clearly explaining what is meant by the term “equity holders” in non-company structures, or using terminology that can apply across different types of entity in the public sector.

The quantum of expected financial surplus is a strong indicator

The current version of XRB A1 – paragraph 11 of Appendix A includes the indicator “*the quantum of expected financial surplus*.” This has been combined with the indicator “*Nature of the benefits*” in the updated appendix.

Some of the text of the previous *quantum of expected financial surplus* indicator (which is now part of the nature of the benefits) has been deleted – namely the sentence in paragraph 20 “The quantum of the expected surplus will provide a strong indication whether an entity is a PBE.”

From our perspective, this sentence has proved to be both relevant and useful. We have found it helpful when considering judgement calls about whether an entity is a public benefit entity.

We recommend that the updated appendix include discussion that the quantum of the expected financial benefits will usually provide a strong indication whether an entity is PBE.

A change in classification could be a for-profit entity becoming a public benefit entity

Paragraph 40 includes an example of an entity’s classification changing from a public benefit entity to a for-profit entity. We recommend that paragraph 40 also include an example of a for-profit entity becoming a public benefit entity. For example, if a Tier 1 or 2 for-profit entity becomes a Tier 1 or Tier 2 public benefit entity, the entity would need to apply PBE FRS-46 *First-time Adoption of PBE Standards by Entities Previously Applying NZ IFRS*.

The reasons for the changes to XRB A1 Appendix A should be explained

We note that the proposed amended XRB A1 Appendix A does not include a basis for conclusions. We think it is important to explain the reason for significant changes to XRB A1 Appendix A, and in particular the inclusion of the indicator regarding the purpose and use of assets.

Purpose and use of assets indicator

The purpose and use of assets is an important indicator because applying existing indicators has led to judgements about entities not being considered public benefit entities, which has resulted in illogical asset accounting. An example of illogical accounting of assets is the situation where an entity reports using for-profit accounting standards and each year acquires and capitalises assets only to impair (or write-off) the assets because the cash flows from the assets do not support their cost.

We recommend the purpose and use of asset indicator include discussion that if an entity’s primary objective is to operate an asset, such as infrastructure, and any new investment in that asset is not supported by future cash flows generated from the asset, this provides a strong indication an entity is a PBE.

If you have any questions about our submission, please phone Sara Moonlight, Director, Accounting Policy on +64 21 244 0545 or email her at Sara.Moonlight@oag.govt.nz.

Yours sincerely



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