

Board Meeting Agenda

Thursday 17 June 2020 by videoconference

Est Time	Item	Topic	Objective		Page
B: PUBLIC SESSION					
PBE Item for Consideration					
10.45 am	3	IPSASB Revenue and Transfer Expenses	(JS/VSF)		
	3.1	Cover memo ED 72	Consider	Paper	
	3.2	IPSASB EDs 70–72	Note	Link	
For-profit Items for Consideration					
11.35 am	4	Goodwill and Impairment	(GS)		
	4.1	Cover memo	Consider	Paper	
	4.2	IASB DP/2020/1 <i>Business Combinations—Disclosures, Goodwill and Impairment</i>	Note	Link	
12.35 pm		<i>Lunch</i>			
1.05 pm	5	Primary Financial Statements	(LK)		
	5.1	Cover memo	Consider	Paper	
	5.2	Draft comment letter	Consider	Paper	
	5.3	IASB ED/2019/7 <i>General Presentation and Disclosures</i>	Note	Link	
	5.4	IASB ED/2019/7 <i>General Presentation and Disclosures – Basis for Conclusions</i>	Note	Link	
	5.5	IASB ED/2019/7 <i>General Presentation and Disclosures – Illustrative Examples</i>	Note	Link	
	5.6	IASB ED/2019/7 <i>General Presentation and Disclosures – Snapshot</i>	Note	Link	
For-profit Items for Approval					
2.05 pm	6	Reference to the Conceptual Framework	(JS)		
	6.1	Cover memo	Consider	Paper	
	6.2	<i>Reference to the Conceptual Framework</i>	Approve	Paper	
	6.3	Draft signing memorandum	Approve	Paper	
	6.4	Memo: PBE Policy Approach	Consider	Paper	

Est Time	Item	Topic	Objective		Page
2.20 pm	7	Onerous Contracts—Cost of Fulfilling a Contract	(GS)		
	7.1	Cover memo	Consider	Paper	
	7.2	<i>Onerous Contracts—Cost of Fulfilling a Contract</i>	Approve	Paper	
	7.3	Draft signing memorandum	Approve	Paper	
	7.4	Memo: PBE Policy Approach	Consider	Paper	
2.35 pm	8	Annual Improvements to NZ IFRS 2018–2020	(TC)		
	8.1	Cover memo	Consider	Paper	
	8.2	<i>Annual Improvements to NZ IFRS 2018–2020</i>	Approve	Paper	
	8.3	Draft signing memorandum	Approve	Paper	
	8.4	Memo: PBE Policy Approach	Consider	Paper	
2.50 pm	9	Property, Plant and Equipment: Proceeds before Intended Use	(JC)		
	9.1	Cover memo	Consider	Paper	
	9.2	<i>Property, Plant and Equipment: Proceeds before Intended Use</i>	Approve	Paper	
	9.3	Draft signing memorandum	Approve	Paper	
	9.4	Memo: PBE Policy Approach	Consider	Paper	
3.05 pm		<i>Afternoon tea</i>			

Next NZASB meeting: Thursday 13 August 2020



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Joanne Scott

Subject: IPSASB ED 72 Transfer Expenses

Purpose and introduction¹

1. This memo seeks feedback on the proposals in IPSASB ED 72 *Transfer Expenses*. It outlines our thoughts on the proposals and seeks direction on which issues to raise in the comment letter on ED 72.

Recommendations

2. We recommend that the Board PROVIDES FEEDBACK on the proposals in IPSASB ED 72 *Transfer Expenses*, including the issues on which it wishes to comment.

Background

3. Since the last meeting we have met with the TRG and the NZAuASB to discuss the proposals in the EDs. Feedback from TRG members is noted in the TRG report at agenda item 10.4. NZAuASB members were supportive of the proposal to develop a standard based on IFRS 15 and agreed to encourage discussions on ED 71. We touch on one issue raised in relation to ED 72 (about assessing when the transfer recipient loses control of resources) later in this memo.
4. We have also begun targeted outreach, including contacting those who commented on the IPSASB's 2017 Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (2017 CP). We have had discussions with a number of people and have more planned.
5. In previous meetings we have focussed on the two revenue EDs. Pending feedback from constituents, we would like to put the revenue standards to one side and focus on ED 72.²
6. There is currently no IPSAS or PBE Standard that deals with transfer expenses, such as grants made. In the absence of a standard there have been differing views about when to recognise a liability and an expense, especially when the transfer relates to multiple periods or has a use or return condition and the conditions have not been completely fulfilled by the recipient.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

² In May 2020 the Board discussed aspects of ED 71 *Revenue without Performance Obligations* and indicated that it would welcome feedback from constituents before finalising its views on these proposals.

Some entities have wanted to recognise expenses over time whereas others have wanted to recognise them upfront.³ The accounting policies of public sector entities are likely to have been influenced by guidance issued by the Treasury in 2013⁴ and an Audit NZ *Financial reporting update* (April 2016) which discusses accounting for grant expenditure. Appendix 1 to this memo includes extracts from the Audit NZ reporting update.

7. The NZASB has been waiting for the IPSASB to complete its project on transfer expenses before considering the adoption of:
 - (a) IPSAS 42 *Social Benefits*; and
 - (b) the collective and individual service amendments to IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

Structure of this memo

8. The remaining sections in this memo are as follows.
 - (a) Overview of ED 72
 - (b) What are transfer expenses?
 - (c) NZASB's views on 2017 CP
 - (d) Possible issues
 - (e) Next steps

Overview of ED 72

9. ED 72 sets out proposals for a new standard on transfer expenses, such as grants made to other parties (see definition below). ED 72 does not cover expenses associated with goods and services provided directly to a purchaser – such expenses are not transfer expenses.

A transfer expense is an expense arising from a transaction, other than taxes², in which an entity provides a good, service, or other asset to another entity (which may be an individual) without directly receiving any good, service, or other asset³ in return (paragraphs AG6–AG7 provide additional guidance).

² Taxes include other compulsory contributions and levies, as defined in [draft] IPSAS [X] (ED 71).

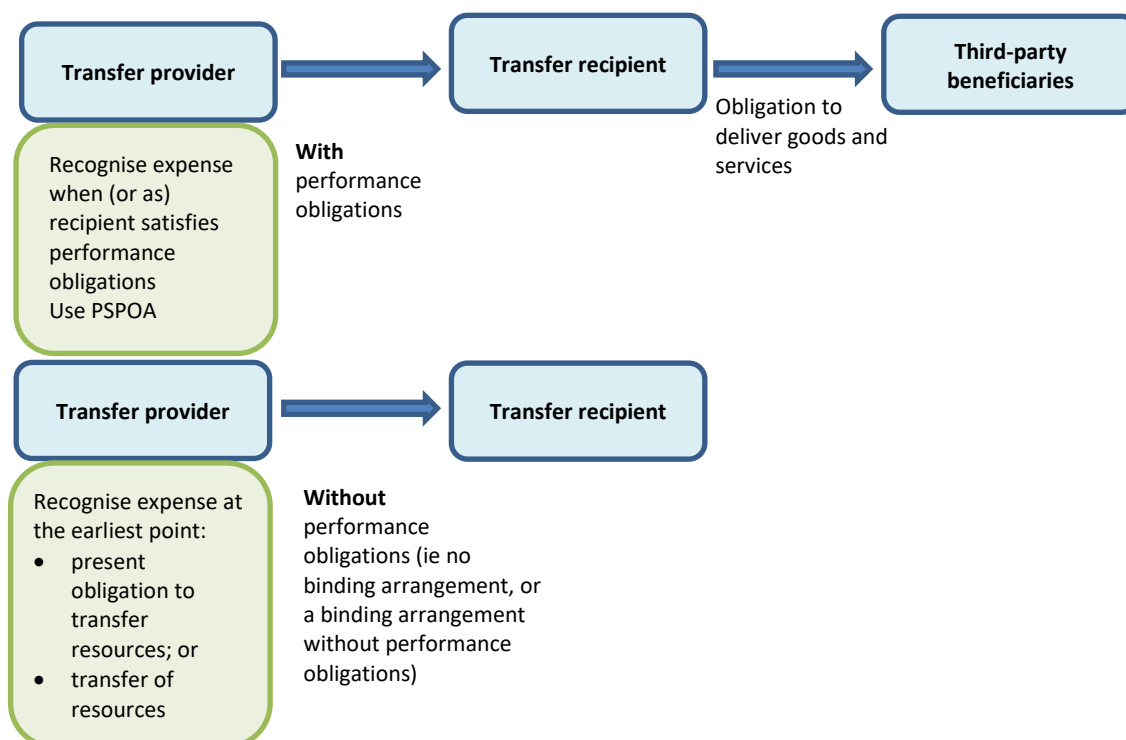
³ The definition of a transfer expense includes references to “other asset” (for example, a non-current asset) for completeness. Elsewhere in this [draft] Standard, references to goods and services or to goods or services are to be read as incorporating references to assets.

10. The requirements in ED 72 differ, depending upon whether there is a binding arrangement and, if there is, whether that binding arrangement establishes performance obligations (see Diagram 1).

³ For example, in its submission on the 2017 CP the New Zealand Film Commission argued that in order to provide useful information to readers of the financial statements, its statements need to reflect the obligations created by the Board. It therefore recognises an expense and a liability at the point that it makes funding offers to successful applicants, not in accordance with the drawdown schedules, which can span more than one period.

⁴ *Guidance on Recognising Liabilities and Expenses*, the Treasury, November 2013.

Diagram 1 ED 72



Transfer expenses with performance obligations

11. If a transfer expense transaction gives rise to performance obligations and meets certain criteria, the transfer provider recognises an expense when (or as) the transfer recipient satisfies the performance obligations in accordance with the public sector performance obligation approach (PSPOA). The definition of a performance obligation and a binding arrangement (as per ED 70) are shown below. We have highlighted the reference to third-party beneficiaries because expenses arising from performance obligations to deliver goods and services back to the purchaser are not transfer expenses. The definition of a transfer expense (shown above) excludes expenses where an entity directly receives any good, service, or other asset in return.

A performance obligation is a promise in a binding arrangement with a purchaser to transfer to the purchaser or third-party beneficiary either:

- (a) A good or service (or a bundle of goods or services) that is distinct; or
- (b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the purchaser or third-party beneficiary.

A binding arrangement is an arrangement that confers both enforceable rights and obligations on both parties to the arrangement. A contract is a type of binding arrangement (paragraphs AG7-AG12 provide additional guidance).

12. The application of the PSPOA in ED 72 can lead to the recognition of assets and liabilities before the recognition of expenses. The assets and liabilities recognised under ED 72 are

transfer provider binding arrangement liabilities, payables and transfer provider binding arrangement assets.⁵

13. As we have explained above, the performance obligations referred to in ED 72 are performance obligations on the transfer recipient to deliver goods and services to third-party beneficiaries. Those performance obligations must be set out in a binding arrangement. In order to apply the PSPOA in ED 72, all of the following criteria must be met.
 - (a) There is an approved binding arrangement and all parties are committed to perform their respective obligations.
 - (b) The transfer provider can identify each party's rights regarding the goods and services to be transferred.
 - (c) The transfer provider can identify the payment terms for the goods and services to be transferred.
 - (d) The transfer provider can identify the other party's performance obligations and monitor satisfaction of them throughout the arrangement.
14. If any of these conditions are not met the transfer provider accounts for the transaction as being without performance obligations.
15. The proposals for transactions with performance obligations in ED 72 mirror those in ED 70. Under ED 70 a transfer recipient recognises revenue when (or as) the transfer recipient satisfies the performance obligation.

Transfer expenses without performance obligations

16. If a transfer expense transaction does not give rise to performance obligations, the transfer provider recognises an expense at the **earliest** of the following two points:
 - (a) when it has a present obligation to transfer resources to the transfer recipient; or
 - (b) when it transfers the resources.
17. If an entity transfers resources *in advance* of having to do so and is entitled to a refund on demand, it may recognise an asset. However transfers with return obligations do not give rise to an asset for the transfer provider liability until the transfer recipient breaches the agreement (ie accounting for the breach is treated as a separate event).
18. The requirements in this section of ED 72 (paragraphs 90–119) do not mirror those in ED 71. ED 71 says that transfer recipients that do not have performance obligations might still have present obligations (to carry out specified activities or incur eligible expenditure) – and in such cases they recognise revenue when (or as) they satisfy those obligations. In contrast, transfer expenses without performance obligations will be recognised immediately when resources are transferred (or when the transfer provider has a present obligation to transfer resources) regardless of whether the transaction gives rise to the resource recipient having a present

⁵ The asset represents the transfer provider's right to have a transfer recipient transfer goods and services to third-party beneficiaries. This is a temporary asset that will be derecognised as the transfer recipient fulfils its performance obligations. The rationale for this is set out in ED 72 paragraphs BC21 to BC34.

obligation or not. This will lead to different recognition of expenses and revenue for some transactions. The IPSASB’s rationale for this is set out in ED 72 paragraphs BC16–BC34.

What are transfer expenses?

19. As mentioned above, ED 72 deals with transfers to a recipient (i) for the recipient to use in delivering goods and services to a third party beneficiary, or (ii) for use by the recipient. It does not deal with the purchase of goods and services for use by the entity itself. We thought it might be useful to illustrate the scope of ED 72 by looking at examples (see Table 1 below).⁶

Table 1

Expenses	Scope of ED 72?
New Zealand Superannuation Unemployment benefits Pre-paid debit cards for beneficiaries	Outside the scope of ED 72 as they are social benefits. See IPSAS 42 <i>Social Benefits</i> <ul style="list-style-type: none"> • Social benefits are cash transfers to individuals or households (who meet eligibility criteria) to mitigate a social risk and to address the needs of society as a whole. • A social risk is a risk related to the characteristics of an individual or household (for example, age, health, poverty and employment) that may adversely affect the welfare of individuals or households. • Social benefits are designed to address the broader needs of a community or society rather than specific individuals or groups of individuals. IPSAS 42 limits the recognition of social benefit expenses to the amount owed to those that have satisfied the eligibility criteria <i>for the next payment</i> . IPSAS 42 says that the past event that gives rise to a liability for a social benefit scheme is the satisfaction by each beneficiary of all eligibility criteria to receive a social benefit payment. The satisfaction of eligibility criteria for each social benefit payment is a separate past event. Amounts paid in advance are treated as assets (unless irrecoverable). In New Zealand it is mainly central government that would have social benefit expenses.
Education and health services provided for no or nominal cost Policing Defence Street lighting	Outside the scope of ED 72 as they are collective and Individual services. See IPSAS 19 <i>Provisions, Contingent Liabilities and Contingent Assets</i> – which contains guidance on collective and individual services. <ul style="list-style-type: none"> • Collective services are services provided by a public sector entity simultaneously to all members of the community that are intended to address the needs of society as a whole.

⁶ In classifying the COVID-19 spending examples we referred to *Special Series on Statistical Issues in Response to COVID-19* published by the IMF. This was because the IPSASB tries to align with GFS as much as possible. However, IPSAS are not 100% aligned with GFS requirements. Table 1 reflects our understanding of ED 72 rather than a strict application of the IMF publication.

Expenses	Scope of ED 72?
	<ul style="list-style-type: none"> • Individual services are goods and services provided to individuals and/or households by a public sector entity that are intended to address the needs of society as a whole. • Although collective and individual services meet the needs of society as a whole, they may have eligibility criteria and they may be provided to segments of society. <p>IPSAS 19 explains that expenses relating to collective and individual services are ongoing expenses and that an entity should not recognise a provision for such expenses.</p> <p>In New Zealand central government and local government would have expenses meeting the definition of collective and individual services. We do not think that not-for-profit entities would.</p>
<p>Salaries of employees Operating lease expenses Insurance expenses</p>	<p>Outside scope of ED 72. See IPSAS in general.</p> <p>These are not transfer expenses because they are for the transfer provider’s own use. The definition of a transfer expense excludes expenses where the entity “is directly receiving a good service or other asset in return”.</p>
<p>Taxes and levies paid</p>	<p>Outside the scope of ED 72. They are not covered by the definition of a transfer.</p>
<p>COVID-19 increased healthcare spending (eg more staff).</p>	<p>Outside scope of ED 72. See IPSAS in general.</p>
<p>COVID-19 spending on healthcare supplies for distribution to not-for-profit entities (for use by the not-for-profit entities).</p>	<p>Transfer expense. Apply ED 72. This would be a transfer expense without performance obligations.</p>
<p>COVID-19 payments to hotels to provide accommodation and food to those in quarantine.</p>	<p>Transfer expense. Apply ED 72. The accounting depends on whether there is a binding arrangement and performance obligations.</p>
<p>COVID-19 grant from central or local government to a charity to assist it in meeting increased demand for charitable services.</p>	<p>Transfer expense. Apply ED 72. The accounting depends on whether there is a binding arrangement and performance obligations.</p>
<p>COVID-19 wage subsidy to employers.</p>	<p>Might be within the scope of ED 72. Depends whether the predominant intent is to support the income of households (social benefits) or to support the employer (subsidy under ED 72). If there are differing views on the intent of such a subsidy this could make it difficult to decide which standard to apply.</p>
<p>Aid from central government to local government to support earthquake recovery activities following an earthquake.</p>	<p>Might be within the scope of ED 72. Depends on the nature of the aid. Not a social benefit (as stated in IPSAS 19 paragraph AG10).</p>

NZASB's views on 2017 CP

20. The NZASB made a detailed submission on the 2017 CP. That submission included a diagram setting out the NZASB's proposed framework for expense recognition. A full copy of the XRB's submission to the IPSASB is available on the [XRB](#) website. An extract from the NZASB's submission follows.

Extract from NZASB submission to IPSASB on 2017 CP

Non-exchange expenses

- The proposed approaches for the recognition of non-exchange expenses in the CP appear to have been developed based on applying the proposed CP revenue recognition approaches in reverse (a mirror approach). However, we consider that the recognition of non-exchange expenses from a resource provider perspective should encompass a distinct set of considerations and recognition issues in contrast to the recognition of revenue by the resource recipient.
- The CP does not fully address the accounting for all types of non-exchange expense transactions and the related recognition issues that arise in the public sector. Some types of transactions are not discussed, such as expense transactions with no performance obligations but with various types of stipulations. In our opinion, the analysis of those transactions discussed in the CP is insufficient, both in terms of the rationale provided and the consideration of alternative views.
- The CP's inadequate analysis of non-exchange expenses has compelled us to do a lot of thinking about the range of expenses in the public sector and the appropriate recognition approaches for various types of expenses. Similar to our proposed framework for the recognition of revenue, our proposed framework for the recognition of expenses is also based on a distinction between transactions that impose performance obligations on the resource recipient and those that do not.
- We do not agree with the discussion of universally accessible services and collective services in the CP. We consider that there are no significant conceptual differences between the types of transactions that would fall within the scope of Exposure Draft 63 *Social Benefits* and universally accessible services and collective services. In our opinion, the accounting for these expenses would require consideration of similar issues and should be consistent. We therefore encourage the IPSASB to consider how any decisions made in the development of standards-level requirements for social benefits would impact the development of an approach for recognising other expenses and liabilities arising from similar types of transactions, such as universally accessible services and collective services.
- We broadly agree with the PSPOA for expenses arising from transactions that impose performance obligations on the resource recipient. However, we do not support the use of an Extended Obligating Event Approach (EOEA) for other non-exchange expense transactions. We propose an alternative approach, which we refer to as the Obligating Event Approach (OEA).
- Under our proposed OEA, the first question to consider is when does an obligating event which leads to the recognition of a liability arise. The guidance on an obligating event can be drawn from the Conceptual Framework and IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. The second question to consider is when should a corresponding expense or asset be recognised. The expense would be recognised when the entity no longer has control over the resources transferred.
- We recommend that the IPSASB considers two options for presenting information about expenses arising from transactions when there are stipulations (but not performance obligations) imposed on the resource recipient. These two options are outlined in our detailed response. Whilst we have proposed the same options as for revenue transactions, we note that the rationale for applying either of these options to expense transactions is not necessarily the same.

21. In many respects the IPSASB’s proposals in ED 72 align with the NZASB’s views. In Table 2 below we have used shading to indicate areas of difference between the NZASB’s proposed framework for expense recognition, as set out in its submission on the 2017 CP, and the proposals in ED 72. Table 2 shows the NZASB’s proposed framework for expense recognition – apart from the first two columns which dealt with social benefits and general obligations to provide services to the public.

Table 2 Differences between NZASB’s proposals and ED 72

Grants, contributions and other transfers				Contracts for purchase of goods or services	
Transactions with no performance obligations				Transactions with performance obligations	
Other transfers to individuals or households (excluding social benefits and collective/universally accessible services)	Expense transactions where resource recipient has no performance obligations, or any stipulations	Expense transactions where resource recipient has no performance obligations but with stipulations over use (with no enforcement mechanisms)	Expense transactions where resource recipient has no performance obligations but with stipulations over use (with enforcement mechanisms)	Grant to another entity in exchange for the transfer of goods or services to beneficiaries (specific and enforceable)	Outflow of resources in exchange for the transfer of goods or services in a commercial buyer/seller relationship (specific and enforceable)
e.g. transfers to individuals or households in response to a natural disaster	e.g. general operating grant	e.g. operating grant with time requirements	e.g. grant to fund salary costs of resource recipients	e.g. grant for the delivery of a specific number of vaccinations to beneficiaries	e.g. purchase of vaccinations from supplier
Obligating event approach (with no particular presentation)		Obligating event approach (with enhanced presentation or OCI for stipulations)		PSPOA for expenses (simplified)	
Liability recognised when the entity is obliged to transfer resources (the obligating event) and expense recognised when the entity no longer has control over resources (refer to below).				Liability recognised when the resource recipient has performed by delivering the agreed goods or services (the obligating event) and expense recognised when those goods or services are transferred to beneficiaries (either by resource recipient or resource provider).	
If payment made after the obligating event has occurred, then payment settles liability, with expense recognised when obligating event occurs (i.e. when the definition of a liability is satisfied).		If payment will be made only after stipulations are satisfied, expense and liability recognition depends on whether (and to what extent) the resource provider has the discretion to terminate or modify the arrangement and avoid future payments until stipulations are satisfied.		If payment made after obligating event occurs, payment settles liability.	
If payment made before an obligating has occurred, then expense recognised when paid.		If payment made before stipulations are satisfied, then expense typically recognised when paid (unless, in certain limited circumstances, an asset exists).		If payment made before the obligating event occurs, a prepayment asset is recognised.	

22. We now discuss the four shaded areas in Table 2 where we think there are differences between the proposals in ED 72 and the NZASB’s earlier suggestions.

(a) PSPOA for expenses

23. The section of ED 72 that deals with transfer expenses with performance obligations (the PSPOA) is as detailed as ED 70. It could not be described as a *simplified approach*. The IPSASB has explained its thinking about this in ED 72 paragraphs BC44 and BC45.

Complexity of Requirements

BC44. The IPSASB reviewed the requirements for the PSPOA and considered whether these were more complex than was required for accounting for transfer expenses. The IPSASB accepted that in many cases, a binding arrangement for a transfer expense would contain only a single performance obligation and that many of the requirements would therefore not be needed. However, the IPSASB noted that there would be some transactions, for example where a national government provided funding to a provincial government with multiple performance obligations, possibly over multiple accounting periods, where the more detailed requirements would be needed.

BC45. Consequently, the IPSASB concluded that the level of complexity was appropriate for the transactions that might be encountered by some public sector entities. In coming to this conclusion, the IPSASB noted that where a transaction contained a single performance obligation, the application of the requirements would be straightforward.

24. We do not plan to raise this issue in the comment letter unless the Board wishes to.

(b) Obligating event approach (with enhanced presentation or OCI for stipulations)

25. ED 72 does not require enhanced presentation for transfers without performance obligations, but with time or purpose requirements. However, when a transfer of resources is conditional on a transfer recipient undertaking specified activities, it does require a description of activities undertaken or to be undertaken (paragraph 146). We will look at disclosures in more detail at the NZASB's August meeting.

26. Nor does ED 72 require the use of OCI or other resources for transfers without performance obligations, but with time or purpose requirements. The Basis for Conclusions (paragraph BC56) says that the IPSASB considered the use of other resources but did not think that was appropriate.

BC56. The IPSASB considered whether the recognition of other resources would be necessary to achieve the objectives of financial reporting. The IPSASB concluded that the recognition of an expense best reflected the substance of the transaction for the transfer provider, and that recognizing other resources would therefore not achieve the objectives of financial reporting.

27. We do not plan to raise this issue in the comment letter unless the Board wishes to.

(c) Payment made only after stipulations are satisfied

28. We have used the word stipulations in this subheading as it is the term used in the NZASB's diagram. Stipulations, as per the definition in IPSAS 23, cover both conditions (use or return) and restrictions. The NZASB's framework suggested that slightly different requirements might be appropriate for some transfers without performance obligations, but with stipulations. ED 72 does not establish specific requirements for transfer expenses with stipulations.

29. We do not plan to raise this issue in the comment letter unless the Board wishes to.

(d) Payment made before stipulations are satisfied

- 30. The NZASB’s diagram said “If payment made before stipulations are satisfied, then expense typically recognised when paid (unless, in certain limited circumstances, an asset exists).”
- 31. ED 72 paragraph BC54 discusses why the IPSASB does not think that a transfer provider should be able to recognise an asset for its right to have resources returned if the recipient does not comply with its obligations.

BC54. The IPSASB then considered whether the transfer provider’s right to have the resources returned if the transfer recipient did not comply with its obligations in the binding arrangement, or had not spent the funds by the agreed date, would constitute an asset for the transfer provider. The IPSASB concluded that, at the point that the resources are transferred, the transfer provider does not have a right of return. The right of return is contingent on the transfer recipient’s future noncompliance with the binding arrangement (or future failure to fully utilize the funds), and therefore does not constitute a resource that is presently controlled by the transfer provider. Consequently, the IPSASB concluded that the right to have the resources returned if the transfer recipient did not comply with its obligations in the binding arrangement, or has not spent the funds by the agreed date, does not give rise to an asset for the transfer provider at the point the resources are transferred.

- 32. ED 72 paragraph 94 also discusses wholly unperformed binding arrangements. Paragraph 94 is discussed in the next section of this memo.
- 33. We do not plan to raise this issue in the comment letter unless the Board wishes to.

Question for the Board

Q1 Many of the IPSASB’s proposals in ED 72 are similar to the Board’s comments on the 2017 CP. The above section has highlighted a few differences. We do not plan to raise any of these issues in the comment letter unless the Board wishes to. Does the Board agree?

Possible issues

- 34. We have identified a few issues that we would like the Board to consider, with a view to deciding whether to raise these issues in the comment letter on ED 72.
 - (a) Issue 1: Monitoring satisfaction of obligations
 - (b) Issue 2: Multi-year grants (and a closer look at paragraphs 91–94)
 - (c) Issue 3: Appropriations
 - (d) Issue 4: Provisions
 - (e) Issue 5: Subsequent measurement and payables
- 35. Each of these issues is discussed below.

Issue 1: Monitoring satisfaction of obligations

36. An entity that wants to account for transfer expenses that impose performance obligations on the transfer recipient to deliver goods and services to third-party beneficiaries using the PSPOA (mirroring ED 70) must be able to identify the transfer recipient's performance obligations (to transfer of goods or services to third-party beneficiaries) and monitor satisfaction of them throughout the arrangement. If an entity cannot monitor satisfaction of the transfer recipient's performance obligations, then it accounts for the transaction as being without performance obligations, and discloses that fact.
37. We are highlighting this requirement in outreach as some entities might not have sufficiently detailed monitoring in place to apply the PSPOA. Transfer providers that have insufficient information to monitor satisfaction of obligations by the recipient would have to decide whether to change their arrangements so that they could apply the PSPOA, or not to use the PSPOA.
38. Two points emerged during the NZAuASB discussions. The first was that transfer providers and auditors might have differing views about whether a provider has sufficient information (about the satisfaction of obligations by the recipient) to apply the PSPOA. The second was a query about whose perspective is used when determining that a transfer recipient has satisfied a performance obligation. Paragraph 33 of ED 72 is relevant. Our thoughts were that a transfer provider would most likely have to do this based on information received from the transfer recipient, as the provider would be unlikely to collect information from a number of third-party beneficiaries.

Satisfaction of Performance Obligations (Step 5)

33. **A transfer provider shall recognize an expense when (or as) the transfer recipient satisfies a performance obligation by transferring a promised good or service (i.e., an asset) to a third-party beneficiary. An asset is transferred when (or as) the third-party beneficiary obtains control of that asset. A transfer provider may determine the point at which the third-party beneficiary obtains control of the asset by reference to the transfer recipient losing control of that asset.**

Paragraphs AG39–AG52 provide additional guidance on the satisfaction of performance obligations.

Question for the Board

- Q2 Does the Board think that the requirement to monitor satisfaction of performance obligations in order to apply the PSPOA is appropriate? If so, are there any points to raise in the comment letter?

Issue 2: Multi-year grants (and a closer look at paragraphs 91–94)

39. One of the issues facing entities that commit to transferring resources over multiple periods (for example, a three year grant to be paid in three equal instalments) is whether they have to recognise a liability for the entire amount at the point that they commit to the funding, or whether they recognise a portion in each year. We therefore looked at ED 72 to see how much guidance it contains on such multi-year grants.

40. If the grant is a transfer expense *with* performance obligations (and meets all the criteria to apply the PSPOA) then the grant expense would be recognised when (or as) the recipient satisfies the performance obligations. If the grant is *without* performance obligations, ED 72 paragraphs 91 to 94, 97 and BC63 (shown below) are relevant.
41. We have not been able to form a view about the treatment of multi-year grants under ED 72 because, when we looked at the requirements about present obligations, we found it difficult to follow paragraphs 91–94. Our impression is that the discussion of present obligations in ED 72 is confused and that ED 72 would not provide much guidance on multi-year grants. We have taken a closer look at paragraphs 91–94 below.

A closer look at paragraphs 91–94

42. We agree with the requirement (in paragraph 91) for a transfer provider to recognise a transfer expense when the transfer provider has a present obligation. We agree that a present obligation should be enforceable.
43. However, paragraph 92 then goes on to link the concept of a present obligation of the transfer provider with present obligations *on the transfer recipient*. Paragraph 92 says that, in order for a transfer provider to have a present obligation there must be a binding arrangement. A binding arrangement (as defined in ED 70) creates *both enforceable rights and obligations on both parties to the arrangement*. We think that a transfer provider could have a present obligation to transfer resources to a transfer recipient (that could be enforced by the recipient) without there being both enforceable rights and obligations on both parties.
44. In New Zealand a range of legal documents (contracts, agreements and deeds) might be used for a grant, not all of which establish obligations on the other party. A promise (made verbally or in writing) is legally enforceable only if the other party is giving something in return, or the promise is recorded in a Deed. Unlike a contract, a promise in a Deed is enforceable whether or not there is any payment or consideration given for it.
45. Our reasons for shading parts of paragraphs 92–94 are as follows.
- (a) Paragraph 92: We think the shaded text is confusing the concept of a present obligation of the transfer provider with a present obligation of the recipient. We think that you can have one without the other.
 - (b) Paragraph 93: We do not think it is correct to say that “transfers to be made outside of a binding arrangement are not enforceable.” We do not think that deeds would meet the definition of a binding arrangement in ED 70, but deeds are enforceable.
 - (c) Paragraph 94: This was a wording issue. We think that the IPSASB intended to say that a transfer provider does not have a present obligation in these circumstances. As written, the sentence says that the transfer expense does not exist.

Recognition

91. **A transfer provider shall recognize a transfer expense without performance obligations at the earlier of the following dates:**
- (a) **When the transfer provider has a present obligation to transfer resources to a transfer recipient. In such cases, the transfer provider shall recognize a liability representing its obligation to transfer the resources; and**
 - (b) **When the transfer provider ceases to control the resources; this will usually be the date at which it transfers the resources to the transfer recipient. In such cases, the transfer provider derecognizes the resources it ceases to control in accordance with other Standards.**
92. For a present obligation to exist, the transfer recipient must be able to enforce the transfer of resources by the transfer provider, i.e., there must be a binding arrangement that imposes present obligations on the transfer recipient. For a binding arrangement to exist, the following conditions must be met:
- (a) The parties to the binding arrangement have approved the binding arrangement (in writing, orally or in accordance with other customary practices) and are committed to perform their respective obligations;
 - (b) The transfer provider can identify each party's rights regarding the obligations to be performed; and
 - (c) The transfer provider can identify the payment terms for the contribution to be transferred.
93. Transfers to be made outside of a binding arrangement are not enforceable by the transfer recipient, and no expense is recognized prior to the transfer provider transferring the resources. Paragraphs AG15–AG23 provide additional guidance on enforceability.
94. For the purpose of applying this [draft] Standard, where a transfer expense without performance obligations is to be made under a binding arrangement, the transfer expense without performance obligations does not exist if each party to the binding arrangement has the unilateral enforceable right to terminate a wholly unperformed binding arrangement without compensating the other party (or parties). A binding arrangement is wholly unperformed if both of the following criteria are met:
- (a) The transfer provider has not yet transferred, and is not yet obligated to transfer, any resources to the transfer recipient; and
 - (b) The transfer recipient has not yet performed any activities that it agreed to perform as part of the binding arrangement.

...

Transfer Expenses without Performance Obligations Made as a Series of Transfers

97. Transfer expenses without performance obligations may be made as a series of transfers of resources, for example where the transfer provider enters into a binding arrangement to provide annual funding over a three-year period. A transfer provider applies the requirements of paragraphs 91–94 to each transfer of resources to determine whether an expense is to be recognized.

Basis for Conclusions on ED 72

- BC63. The IPSASB noted that some binding arrangements may require a transfer provider to make a series of transfers, for example one transfer per year over a three-year period. The IPSASB considered when a present obligation to make each transfer would arise, and concluded that this would be dependent on the nature of the binding arrangement. The IPSASB concluded that a transfer provider should apply

the recognition principle to each transfer of resources to determine whether an expense is to be recognized.

BC64. The IPSASB noted that in some jurisdictions, a binding arrangement for a transfer expense without performance obligations might be made subject to the authorization of the related appropriation. The IPSASB considered whether such a limitation should affect the recognition of an expense. The IPSASB concluded that the impact of such a limitation would depend on whether the limitation had substance. The IPSASB agreed that where the limitation has substance, the transfer provider should not recognize an expense prior to the appropriation being authorized. The IPSASB also agreed to include guidance on determining whether the limitation that future transfers were subject to the appropriation being authorized has substance.

Question for the Board

Q3 Does the Board agree that our concerns about paragraphs 91–94 should be raised in the comment letter, including our view that clear guidance on present obligations, and the application of that guidance to multi-year grants is required?

Issue 3: Provisions

46. We have agreed to look at how the IPSASB EDs interact with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. This memo focuses on how ED 72 interacts with IPSAS 19.
47. A provision is defined in IPSAS 19 as a liability of uncertain timing or amount. Paragraph 19 of IPSAS 19 (shown below) explains the distinction between provisions and other liabilities.

Provisions and Other Liabilities

19. Provisions can be distinguished from other liabilities such as payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:
- (a) Payables are liabilities to pay for goods or services that have been received or supplied, and have been invoiced or formally agreed with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist); and
 - (b) Accruals are liabilities to pay for goods or services that have been received or supplied, but have not been paid, invoiced, or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of accounts payable, whereas provisions are reported separately.

48. IPSAS 19 also defines onerous contracts (see below) and requires that an entity recognise a provision for onerous contracts.

An onerous contract is a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.

49. ED 72 excludes provisions, as defined in IPSAS 19, from its scope. We read that as meaning that a transfer provider would not consider whether it has an onerous contract, even if that contract is for the provision of goods and services to third party beneficiaries.
50. We will look at the interaction between ED 70 and ED 71, and IPSAS 19 at the next meeting.

Issue 4: Subsequent measurement and payables

51. Given the issues that we have previously raised in relation to subsequent measurement under ED 70 and ED 71 we have looked at how ED 72 deals with subsequent measurement.
52. ED 72 has three sets of measurement requirements:
 - (a) Transfer expenses with performance obligations (paragraph 47);
 - (b) Transfer expenses without performance obligations (initial measurement is set out in paragraphs 102–104 and subsequent measurement in paragraphs 116–19); and
 - (c) Non-contractual payables that are not transfer expenses (paragraph 120).

Transfer expenses with performance obligations

53. Paragraph 47 deals with the measurement of an expense. It does not deal with the subsequent measurement of a transfer provider’s binding arrangement asset, binding arrangement liability or payable.
54. Subsequent measurement of those balances is discussed in the presentation section (paragraphs 121–125). Those paragraphs say that:
 - (a) A binding arrangement asset may arise when the provider pays, or has an obligation to pay before the recipient performs. A transfer provider shall assess its binding arrangement assets for impairment in accordance with IPSAS 21 *Impairment of Non-Cash-Generating Assets*.
 - (b) A binding arrangement liability (or payable) may arise when the recipient performs before the provider pays or before payment is due. A transfer provider presents any unconditional obligations to pay consideration separately as a payable. A transfer provider shall account for a payable in accordance with IPSAS 41 *Financial Instruments*.
55. We suggest that the comment letter make the following points in relation to transfer expenses with performance obligations:
 - (a) The discussion of subsequent measurement might be better located somewhere in the section on *transfer expenses with performance obligations* (somewhere following the discussion of initial measurement in paragraph 47).
 - (b) The ED does not appear to discuss the subsequent measurement of binding arrangement liabilities (other than payables).
 - (c) Not all payables will be financial liabilities. The statement that they shall be accounted for as a payable in accordance with IPSAS 41 does not acknowledge this point. The proposed requirements for transfer expenses without performance obligations (see below) are clearer.

Transfer expenses without performance obligations

56. The section on measurement of transfer expenses without performance obligations deals with both initial and subsequent measurement (paragraphs 102–104 and 116–119).
57. In relation to subsequent measurement those paragraphs say that:
- (a) where the liability for a transfer expense without performance obligations is a financial liability it shall be accounted for in accordance with IPSAS 41; and
 - (b) where the liability for a transfer expense without performance obligations is not a financial liability as defined in IPSAS 41, the liability is reduced as the transfer provider transfers resources to the transfer recipient. Any difference between the carrying amount of the resources transferred and the carrying amount of that liability is recognised in surplus or deficit in the period in which the liability is settled.
58. We do not plan to comment on these requirements.

Other non-contractual payables

59. ED 72 paragraph 120 also specifies the subsequent measurement of other non-contractual payables arising out of the operation of legislation or regulation that are not transfer expenses. The IPSASB has included them in this ED because there is currently no guidance in IPSAS on subsequent measurement of such payables.
60. The ED proposes that after initial recognition, such payables be accounted for in the same way as a payable for a transfer expense without performance obligations (except where the payable is within the scope of another Standard, in which case the requirements in that Standard are applied).
61. We have one comment on this proposal. The requirements should be set out in a separate section. At the moment they are located at the end of the section on measurement of transfer expenses without performance obligations.

Question for the Board

- Q4 Does the Board agree with the suggested points for the comment letter in relation to subsequent measurement and payables? Are there any other points?

Issue 5: Appropriations

62. ED 72, SMC 8 asks whether respondents agree with what the ED says about recognising a transfer expense that is subject to an appropriation being authorised. Paragraphs 98 and 99 are shown below.

Transfer Expenses without Performance Obligations Subject to Appropriations

98. Where a binding arrangement specifies that the resources to be transferred to a transfer recipient by a transfer provider are subject to an appropriation being authorized, the transfer provider considers substance over form in determining

whether it has a present obligation to transfer the resources prior to the appropriation being authorized.

99. This limitation (that the resources to be transferred are subject to the appropriation being authorized) does not have substance where the transfer recipient can establish an enforceable right to those resources (and as a consequence the transfer provider has a present obligation to transfer the resources) before the appropriation is authorized. Paragraphs AG98–AG102 provide additional guidance on appropriations.
63. An appropriation is an authority for the Crown or an Office of Parliament to incur expenses or capital expenditure. The Public Finance Act 1989 describes the types of appropriations (for example, output expenses, capital expenditure, departmental vs non-departmental, and annual vs multi-year). The Public Finance Act, section 4, states that the Crown or an Office of Parliament must not incur expenses or capital expenditure, except as expressly authorised by an appropriation, or other authority, by or under an Act.⁷
64. The restrictions imposed by the Public Finance Act mean that most central government agencies will not commit to transferring funds to others unless they have an appropriation. We think that public sector constituents are best placed to decide if the proposals about appropriations in ED 72 work. We suggest that we do not comment on this SMC unless we hear concerns from public sector constituents.

Questions for the Board

- Q5 Does the Board agree not to comment on SMC 8 (about appropriations)?
- Q6 We plan to comment on all the SMCs apart from SMC 8 (see Table 4 for all the SMCs). Most of the issues we have identified to date would fall under SMC 1 (scope) and SMC 5 practical (difficulties). Which other SMCs or issues would the Board like us to focus on?

Table 4 ED 72 SMCs

	SMC
1	The scope of this [draft] Standard is limited to transfer expenses, as defined in paragraph 8. The rationale for this decision is set out in paragraphs BC4–BC15. Do you agree that the scope of this [draft] Standard is clear? If not, what changes to the scope or definition of transfer expense would you make?
2	Do you agree with the proposals in this [draft] Standard to distinguish between transfer expenses with performance obligations and transfer expenses without performance obligations, mirroring the distinction for revenue transactions proposed in ED 70, <i>Revenue with Performance Obligations</i> , and ED 71, <i>Revenue without Performance Obligations</i> ? If not, what distinction, if any, would you make?
3	Do you agree with the proposal in this [draft] Standard that, unless a transfer provider monitors the satisfaction of the transfer recipient’s performance obligations throughout the duration of the binding arrangement, the transaction should be accounted for as a transfer expense without performance obligations?
4	This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses with performance obligations:

⁷ An expense, as per section 4 of the Act does not include a remeasurement of an asset or a liability or an operating loss of certain specified entities.

	<p>SMC</p> <p>(a) A transfer provider should initially recognize an asset for the right to have a transfer recipient transfer goods and services to third-party beneficiaries; and</p> <p>(b) A transfer provider should subsequently recognize and measure the expense as the transfer recipient transfers goods and services to third-party beneficiaries, using the public sector performance obligation approach.</p> <p>The rationale for this decision is set out in paragraphs BC16–BC34.</p> <p>Do you agree with the recognition and measurement requirements for transfer expenses with performance obligations? If not, how would you recognize and measure transfer expenses with performance obligations?</p>
5	<p>If you consider that there will be practical difficulties with applying the recognition and measurement requirements for transfer expenses with performance obligations, please provide details of any anticipated difficulties, and any suggestions you have for addressing these difficulties.</p>
6	<p>This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses without performance obligations:</p> <p>(a) A transfer provider should recognize transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources (this proposal is based on the IPSASB’s view that any future benefits expected by the transfer provider as a result of the transaction do not meet the definition of an asset); and</p> <p>(b) A transfer provider should measure transfer expenses without performance obligations at the carrying amount of the resources given up?</p> <p>Do you agree with the recognition and measurement requirements for transfer expenses without performance obligations?</p> <p>If not, how would you recognize and measure transfer expenses without performance obligations?</p>
7	<p>As explained in SMC 6, this [draft] Standard proposes that a transfer provider should recognize transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources. ED 71, <i>Revenue without Performance Obligations</i>, proposes that where a transfer recipient has present obligations that are not performance obligations, it should recognize revenue as it satisfies those present obligations. Consequently, a transfer provider may recognize an expense earlier than a transfer recipient recognizes revenue.</p> <p>Do you agree that this lack of symmetry is appropriate? If not, why not?</p>
8	<p>This [draft] Standard proposes that, when a binding arrangement is subject to appropriations, the transfer provider needs to consider whether it has a present obligation to transfer resources, and should therefore recognize a liability, prior to the appropriation being authorized. Do you agree with this proposal?</p> <p>If not, why not? What alternative treatment would you propose?</p>
9	<p>This [draft] Standard proposes disclosure requirements that mirror the requirements in ED 70, <i>Revenue with Performance Obligations</i>, and ED 71, <i>Revenue without Performance Obligations</i>, to the extent that these are appropriate.</p> <p>Do you agree the disclosure requirements in this [draft] Standard are appropriate to provide users with sufficient, reliable and relevant information about transfer expenses? In particular,</p> <p>(a) Do you think there are any additional disclosure requirements that should be included?</p> <p>(b) Are any of the proposed disclosure requirements unnecessary?</p>

Next steps

65. We will reflect on feedback received at this meeting in drafting the comment letter or in seeking feedback from constituents.
66. We plan to consider disclosures in all three EDs at a future meeting. We have also agreed to look at the interaction between the revenue EDs and provisions. We will continue targeted outreach.
67. The closing date for comments to the IPSASB is now 1 November 2020 and to the NZASB is now 23 September. We will need to seek approval of the NZASB's comment letter towards the end of October and will discuss the possibility of scheduling an additional short meeting to do this.

Appendix 1

This appendix contains extracts from an Audit NZ Financial reporting update and an extract from Treasury Instructions on accounting for grants.

Audit NZ Financial reporting update (April 2016)

2 Grant expenditure

- Grants are widespread in the public sector. That term encompasses a wide variety of funding flows from the public sector to individuals, NGOs and the private sector, and also funding flows within the public sector. For government departments, the focus is on non-departmental grant expenses.
- In last year's audit of some grant-paying entities we identified that the accounting for grant expenditure may not always be appropriate under the new PBE Standards. The particular concern is the timing of recognition of the expense and liability.
- It is a difficult area and there has been very little – if any – guidance in the standards under the IFRS-regime. Even in the new PBE standards there is still only limited guidance, but the accounting standard on Revenue from Non-exchange Transactions, PBE IPSAS 23, does give some guidance by “reverse-application”.
 - That Standard outlines the matters that should be taken into account when deciding when to recognise revenue that is received by way of a grant. By analogy, it can be applied by the entity that is paying the grant to determine when the expense should be recognised.
- An important issue is whether the funding agreement contains conditions. For the purpose of applying the Standard, “conditions” are terms in the agreement that specify how the money is to be used and, if it is not used as specified, then it must be returned. The types of issues that can be encountered and will need to be considered include:
 - Grants with no conditions:
Currently, these may have been recognised as they are paid (that is, on a cash-basis or time period basis) even if multi-year. If there are no conditions then perhaps they should be recognised “upfront”.
 - Grants with conditions or payments made upon achieving milestones:
In some cases these may have been recognised up-front when the grant application is approved and the approval has been communicated to the recipient. If there are conditions/milestones then perhaps the grants should be recognised as conditions/milestones are achieved.

There can be significant judgement whether the terms of the grant do actually give rise to “conditions” that are sufficiently substantive that they should drive the accounting treatment.

Treasury Instructions (July 2018)

3.5.4.2 Welfare benefits and entitlements

Welfare benefits and entitlements, including New Zealand Superannuation, must be recognised in the period when an application for a benefit has been received and the eligibility criteria have been met.

3.5.4.3 Grants and subsidies

Where grants and subsidies are at the government's discretion until payment, the expense is recognised when the payment is made. Otherwise, the expense is recognised when the specified criteria for the grant or subsidy have been fulfilled and notice has been given to the government.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Gali Slyuzberg

Subject: *Business Combinations – Disclosures, Goodwill and Impairment*

Recommendations¹

1. We recommend that the Board PROVIDES FEEDBACK on the sections of IASB Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment* (the DP), discussed in this memo.

Background

2. The IASB issued the DP in March 2020. This DP was issued as part of the IASB's *Goodwill and Impairment* project – a research project initiated with a view to considering issues identified in the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*.
3. In issuing the DP, the IASB's objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Better information should help investors assess the performance of companies that have made acquisitions and hold a company's management to account for acquisition decisions.
4. At its May 2020 meeting, the Board discussed the following sections of the DP.
 - (a) Section 3, which discusses the IASB's preliminary views on goodwill impairment and amortisation (and a proposal to present equity excluding goodwill on the balance sheet);
 - (b) Section 4, which discusses the IASB's preliminary views on simplifying the impairment test;
 - (c) Section 5, which discusses the IASB's preliminary views to retain the existing requirement of recognising certain intangible assets separately from goodwill on acquisition.
5. At this meeting, we are seeking the Board's feedback on the remaining topics in the DP.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

6. Since the Board’s May meeting, we have sought feedback on the DP from the XRAP, the TRG and the NZAuASB. This memo refers to feedback received from these groups, to inform the Board’s discussion.

Structure of this memo

7. The sections of the DP that we propose to discuss at this meeting are listed in the table below. We recommend that Board members read these sections of the DP. The DP is attached as agenda item 4.2 (in the supporting papers).

Table 1 DP topics for discussion at this meeting

DP topic	DP reference
<ul style="list-style-type: none"> Improving disclosures on acquisitions 	Section 2 (paragraphs 2.1–2.91 and questions 2–5)
<ul style="list-style-type: none"> Whether the IASB’s package of preliminary views meet the objectives of the project, and whether any questions are interdependent 	Section 1 (paragraphs 1.1–1.9 and question 1)
<ul style="list-style-type: none"> Other recent publications 	Section 6 (paragraphs 6.1–6.16 and questions 13 and 14)

8. Similar to the Board’s previous discussion of the DP, this memo is set up as a “navigation tool” for the relevant sections of the DP.
9. This means that rather than repeating the information contained in the DP, the memo:
- (a) refers Board members to the relevant sections of the DP;
 - (b) reproduces questions in the DP
 - (c) sets out the preliminary staff views on these questions; and
 - (d) asks for the Board’s feedback on the DP questions.

Improving disclosures on acquisitions (DP Section 3)

Subsequent performance of acquisitions

10. Currently, IFRS 3 requires a number of disclosures to be provided in the year that an acquisition occurs. However, IFRS Standards do not specifically require disclosures on how an acquisition performs after the year of acquisition. The IASB received feedback from investors that companies do not typically provide enough information about the subsequent performance of acquisitions. As a result, these investors find it difficult to assess whether management’s objectives for the acquisition are being met – for example, whether the expected synergies are being realised.

11. To provide investors with better information about the subsequent performance of acquisitions, the IASB's preliminary view is that it should propose to add the following new disclosure requirements.

Table 2 Proposed disclosure requirements on the subsequent performance of acquisitions

Proposed new disclosure requirement	DP ref
(i) In the year of acquisition, disclose: <ul style="list-style-type: none"> • information about the strategic rationale for undertaking the acquisition • management's (i.e. the chief operating decision maker's (CODM's)² objectives for an acquisition as at the acquisition date • the metrics that management (CODM) will use to monitor whether the objectives of the acquisition are being met. 	Paragraphs 2.8–2.12
(ii) Disclose the extent to which management's (CODM's) objectives for the acquisition are being met using the abovementioned metrics. This information: <ul style="list-style-type: none"> • should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives, rather than on metrics prescribed by the IASB; and • should be provided for as long as management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives. 	Paragraphs 2.13–2.44
(iii) If management (CODM) does not monitor an acquisition, disclose that fact and explain why it does not do so. In such cases, disclosure of metrics would not be required.	Paragraphs 2.19–2.20
(iv) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, disclose that fact and the reasons why it has done so.	Paragraphs 2.41–2.44
(v) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, disclose the new metrics and the reasons for the change.	Paragraph 2.21

12. The Board is asked to refer to paragraphs 2.1–2.45 for further information on this topic.
13. Question 2 of the DP is the relevant question for this sub-topic. The preliminary staff views on these questions, as well as feedback received from outreach conducted so far are included in the following paragraphs. Question 2 is then reproduced again to seek the Board's feedback.

² Paragraph 7 of IFRS 8 *Operating Segments* discusses the term 'chief operating decision maker'.

Feedback from outreach

14. The following table summarises the feedback received from outreach regarding the IASB’s proposed disclosures on the subsequent performance of acquisitions.

Table 3 Disclosures on subsequent performance of acquisitions: feedback from outreach

Comments in favour of proposed disclosures	Challenges and concerns relating to the proposed disclosures
<u>TRG:</u>	
<ul style="list-style-type: none"> • The disclosures would provide useful information to users of financial statements about major transactions of the entity. • The disclosures could shed light on unsuccessful acquisitions and lead to impairment of excessive goodwill balances, particularly for Tier 2 for-profit entities. • The disclosures would provide insight into management’s thought process behind acquisitions, and would encourage management to consider more carefully the objectives for the acquisition at the time of the transaction (rather than after the fact). It could also encourage management to re-think some acquisitions. • In light of the discussion on materiality in the DP, the proposal that disclosures on subsequent performance should be provided for acquisitions that are monitored by the CODM seems sensible. 	<ul style="list-style-type: none"> • The disclosures could help identify unsuccessful acquisitions and lead to goodwill impairment. While this was identified as a benefit, this could also be a reason for some preparers to strongly oppose the proposals. • When an acquired business is integrated into the existing business, it can be difficult to track the acquisition’s performance separately. • Commercial sensitivity could be a big concern. Entities would be concerned about their competitors having access to the information that the proposals would require. The commercial sensitivity argument is perhaps stronger in New Zealand than in other countries. • The proposals aim to address investors’ needs, but it is uncertain how much they would ultimately affect investment decisions – plus, there would be additional compliance costs for preparers. When speaking to New Zealand constituents, it is important to be clear about the benefits of the proposals and who is expected to benefit.
<u>XRAP:</u>	
<ul style="list-style-type: none"> • The disclosures could be useful for judging management’s performance regarding acquisitions, and how they are likely to perform in future acquisition. • The disclosures could help investors differentiate between businesses based on the performance of their acquisitions. 	<ul style="list-style-type: none"> • There may be challenges in auditing the proposed disclosures. • When acquisitions are integrated into the existing business, the proposed disclosures can lose value. • Some entities may be reluctant to disclose the strategic rationale and objectives for acquisitions, as there is a risk that these expectations will not be achieved. • The proposals would require a lot of disclosures on the performance of acquisitions, but not about the core business.

Comments in favour of proposed disclosures	Challenges and concerns relating to the proposed disclosures
	<p>For example, while entities would need to report on the performance of acquisitions against forecasts, there would be no such requirement for the entity’s core business.</p> <ul style="list-style-type: none"> • The focus of the proposals seems too narrow. That is, the proposed disclosures would provide information on only one type of investment: the acquisition of businesses. There are other types of investments that entities make to provide value to stakeholders. The proposals should be broader to cover such investments
<u>NZAuASB:</u>	
<p>When some companies make acquisitions, they focus on ‘closing the deal’ and do not always consider or report on the consequences of integrating the acquired business into the group. The proposed disclosure requirements on subsequent performance of acquisitions and on synergies (see the next sub-topic in this memo) could be useful in this regard.</p>	<ul style="list-style-type: none"> • Acquisitions get absorbed into the existing business, therefore it can be difficult to track the subsequent performance of acquisitions. • The ability to audit the proposed disclosures would depend on entities having sufficient documentation of the rationale for acquisitions and systems that can track the performance of acquisitions. • Entities will be able to avoid providing disclosures on the subsequent performance of acquisition simply by explaining that they are not monitored by the CODM. • The requirement to report against those objectives that were set at acquisition date does not take into account that much can change since the date of acquisition. • It would be important to clearly articulate the difference between the strategic rationale for the acquisition and the objectives for the acquisition, otherwise some will find it challenging to distinguish between the two terms.

Staff preliminary views

Question 2(a): Do you think the proposed disclosure requirements (see Table 2 above) would meet investors’ need for better information on the subsequent performance of an acquisition? Why or why not?

Question 2(b): Do you agree with each of the disclosure proposals listed in Table 2 above? Why or why not?

15. Staff's preliminary view is that the disclosures would provide useful information to investors about the subsequent performance of acquisitions.
16. As noted by the IASB, the impairment test for goodwill cannot indicate to what extent an acquisition is meeting management's expectations – nor is it the purpose of the impairment test. Similarly, if the IASB was to reintroduce goodwill amortisation (as discussed at the Board's May meeting), information on the annual amortisation of goodwill would not indicate whether an acquisition is successful. Therefore, whether the IASB reintroduces goodwill amortisation or retains the impairment-only model for goodwill, we think the proposed disclosures on the subsequent performance of acquisitions would be useful to investors for assessing the subsequent performance of an acquisition, and management's ability to realise the benefits expected from the acquisition. However, we think it will be important to receive feedback from investors and analysts as to the usefulness of these proposed disclosures.
17. At the TRG meeting, XRAP meeting and NZAuASB meeting, comments were raised about the integration of the acquired business into the existing business, and how such integration could either make the preparation of the proposed disclosures challenging or diminish the value of these disclosures. However, the DP explains that if the acquired business is integrated with the acquirer's business, information about the subsequent performance of the acquisition may be based on the combined business. Therefore, we think the proposed disclosures could provide useful information on the subsequent performance of acquisitions, even in cases where the acquired business is integrated into the existing business soon after acquisition. We also note that the IASB's proposals acknowledge the fact that the challenges of integration become stronger as time passes: if the CODM stops monitoring the performance of an acquisition after two years, no explanation would be needed under the proposed requirements.
18. As noted by a TRG member, the proposed disclosures could highlight unsuccessful acquisitions and lead to write-downs of overstated goodwill balances. On this basis, we think the proposed disclosures could strengthen the robustness of the goodwill impairment test. In particular, we think that the additional transparency around acquisitions could help guard against the risk of management over-optimism in performing the impairment test (as discussed at the Board's May meeting).
19. While we acknowledge that there would be challenges in auditing the proposed disclosures, we agree with the IASB that the following information should be verifiable by an auditor:
 - (a) whether the information disclosed is the information that management receives to monitor the acquisition;
 - (b) whether there is an adequate explanation of how the information has been prepared; and
 - (c) whether the information faithfully represents what it purports to represent.
20. We acknowledge the comments provided at the XRAP meeting that the proposed disclosures would provide information on a potentially narrow aspect of the business. That is, information would be provided only on the performance of acquisitions – not on the performance of the

entity's core business or on investments that create value for stakeholders but do not arise through business combinations. However, we also acknowledge that the DP was published as a consequence of the PiR of IFRS 3, which focuses on business combinations, therefore this is also the focus of the proposals.

21. We agree that information on the subsequent performance of other investments and value-creating activities could be useful to investors and other stakeholders of an entity. This could be the case for intangible assets and unrecognised intangible resources, as well as investments in joint ventures and associates. However, developing disclosures on these types of assets seems to be outside the scope of the DP. Therefore, we think that recommendations to the IASB to initiate projects in this area could be made as part of the Board's response to the IASB's forthcoming agenda consultation.

Regarding the proposal that information provided should be based on the information and the acquisitions a company's CODM reviews: Do you agree with this proposal? Why or why not?

Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews?

Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews?

22. We agree with the IASB that requiring the proposed disclosures for those acquisitions that are reviewed by the CODM, and using the metrics the CODM uses, strikes a reasonable balance between providing investors with information that is important to them, avoiding disclosure overload, and making it feasible for preparers to provide information to investors.
23. We also agree that this approach is superior to requiring disclosures for 'major' or 'fundamental' acquisitions. Those approaches would have effectively introduced a new layer of materiality, whereas the IASB's proposed approach builds on existing concepts that are already used under IFRS 8 *Segment Reporting*.
24. We also think that auditing disclosures on acquisitions that are monitored by the CODM could be easier than auditing disclosures on all material acquisitions, as it would be easier to ascertain whether an acquisition is monitored by the CODM as compared to whether an acquisition is material.
25. Having said this, we are aware that under this 'CODM approach', there is a risk that investors will not receive material information on acquisitions that are not monitored by the CODM but are nevertheless material. However, if an acquisition is not monitored by the CODM, we note that the IASB proposes to require entities to explain why that is the case. We think this proposed requirement could somewhat guard against entities omitting material information on acquisitions.

Question 2(d): Regarding possible concerns about commercial sensitivity:

Could concerns about commercial sensitivity inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met?

Why or why not?

Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?

26. Commercial sensitivity was a concern noted during outreach (see above). A TRG member specifically noted that the argument of commercial sensitivity may be particularly strong in New Zealand.
27. We think commercial sensitivity could affect the nature of information and level of detail that entities are prepared to provide under the proposed disclosure requirements. However, we think it should be possible to achieve a balance between providing investors with the information they need under the proposed disclosures and not causing unnecessary damage to an entity's competitive position.
28. It would be useful to receive further feedback from preparers on this matter. It would also be useful to see illustrative examples of what level of detail would be acceptable – including examples of disclosures about the strategic rationale for the acquisition and metrics for measuring subsequent performance (an example is provided in paragraph 2.11 of the DP).

Question 2(e): Paragraphs 2.29–2.32 of the DP explain the IASB's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the IASB considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in New Zealand that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

29. The DP notes that information about management's strategic rationale, objectives and related targets for an acquisition reflects management's target *at the time of the acquisition*; it is not a forecast of the expected outcome at the time the entity prepares its financial statements. Therefore, in the IASB's view, information about the objectives for the acquisition and relevant metrics are not forward-looking information, and as such should not cause a litigation risk to companies.
30. While targets are not necessarily predictions of future outcomes, we think that targets by their nature represent expectations of future performance. Therefore, in the year of acquisition, we think there would be a forward-looking element to the disclosure of management's objectives and targets for the acquisition.
31. As noted at the XRAP meeting, some entities may be reluctant to disclose the objectives for the acquisition, as the expected performance may not be achieved. We are not sure that this would lead to litigation in New Zealand, but it may lead to criticism of management.

32. We note that disclosures about expectations for the future are already required in IFRS Standards. For example, IAS 36 *Impairment of Assets* requires information about growth rates used to determine forecast cash flows, and IFRS 7 *Financial Instruments: Disclosures* requires information on expected credit losses for certain financial assets. However, not achieving the objectives of an acquisition may possibly attract greater criticism of management as compared to not achieving the expected growth rate disclosed under IAS 36 or actual credit losses on a financial instrument being different to those disclosed under IFRS 7.
33. However, we think that the risks of not achieving objectives and targets is not necessarily a reason to not provide investors with the information they need to be able to assess the performance of acquisitions.

Questions for the Board	
Q1. Disclosures about the subsequent performance of acquisitions (Question 2 of the DP)	
(a)	Do you think the proposed disclosure requirements listed in Table 2 above would meet investors' need for better information on the subsequent performance of an acquisition? Why or why not?
(b)	Do you agree with each of the disclosure proposals listed in Table 2 above? Why or why not?
(c)	Regarding the proposal that information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40 of the DP): <ul style="list-style-type: none"> • Do you agree with this proposal? Why or why not? • Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? • Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews?
(d)	Regarding possible concerns about commercial sensitivity (see paragraphs 2.27–2.28 of the DP): <ul style="list-style-type: none"> • Could concerns about commercial sensitivity inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met? Why or why not? • Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?
(e)	Paragraphs 2.29–2.32 of the DP explain the IASB's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the IASB considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in New Zealand that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

Other targeted improvements to disclosure requirements

- 34. This sub-topic is covered in paragraphs 2.46–2.87 of the DP. A summary is provided below.
- 35. Investors told the IASB that disclosures provided under IFRS 3 are not enough to fully understand how acquisitions affected entities in the year of acquisition, and that these disclosures tended to be “boilerplate”. These investors wanted to better understand the benefits that management had expected when it acquired a business – which would help them assess whether the price the entity paid for the acquired business was reasonable.
- 36. On the other hand, the IASB has heard from preparers that the current disclosure requirements in IFRS 3 are already excessive.
- 37. In response to the above concerns, the IASB’s preliminary view is that it should make targeted improvements to the current disclosure objectives and disclosure requirements of IFRS 3, as summarised in the table below.

Table 4: Other targeted improvements to existing disclosures on acquisitions

Sub-topic	IASB preliminary view	DP reference
More specific disclosure objectives	<p>Add into IFRS 3 disclosure objectives to provide information to help investors understand:</p> <ul style="list-style-type: none"> • the benefits that a company’s management expected from an acquisition when agreeing the price to acquire a business; and • the extent to which an acquisition is meeting management’s (CODM’s) objectives for the acquisition 	Paragraphs 2.53–2.60
Factors that make up goodwill (synergies)	<p>Require the following disclosures to help investors understand the factors that make up goodwill:</p> <ul style="list-style-type: none"> • a description of the synergies expected from combining the operations of the acquired business with the company’s business; • when the synergies are expected to be realised; • the estimated amount or range of amounts of the synergies; and • the expected cost or range of costs to achieve those synergies. 	Paragraphs 2.62–2.68
Financing and defined benefit pension liability	<p>Specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of the acquiree’s liabilities, and therefore should be disclosed separately under IFRS 3.</p> <p>(Explanation: When calculating return on capital employed in an acquisition, some investors consider the acquired entity’s financing liabilities and defined benefit pension liabilities to be part of the total capital employed by the acquirer. However, there is no specific requirement to disclose these separately.)</p>	Paragraphs 2.69–2.71

Sub-topic	IASB preliminary view	DP reference
Contribution of the acquired business	<p>Currently, IFRS 3 requires entities to disclose the following in the year of acquisition.</p> <ul style="list-style-type: none"> • ‘pro forma’ information that shows the revenue and profit or loss of the combined business for the current reporting period, as though the acquisition date had been at the beginning of the annual reporting period. • the revenue and profit or loss of the acquired business after the acquisition date. <p>The IASB propose to:</p> <ul style="list-style-type: none"> • Retain the requirement to disclose the above ‘pro forma’ information; • Replace the term ‘profit or loss’ with the term ‘operating profit before acquisition-related transaction and integration costs’ for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the IASB Exposure Draft <i>General Presentation and Disclosures</i>. • Require entities to disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a ‘pro forma’ basis for the current reporting period. 	Paragraphs 2.77–2.87

38. Questions 3–5 of the DP are the relevant questions for this sub-topic. The preliminary staff views on these questions as well as feedback received from outreach conducted are included in the following paragraphs. Questions 3–5 are then reproduced again to seek the Board’s feedback.

Feedback from outreach

39. TRG members specifically commented on some of the proposed targeted improvements to existing disclosures. Their comments are summarised in the table below.

Table 5: TRG feedback on targeted improvements to disclosures

IASB proposals	TRG comments
<p>Factors that make up goodwill (synergies):</p> <p>The IASB proposes to require more detailed disclosures on the synergies expected from a business combination.</p>	<ul style="list-style-type: none"> • Some TRG members think the proposed disclosures on synergies will be difficult to audit. A TRG member hoped that auditors will not be expected to confirm the reasonableness of projections relating to synergies. • There were concerns about commercial sensitivity.

IASB proposals	TRG comments
	<ul style="list-style-type: none"> There is a strong regulatory influence on disclosures about acquisitions. Therefore, disclosures in this area are and will be subject to judgement and trade-offs.
<p>Contribution of the acquired business:</p> <p>The IASB proposes to retain the requirement to disclose ‘pro forma’ information on the performance of the group as if the acquisition occurred at the start of the reporting period.</p>	<p>There was a general preference among TRG members to remove this requirement. Members noted that this disclosure would not be needed if the proposed additional disclosures on the subsequent performance of acquisitions are introduced. It was also noted that preparing this disclosure can be difficult, and that the usefulness of this disclosure to investors is questionable.</p>
<p>Contribution of the acquired business:</p> <p>The IASB proposes that the existing disclosures on how a business combination contributes to the group’s financial performance in the year of acquisition should be based on operating profit, rather than profit or loss.</p>	<p>A TRG member noted that the IASB ED <i>General Presentation and Disclosures</i> already proposes new subtotals in the statement of financial performance and new defined terms, and it is important that this DP does not to introduce additional ‘moving parts’ in this regard.</p>

40. NZAuASB members also commented on the proposed requirement for more specific disclosures on expected synergies. An NZAuASB member noted that disclosures on synergies could be useful, as they would help understand the consequences of integrating the acquired business into the group. However, another member noted that that providing and auditing these disclosures would depend on the entity having systems that can quantify synergies.

Staff preliminary views

Question 3: *The IASB’s preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:*

- the benefits that a company’s management expected from an acquisition when agreeing the price to acquire a business; and*
- the extent to which an acquisition is meeting management’s (CODM’s) objectives for the acquisition.*

Do you agree with the IASB’s preliminary view? Why or why not?

41. We agree with the proposals to update the disclosure objectives in IFRS 3 so that they specifically refer to providing information on benefits expected from an acquisition and the extent to which these benefits are being realised. This is consistent with the IASB’s proposed

new disclosure requirements on the subsequent performance of acquisitions and on expected synergies at the time of acquisition.

Question 4: The IASB's preliminary view is that it should develop the following proposals:

- *To require a company to disclose a description of the synergies expected from combining the operations of the acquired business with the company's business, when the synergies are expected to be realised, the estimated amount or range of amounts of the synergies, and the expected cost or range of costs to achieve those synergies.*
- *To specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.*

Do you agree with the Board's preliminary view? Why or why not?

42. We agree that the IASB's proposals to require more specific disclosures on synergies should help provide investors with more useful information about the expected benefits of the acquisition and the rationale for the transaction price (and therefore the value of goodwill on acquisition). Therefore, we agree with proposing these disclosures.
43. However, as noted by TRG members, concerns about commercial sensitivity could affect the level of detail that entities are prepared to provide regarding expected synergies.
44. Also, if the proposed disclosures are introduced, we think it would be important for auditors and/or regulators to clarify the auditor's role regarding assurance over the disclosures over synergies (given the abovementioned concerns raised during outreach about the audit of the disclosures on synergies).
45. The IASB's also proposes to require separate disclosure of the acquiree's liabilities from financing activities and pension liabilities. If investors find this information useful, we agree that this information should be disclosed. When discussing the DP with investors, we hope to receive feedback as to whether they consider such information useful.

Question 5: IFRS 3 Business Combinations requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

The IASB's preliminary view that it should retain the requirement for companies to prepare this pro forma information.

- (a) *Do you agree with the Board's preliminary view? Why or why not?*
- (b) *Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the IASB require companies to disclose how they prepared the pro forma information? Why or why not?*

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

The IASB’s preliminary view that it should develop proposals:

- *to replace the term ‘profit or loss’ with the term ‘operating profit before acquisition-related transaction and integration costs’ for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft General Presentation and Disclosures.*
 - *to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.*
- (c) *Do you agree with the Board’s preliminary view? Why or why not?*

46. Based on feedback received from the TRG, we tend to think that the abovementioned requirement to disclose ‘pro forma’ information should be removed. We agree with TRG members that if the IASB introduces the disclosures on subsequent performance of acquisitions as discussed in the DP, then it is unlikely the ‘pro forma’ disclosures would be needed by investors. This will also help address some preparers’ concerns on the amount of disclosures currently required by IFRS 3.
47. The IASB also proposes that disclosures on the contribution of the acquiree to the group in the year of acquisition should be based on operating profit and operating cash flows. We are not to what extent this change will be more useful to investors as compared to the current requirements. We hope to receive feedback from investors on this proposal.

Questions for the Board

Q2. More specific disclosure objectives (Question 3 of the DP)

Paragraphs 2.53–2.60 of the DP explain the IASB’s preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:

- the benefits that a company’s management expected from an acquisition when agreeing the price to acquire a business; and
- the extent to which an acquisition is meeting management’s (CODM’s) objectives for the acquisition.

Do you agree with the IASB’s view? Why or why not?

Q3. Factors that make up goodwill and other targeted improvements (Question 4 of the DP)

Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 of the DP explain the IASB’s preliminary view that it should develop proposals:

- to require a company to disclose a description of the synergies expected from combining the operations of the acquired business with the company’s business, when the synergies are expected to be realised, the estimated amount or range of amounts of the synergies; and the expected cost or range of costs to achieve those synergies.
- to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

Do you agree with the IASB’s preliminary view? Why or why not?

Questions for the Board

Q4. Contribution of the acquired business (Question 5 of the DP)

IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

Paragraphs 2.82–2.87 of the DP explain the IASB’s preliminary view that it should retain the requirement for companies to prepare this pro forma information.

- (a) Do you agree with the IASB’s preliminary view? Why or why not?
- (b) Should the IASB develop guidance for entities on how to prepare the pro forma information? Why or why not? If not, should the IASB require companies to disclose how they prepared the pro forma information? Why or why not?

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

Paragraphs 2.78–2.81 of the DP explain the IASB’s preliminary view that it should develop proposals:

- to replace the term ‘profit or loss’ with the term ‘operating profit before acquisition-related transaction and integration costs’ for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*.
 - to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.
- (c) Do you agree with the IASB’s preliminary view? Why or why not?

Whether the IASB’s package of preliminary views meet the objectives of the project, and whether any questions are interdependent (DP Section 1)

48. While Section 1 is the introductory section of the DP, due to the nature of the questions in that section we thought it was more appropriate to discuss these questions with the Board once the Board has discussed the other DP topics.
49. The questions and staff’s preliminary views are noted below. The questions are then repeated to seek the Board’s feedback.

Paragraph 1.7 of the DP summarises the objective of the IASB’s research project. Paragraph IN9 summarises the IASB’s preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views.

The IASB has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those

businesses. The IASB is of the view that the benefits of providing that information would exceed the costs of providing it.

- (a) Do you agree with the IASB’s conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project’s objective?*
- (b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the IASB reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?*

50. We agree that, in general, as a package, the IASB’s preliminary views as discussed in the DP would achieve the goal of helping investors assess the performance of acquisitions and hold management to account for their acquisition decisions. This is subject to finalising the Board’s views on the specific questions in the DP (for example, whether removing the requirement to perform the goodwill impairment test annually would be appropriate).

51. We also think that in general, the IASB’s views work well together. For example, the IASB is of the view that it is not feasible to make the impairment test for goodwill significantly more effective at recognising impairment in a timely manner. However, the IASB is proposing to introduce new disclosures on the subsequent performance of acquisitions, which should help inform investors in a more timely manner that an acquisition is not performing as well as expected.

52. As to whether the questions in the DP are interlinked, we think that in general the answers to each topic tend to stand on their own, but some questions are interlinked. For example, as noted by the TRG, if the IASB introduces the proposed disclosures on the subsequent performance of acquisitions, then they would not support retaining the existing requirements to disclose the ‘pro forma’ performance information currently required by IFRS 3 in the year of acquisition.

Questions for the Board

Q5. Whether the IASB’s package of preliminary views meet the objectives of the project, and whether any questions are interdependent (Question 1 of the DP)

The IASB has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The IASB is of the view that the benefits of providing that information would exceed the costs of providing it.

- (a) Do you agree with the IASB’s conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project’s objective?
- (b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on

Questions for the Board
whether the IASB reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

Other recent publications (DP Section 6)

53. This section of the DP summarises the contents of an Invitation to Comment published by the US Financial Accounting Standards Board (FASB) in July 2019 and of a Research Report published by the Australian Accounting Standards Board (AASB) on IAS 36 *Impairment of Assets* in March 2019. The AASB Research Report was discussed with the Board at the joint meeting of the NZASB and NZAuASB in February 2020.
54. The DP notes that some stakeholders think that maintaining alignment between IFRS Standards and US GAAP is important.
55. Regarding the AASB Research Report, the DP notes that this report proposes a holistic review of IAS 36. The IASB is interested in feedback as to whether stakeholders support such a holistic review, but note that such a review is outside the scope of this project. The IASB encourages stakeholders who support such a holistic review to provide this feedback by responding to the IASB's next agenda consultation.
56. The relevant questions in the DP for that topic are Questions 13 and 14, which are reproduced below. We recommend not to comment on these questions, as explained below.

<p><i>Question 13: IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB).</i></p>
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<p><i>Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?</i></p>

Staff preliminary view

57. As alignment with US GAAP is unlikely to be an issue of major concern in New Zealand, we recommend not to comment on this question.

<p><i>Question 14: Do you have any other comments on the Board's preliminary views presented in this Discussion Paper? Should the Board consider any other topics in response to the PIR of IFRS 3?</i></p>

58. The Board has already agreed that the general approach to drafting the comment letter should be as follows.
- (a) Include in the cover letter a general comment expressing support for a holistic review of IAS 36 and the intention to recommend such a review in response to the IASB's forthcoming 2020 agenda consultation; and

- (b) Focus the responses in the comment letter on those specific issues and questions raised in the DP – with the understanding that other issues and views, that would fit better under a holistic review of IAS 36, will be raised when we comment on the IASB’s 2020 agenda consultation.

59. Therefore, other than making the abovementioned general comment in the cover letter, we propose not to provide specific comments on this question.

Questions for the Board

Q6. Does the Board agree not to comment on Questions 13 and 14 of the DP?
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Next steps

60. We will continue to undertake outreach with respect to the DP. We will also begin drafting the comment letter on the DP, based on the Board’s feedback to date. At the Board’s September meeting, we plan to invite investors and analysts to discuss the DP with the Board.

Attachments

Agenda item 4.2: *IASB DP/2020/1 Business Combinations – Disclosures, Goodwill and Impairment* (in the supporting papers)

Date: 5 June 2020

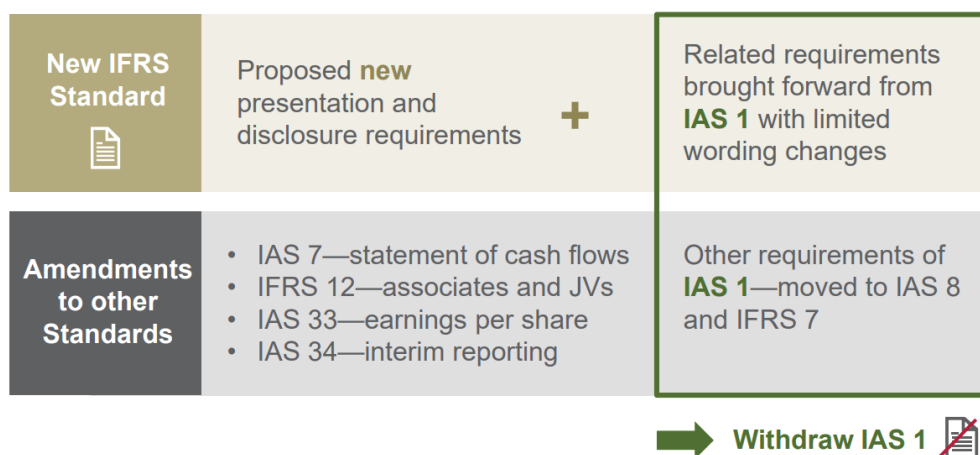
To: NZASB Members

From: Lisa Kelsey

Subject: **General Presentation and Disclosures**

Purpose and introduction¹

- In December 2019, the IASB issued Exposure Draft ED/2019/7 *General Presentation and Disclosures* (the ED) under its *Primary Financial Statements* project. The ED proposes to introduce a new IFRS Standard that sets out general presentation and disclosure requirements. The proposed new standard will replace IAS 1 *Presentation of Financial Statements*. The structure of the ED is shown in the diagram below.



- Comments on this ED were originally due to the IASB by 30 June 2020. However, as part of the IASB's response to COVID-19, the IASB extended the comment period to 30 September 2020. We have extended the comment period for NZ constituents from 21 May 2020 to 7 August 2020.
- Because the ED contains several new proposals, we grouped the proposals for consideration over two NZASB meetings (February and April 2020).
- At this meeting we are asking the Board to consider a first draft of a comment letter based on feedback we received from the Board at its February and April meetings. There are some areas of the comment letter that require further consideration by the Board at this meeting.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

5. Further outreach is planned, and submissions are due to the NZASB by 7 August 2020. Hence the Board may change its preliminary views expressed in this draft as new information comes to hand.

Recommendations

6. We recommend that the Board CONSIDERS and PROVIDES FEEDBACK on the draft comment letter at agenda item 5.2.

Next steps

7. The next steps in the project are as follows.
 - (a) Continue to undertake outreach activities on the ED.
 - (b) Provide a verbal update on any submissions received at the August Board meeting.
 - (c) Bring a final comment letter to the September Board meeting for approval.

Attachments

Agenda item 5.2	Draft comment letter
Agenda item 5.3	IASB ED/2019/7 <i>General Presentation and Disclosures</i> (in supporting papers)
Agenda item 5.4	IASB ED/2019/7 <i>General Presentation and Disclosures</i> – Basis for Conclusions (in supporting papers)
Agenda item 5.5	IASB ED/2019/7 <i>General Presentation and Disclosures</i> – Illustrative Examples (in supporting papers)
Agenda item 5.6	IASB ED/2019/7 <i>General Presentation and Disclosures</i> – Snapshot (in supporting papers)

[September 2020]

Mr Hans Hoogervorst
Chairman of the International Accounting Standards Board
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Submitted to: www.ifrs.org

Dear Hans

ED/2019/7 General Presentation and Disclosures

Thank you for the opportunity to comment on *ED/2019/7 General Presentation and Disclosures*. The ED has been exposed in New Zealand and some New Zealand constituents may comment directly to you.

We are very supportive of the IASB's projects to help make financial information more useful and improve the way financial information is communicated to users of the financial statements.

We are broadly supportive of the proposals contained in the ED. However, this letter identifies areas where we do not agree and identifies a number of issues which we think require further consideration by the IASB.

[summarise main points from comment letter]

New Zealand outreach

We would like to take the opportunity to thank IASB staff member Aida Vatrenjak for her assistance with an outreach event we held on the proposals with institutional investors in New Zealand.

If you have any queries or require clarification of any matters in this letter, please contact Lisa Kelsey (Lisa.Kelsey@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook
Chair – New Zealand Accounting Standards Board

Appendix to General Presentation and Disclosures*Notes for the Board*

- *The last sentence highlighted below will depend on the outcome of the Board's discussions on the proposed definition of MPMs under Question 11.*

Overall comments

1. We support the proposals to provide more structure to the statement of profit or loss by introducing defined and required subtotals, provided an entity can continue to tell 'its own story'. We acknowledge there can be tension between increasing comparability and allowing sufficient flexibility for an entity to communicate its performance story. The proposals in the ED allow an entity to communicate management's view of performance by disclosing information about management performance measures in the notes to the financial statements. We are of the view that the package of proposals can increase comparability between entities without adversely affecting the ability of individual entities to communicate their story to the users of their financial statements. **However, in our view the IASB should allow a wider range of MPMs to be disclosed in the notes to the financial statements.**

Question 1—operating profit or loss

Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss.

Paragraph BC53 of the Basis for Conclusions describes the Board’s reasons for this proposal.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board

- [Click here](#) to read the paragraphs referred to in Question 1.
- Paragraph 5 expresses a staff view; this has not been raised by constituents.

Draft response to question 1

2. We agree with the proposal that all entities present in the statement of profit or loss a subtotal for operating profit or loss.
3. Like the IASB, we have also seen diversity in practice, in terms of (a) entities that present an operating profit subtotal and others that don’t; and (b) for those entities that do present an operating profit subtotal what the subtotal comprises.
4. We believe that having a consistent view of the income and expenses that are included in a subtotal for operating profit or loss will reduce diversity in practice and improve comparability between entities.

Other comments

5. We note that the IASB is proposing to bring forward paragraph 8 (shown below) from IAS 1 *Presentation of Financial Statements* into the new IFRS Standard (as paragraph 12). Paragraph 8 of IAS 1 has been amended to include a reference to subtotals. Proposed paragraph 12 of IFRS X allows entities to use another label when presenting the new operating profit or loss subtotal. In fact, entities may be able to use different labels for all of the proposed new subtotals. As the main objective of the proposals to add defined subtotals to the statement of profit or loss is to increase comparability between entities, we believe that these new required subtotals should be labelled consistently across entities. We recommend that the IASB amend paragraph IFRS X.12 to exclude the subtotals required by paragraph 60 of IFRS X. This will also remove the risk that entities may label the new subtotals with existing labels which may confuse users.

A comparison of proposals with requirements in IAS 1 <i>Presentation of Financial Statements</i>		
IAS 1 para #	Revised text (new text underlined, deleted text struck through)	New para #
IAS 1.8	Although this <u>[draft] Standard</u> uses the terms <u>such as</u> 'other comprehensive income', 'profit or loss' and 'total comprehensive income', an entity may use other terms to describe the totals, <u>subtotals and line items required by this [draft] Standard</u> as long as the meaning is clear. For example, an entity may use the term 'net income' to describe profit or loss.	IFRS X.12

Question 2—the operating category

Paragraph 46 of the Exposure Draft proposes that entities classify in the operating category all income and expenses not classified in the other categories, such as the investing category or the financing category.

Paragraphs BC54–BC57 of the Basis for Conclusions describe the Board’s reasons for this proposal.

Do you agree with this proposal? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board

[Click here](#) to read the paragraphs referred to in Question 2.

Paragraph 10 reflects feedback received from a TRG member.

Draft response to question 2

6. We agree with the proposal that entities classify in the operating category all income and expenses not classified in the other categories, such as the investing category or the financing category.
7. We acknowledge the challenges the IASB faced trying to define operating profit or loss. We agree that, because entities have various business activities, it is difficult to arrive at a direct definition of operating profit or loss that could be applied consistently, even between entities in the same industry. We acknowledge that the IASB’s previous attempts at developing a direct definition of operating profit or loss were not successful. Therefore, for practical reasons we support the operating category being a default or residual category.
8. We agree that the operating category should include all income and expenses from an entity’s main business activities. We have discussed main business activities in more detail under question 3.
9. We have heard concerns that the proposal not to define operating profit or loss directly may mean that some income and expenses not arising from an entity’s core operations may be classified as operating by virtue of the fact that those income and expenses do not meet the definitions to be classified in the other categories. However, in considering this concern, we are satisfied that the disaggregation proposals should provide the users of the financial statements with enough information to enable adjustments to be made where appropriate.

Other comments

10. We have received feedback that the IASB should provide some guidance regarding the classification of the fair value movements for biological assets – are the movements in fair value operating or investing in nature? There is currently diversity in practice so clarity would be welcome.

Question 3—the operating category: income and expenses from investments made in the course of an entity’s main business activities

Paragraph 48 of the Exposure Draft proposes that an entity classifies in the operating category income and expenses from investments made in the course of the entity’s main business activities.

Paragraphs BC58–BC61 of the Basis for Conclusions describe the Board’s reasons for this proposal.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board

- *Click here to read the paragraphs referred to in Question 3.*
- *When classifying income and expenses into each of the categories, entities would need to consider the nature of their main business activities.*
- *The ED does not define ‘main business activity’ and includes limited guidance in this regard*
- *We have highlighted for the Board extracts from the ED that provide guidance on “main business activity”.*
- *Paragraph B27 gives examples of entities that invest in the course of their main business activity.*
- *Paragraph B29 gives examples of entities that provide financing to customers as a main business activity.*
- *The proposals suggest that when an entity reports a segment that constitutes a single business activity, this may indicate that this is a main business activity. It could be inferred from this guidance that a reportable segment constituting a single business activity could, but may not necessarily, be a main business activity (see paragraph B31).*

Operating

- B25 For an entity to include income and expenses from its **main business activities** in the operating category, paragraphs 48, 51 and 52 set out circumstances when income and expenses that would otherwise be classified as investing and financing would instead be classified as operating.
- B26 An entity may have more than one main business activity. For example, an entity that manufactures cars and also provides financing to customers may determine that it has both a manufacturing main business activity and a customer-finance main business activity.
- B27 Paragraph 48 requires an entity to classify in the operating category income and expenses from investments in the course of its **main business activities**. Whether income and expenses from investments arise in the course of an entity’s **main business activities** is a matter of judgement. In general, investments are likely to have been made in the course of an entity’s **main business activity** when investment returns are an **important indicator** of operating performance. Examples of entities that invest in the course of their **main business activities** may include:
- (a) investment entities as defined by IFRS 10 *Consolidated Financial Statements*;
 - (b) investment property companies; and
 - (c) insurers.
- B28 Applying paragraph 51, when an entity provides financing to customers as a **main business activity** it is required to make an accounting policy choice to classify in the operating category either income and expenses from financing activities, and from cash and cash equivalents relating to the provision of financing to customers or all income and expenses from financing activities and all income and expenses from cash and cash equivalents.
- B29 Whether an entity provides financing to customers as a **main business activity** is a matter of judgement. In general, providing financing to customers is likely to be a **main business activity** when the difference between

interest income and the related interest expense is an important indicator of operating performance. Examples of entities that provide financing to customers as a **main business activity** may include:

- (a) banks;
- (b) entities that provide financing to customers to enable those customers to purchase the entity's products; and
- (c) lessors that provide finance leases to customers.

B30 The requirement in paragraph 52(a) for an entity to classify income and expenses from cash and cash equivalents in the operating category applies when any entity invests in financial assets in the course of its **main business activities**. It does not apply to an entity that invests only in non-financial assets in the course of its **main business activities**.

B31 If, applying IFRS 8 *Operating Segments*, an entity reports a segment that constitutes a single business activity, that may indicate that that business activity is a **main business activity**.

- *We received feedback at the February Board meeting that in some cases determining income and expenses generated in the course of an entity's main business activities will involve significant judgement.*
- *Board members suggested we consider whether we should include in our comment letter a request for further guidance to be included on determining main business activities.*
- *In the draft response below we have provided two alternative responses – paragraph 13 or paragraph 14.*
- *We are not convinced we should ask the IASB for more guidance, unless we have some idea of what else they would say? The reason the IASB did not define operating profit or loss was because of the difficulty with trying to define "main business activities" or "core business activities" or a similar term. Entities are just going to have to apply judgement. So as an alternative to paragraph 13 we could just acknowledge that this will be an area of judgement – see paragraph 14?*

Draft response to question 3

11. We agree with the proposal that an entity classifies in the operating category income and expenses from investments made in the course of the entity's main business activities.
12. In paragraph BC60 of the Basis for Conclusions, the IASB explains that for some entities, such as insurers, investing is an important activity performed in the course of their main business activities although it is arguably not their main business activity. For example, an insurer's main business activity may be underwriting, but it may invest in assets that generate returns individually and largely independently of its other resources in the course of its underwriting business activity. To ensure that income and expenses from such activities are included in the operating category, the proposals refer to investments that are made in the course of an entity's main business activities (as opposed to an entity that provides financing to customers as a main business activity). This proposal would also capture entities for whom such activities are their main business activity.

Option 1 response

13. The ability for an entity to classify income and expenses from investments as operating rather than investing rests on the application of judgement as to what is "generated in the course of its main business activities". The ED does not define 'main business activity' and includes limited guidance in this regard. We are of the view that further guidance is needed to clarify the meaning of an entity's 'main business activity'. For some entities, for example, global

conglomerates with multiple business activities, significant judgement may be involved in determining the entity’s main business activities.

OR Option 2 response

14. The ability for an entity to classify income and expenses from investments as operating rather than investing rests on the application of judgement as to what is “generated in the course of its main business activities”. For some entities, for example, global conglomerates with multiple business activities, significant judgement may be involved in determining the entity’s main business activities. In our response to Question 2 we have agreed with the IASB’s proposals not to define operating profit or loss and agreed that, because entities have various business activities, it is difficult to arrive at a direct definition of operating profit or loss that could be applied consistently, even between entities in the same industry. We believe the IASB would have the same difficulty if we requested a definition or further guidance on what is meant by ‘main business activities’.
15. We note that the IASB is proposing to bring across paragraph 138 of IAS 1 into the new IFRS X. This will require an entity to disclose in the notes (if not disclosed elsewhere) a description of the entity’s main business activities. It is this description of main business activities that will drive the classification of income and expenses into each of the categories.

IAS 1.138	<p>An entity shall disclose <u>in the notes</u> the following, if not disclosed elsewhere in information published with the financial statements:</p> <ul style="list-style-type: none"> (a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office); (b) a description of the nature of the entity’s operations and its principal<u>main business</u> activities; (c) the name of the parent and the ultimate parent of the group; and (d) if it is a limited life entity, information regarding the length of its life. 	IFRS X.99
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16. We note that no specific requirement is proposed to disclose information on the significant judgements involved in determining an entity’s main business activities. An entity may disclose information on the significant judgements involved under paragraph 122 of IAS 1, which is moving to IAS 8 as paragraph 27E.

27E	<p>[IAS 1.122] An entity shall disclose <u>in the notes</u>, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125<u>31A</u>), that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements.</p>
27F	<p>[IAS 1.123] In the process of applying the entity’s accounting policies, management makes various judgements, apart from those involving estimations, that can significantly affect the amounts it recognises in the financial statements. For example, management makes judgements in determining:</p> <ul style="list-style-type: none"> (a) {deleted} (b)<u>(a)</u> when substantially all the significant risks and rewards of ownership of financial assets and, for lessors, assets subject to leases are transferred to other entities; (c)<u>(b)</u> whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; and (d)<u>(c)</u> whether the contractual terms of a financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

27G [IAS 1.124] Some of the disclosures made in accordance with paragraph ~~42227E~~ are required by other ~~IFRSs~~ IFRS Standards. For example, IFRS 12 *Disclosure of Interests in Other Entities* requires an entity to disclose in the notes the judgements it has made in determining whether it controls another entity. IAS 40 *Investment Property* requires disclosure in the notes of the criteria developed by the entity to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business, when classification of the property is difficult.

17. Users of the financial statements need to be given enough information to be clear about an entity's main business activities and how this has affected the classification of income and expenses in the statement of profit and loss. Any information provided on main business activities and subsequent classification of income and expenses should also be consistent with any business model information that may be provided by an entity in its annual report, for example, in its management commentary.

Other comments

18. Investors have told us they would support proposals that are applicable to as many company types as possible; they agree with the proposals for banks but would not like to see other exceptions or modifications being made for other types of business.

Question 1 for the Board

- (a) Which alternative response does the Board prefer, option 1 or option 2?
- (b) If the Board prefers option 1, does the Board have any suggestions for additional guidance that the IASB could include?
- (c) Does the Board want to ask the IASB to consider providing a specific requirement regarding the disclosure of information on the significant judgements involved in determining an entity's main business activities?

Question 4—the operating category: an entity that provides financing to customers as a main business activity

Paragraph 51 of the Exposure Draft proposes that an entity that provides financing to customers as a main business activity classify in the operating category either:

- income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or
- all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

Paragraphs BC62–BC69 of the Basis for Conclusions describe the Board’s reasons for the proposals.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board

- [Click here](#) to read the paragraphs referred to in Question 4.
- *We sent the following email to five NZ banks, at the time of drafting the memo we have received two responses. Both responses are included below for the Board. Note the names of the responding banks have been removed.*
- *Request sent:*
By way of introduction, I’m Lisa Kelsey a Senior Project Manager with the New Zealand Accounting Standards Board (NZASB).
The NZASB is currently considering proposals to come out of the International Accounting Standards Board (IASB) to add more structure to the statement of profit or loss with the aim of enhancing comparability between entities. The proposals will affect all entities that report in accordance with IFRS Standards.
We have reached out to you to seek your input on a particular aspect of the proposals that will affect financial institutions.
The proposals if finalised would require companies to classify their income and expenses in the statement of profit or loss into operating, investing and financing categories.
Some companies provide financing to customers or invest as part of their main business activities, for example banks and investment companies. In these circumstances applying the proposed definitions of the categories to such companies would not provide relevant information because some income and expenses that relate to such companies’ main business activities would not be classified in the operating category. Therefore, exceptions to the proposed definitions have been developed which would continue to allow entities such as banks to present a net interest income subtotal within the operating category.
For an entity that borrows funds for the purposes of both lending those funds to customers and investing in other assets, we have heard that it may be difficult for that entity to be able to identify which interest expense relates to funding of which source of income.
We understand that Banks typically borrow from multiple sources, for example a wide range of depositors, other banks, and other instruments each of which will have differing interest rates. If a bank then uses some of that borrowing to lend to customers (presumably its main business activity) and some to invest in a range of equities, it may be difficult to know sources of borrowing (and related interest expense) should be allocated to which income

generating activity (included in the operating category for providing financing to customers or in the financing category for that used to invest in equities).

The NZASB is interested in understanding whether it is possible without undue cost or effort to split out

income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; and

income and expenses from financing activities, and from cash and cash equivalents that are unrelated to the provision of financing to customers

We would very much appreciate your feedback by the 2 June 2020.

If you are interested in looking at the proposals in more detail, these can be found on our website [here](#).

Alternatively if you have any questions please do not hesitate to contact me,

- *Response 1 received:*

Thanks for reaching out for feedback. Ordinarily, I'd circulate and formulate a more structured and formal response including a number of areas but given the current workload, I've needed to just give you my initial high level feedback on the points you've raised below.

"The NZASB is interested in understanding whether it is possible without undue cost or effort to split out

income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; and

income and expenses from financing activities, and from cash and cash equivalents that are unrelated to the provision of financing to customers"

We have information by product that splits out where interest is earned from however funding of the provision of financing is done on a pooled basis i.e. the cost of funds is x% across all funding sources therefore this product offered to customers needs to be offered at y% (there is no direct connection between a debt instrument and the provision of a specific loan or loan product). We don't have any financing costs where we specifically connect that borrowing with specific activities outside of the provision of financing to customers. We therefore would not likely be able to disaggregate income and expenses from financing between amounts that relate to provision of financing to customers and amounts unrelated to financing to customers. Particularly with all deposits held by customers, I don't believe there is a way to separate that out to connect it with other activities outside of providing financing to other customers.

There are perhaps a few exceptions e.g. we could classify interest expense on lease liabilities as related to financing activities unrelated to providing financing to customers (this is currently included within interest expense for [Bank] – something we've need to do to align with RBNZ expectations). The other example would be in longer term debt issuances like subordinated debt which could be classified as financing. This could be clearly outlined as financing as instruments often qualify as capital. I believe all retail and wholesale deposits could clearly be connected to the provision of finance so should clearly be operating anyway. The biggest grey area would be around other longer term debt issuances (medium term notes, covered bonds etc) – these could be used for financing/investment activities but there is no easy way to track or identify that.

I suspect the majority of financing income and expenses for Banks would be best presented within Net Interest Income within "Operating" however there could be certain specific classifications required for debt instruments that are longer term in nature and therefore could be classified differently (this would be best done through specific requirements to

avoid a variety of approaches being applied). For example if Banks were required to classify instruments with long term maturities over a certain point as financing expenses that could be clearly split out based on the product. Where these products are currently recognised in interest expense though, this would skew the reporting of net interest income and net interest margins which is a key measure to compare the performance and profitability across banks. As such, I would propose that only instruments that qualify as capital or perhaps just all subordinated debt should be classified within the financing category with everything else in operating maintaining the reporting of net interest income for comparability.

Let me know if you have any follow up questions on the above or would like to discuss. Do you know the expected timing for implementation yet or any timetable outside of when consultation closes? (I couldn't find anything further on that)

- Response 2 received:

Hi Lisa, sorry for my delayed response, I was just giving some internal parties the opportunity to comment.

From what I understand of the proposal:

“Normal” entities would need to present expenses from financing activities (debt interest expense and cash interest expense or income) under a new **financing** sub-category on the face of the Income Statement.

However, the concession under para 51, permits a bank such as ASB to present all income and expenses from financing activities and cash and cash equivalents in operating activities in the Income Statement, OR just the portion that relates to providing finance to customers. I notice the ED Q4 asks respondents if they agree with this concession, which might be the reason you have reached out. The basis for conclusions sets out the IASB reasoning, and on a personal level I agree with the BC, particularly BC63 which indicates net interest is an important performance measure for banks.

You have asked if we can even split our income and expenses from financing activities and cash and cash equivalents between those that relate to financing customer activities and other activities (e.g. those relating to funding other expenses or capital projects or excess liquidity).

I have briefly consulted internally, and for management purposes we do allocate costs between core activities (customer related) and general liquidity, however:

There is not necessarily a one-to-one matching of drawdowns of funding and customer advances/deposits – so timing and amounts are not identical;

Any allocations are based on a methodology or methodologies that may be appropriate for internal reporting, but not necessarily suitable for external reporting; and

If we did not use the concession, those methodologies would effectively need to be subject to audit.

My initial thought is that [Bank] would elect continue to report all amounts within operating, as this would reflect our current treatment of presenting net interest together in our income statement, and treating all interest as operating activities in our cash flow statement. We would however look to global practice, the approach of our parent [Bank], and would obviously go through necessary approvals internally here at [Bank]. I did reach out to my [Bank] counterpart on this subject, but they have not yet considered the IASB proposals (and are also very busy with CV-19 and year end work).

For completeness, I do note that segment reporting can give readers an understanding of net finance costs for each reportable segment, and that the Reserve Bank also has the ability to require banks to make additional disclosures by amending the Registered Bank Disclosure Statements Orders (for both locally and overseas incorporated banks).

If you need more information, I would be happy to discuss when we are post year end.

Kind regards

- *The feedback mentioned in paragraph 22 was received from TRG members.*

Draft response to question 4

19. We agree with the proposal in paragraph 51 of the Exposure Draft that an entity that provides financing to customers as a main business activity classify in the operating category either:
 - (a) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or
 - (b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

20. We agree that when an entity provides financing to customers as a main business activity, the difference between the interest revenue from that activity and the related interest expense (a cost of earning that income) is an important indicator of operating performance. The IASB's proposals would enable entities such as banks to continue presenting a net interest income subtotal.

21. We have reservations about allowing an accounting policy choice as such choices can lead to a loss of comparability between entities. In addition, if an entity chooses to allocate all income and expenses from cash and cash equivalents and financing activities to the operating category, this could result in a loss of relevant information for users. For example, a car manufacturer that provides financing to customers as one of its main business activities may elect to allocate all income and expenses from cash and cash equivalents and financing activities to the operating category. In this case the car manufacturer would not present a subtotal for profit or loss before financing and income tax and, effectively, the income statement would not have a separate category for financing. The user of the financial statements would therefore not have access to information about the financing activities undertaken by the car manufacturer that are unrelated to the provision of financing to customers.

22. However, we have received feedback from New Zealand banks (the entities most likely to make use of the proposed accounting policy choice) that any methodologies to split (i) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers from (ii) income and expenses from financing activities and from cash and cash equivalents that are unrelated to the provision of financing to customers would be arbitrary at best.

23. We therefore agree with the IASB that an allocation should not be required but should be permitted.

Question 5—the investing category

Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity’s main business activities.

Paragraphs BC48–BC52 of the Basis for Conclusions describe the Board’s reasons for the proposal.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board:

- [Click here](#) to read the paragraphs referred to in Question 5.
- We have provided a comparison of the definitions of operating investing and financing between the ED and IAS 7

ED	IAS 7 <i>Statement of Cash Flows</i> includes proposed consequential amendments from the ED	Staff comment
<p>Operating Default category – income and expenses not included in other categories. *the operating category is designed to include all income and expenses from an entity’s main business activities.</p>	<p>Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.</p>	<p>We note the IASB is not proposing to amend operating activities in IAS 7 to refer to main business activities. We note that IFRS 15 refers to the entity’s ordinary activities. There is no consequential amendment to IFRS 15 in the ED.</p>
<p>Investing Income and expenses from investments (including non-integral associates and joint ventures) and incremental expenses. <i>income and expenses from investments:</i> Income and expenses from assets except for income and expenses from cash and cash equivalents that generate a return individually and largely independently of other resources held by an entity</p>	<p>Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents <u>and the receipt of some interest and dividends as described in paragraphs 34A–34D.</u></p>	<p>We have heard concerns that using the term investing for both these categories will be confusing for users.</p>
<p>Financing Income and expenses from cash and cash equivalents Income and expenses on liabilities arising from financing activities Interest income and expenses on other liabilities</p>	<p>Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity. <u>In relation to borrowings, financing activities involve the</u></p>	<p>There could be potential confusion here as the term “financing activities” is not consistently defined across the two standards.</p>

ED	IAS 7 <i>Statement of Cash Flows</i> includes proposed consequential amendments from the ED	Staff comment
<p><i>financing activities</i>: Activities involving the receipt or use of a resource from a provider of finance with the expectation that:</p> <p>(a) the resource will be returned to the provider of finance; and</p> <p>(b) the provider of finance will be compensated through the payment of a finance charge that is dependent on both the amount of the credit and its duration.</p>	<p><u>receipt or use of a resource from a provider of finance with the expectation that:</u></p> <p>(a) <u>the resource will be returned to the provider of finance; and</u></p> <p>(b) <u>the provider of finance will be appropriately compensated through the payment of a finance charge that is dependent on both the amount of the credit and its duration</u></p>	

Draft response to question 5

24. We agree that an investing category will provide users with useful information about the returns from investments that are not part of the entity's main business activities, particularly for non-financial institutions.
25. We have heard concerns that users will not understand the difference in the definition of the proposed investing category in the statement of profit and loss and the existing 'investing activities' in the cash flow statement. Although both are labelled as investing their definitions are not aligned, for example, cash proceeds from the disposal of property, plant and equipment would be classified as investing activities in the cash flow statement, but the disposal gain/loss would be classified in the operating category in the statement of profit or loss. This is because property, plant and equipment are used in combination with other resources of an entity in its main business activities and do not 'generate a return individually and largely independently of other resources held by an entity'.
26. We recommend that the IASB consider using different terms or more descriptive terms in each of the statements. For example, the definition for income and expenses from investments in the statement of profit or loss seems to focus on 'distinct' or 'separable' investing activities (which generate returns independently of other assets), whereas the IAS 7 definition seems to focus on 'long-term' investing activities. We suggest the IASB consider using a more descriptive label, based on the key underlying principle that drives the classification in each statement. We believe this would at least make it clearer that they are not the same thing.

Question 6—profit or loss before financing and income tax and the financing category

- (a) Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.
- (b) Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category.

Paragraphs BC33–BC45 of the Basis for Conclusions describe the Board’s reasons for the proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board

- [Click here](#) to read the paragraphs referred to in Question 6.
- Feedback in paragraph 31 is from a TRG member.

Draft response to question 6

27. We support the proposal for all entities, except for some specific entities (i.e. entities that provide financing to customers as a main business activity (e.g. banks) and classify all income and expenses from financing activities and all income and expenses from cash and cash equivalents in the operating category), to present a profit or loss before financing and income tax subtotal in the statement of profit or loss.
28. We support the proposals for entities to classify in the financing category:
- (a) income and expenses on liabilities arising from financing activities;
 - (b) income and expenses from cash and cash equivalents; and
 - (c) interest income and expenses on liabilities that do not arise from financing activities.
29. We acknowledge that some users have different views on the appropriate classification of income and expenses from cash and cash equivalents (e.g. as investing, financing or operating). However, we support their inclusion in the financing category (with the proposed exceptions for some specific entities) for reasons similar to including interest income and expenses on liabilities that do not arise from financing activities in the financing category (i.e. a consistent location for the presentation of information). This consistent location would enable users to reclassify income and expenses from cash and cash equivalents to other categories if they wish to do so.
30. The ED stipulates that entities would classify in the investing category incremental expenses incurred to generate income and expenses from investments. However, the ED is silent on incremental expenses related to the financing category. We recommend that it would be useful to have guidance on whether incremental expenses related to financing activities should also be in the financing category.

Other comments

31. Although the proposals now define financing activities, it is unclear whether the 'payment of a finance charge' would include imputed interest calculated for accounting purposes, rather than a contractual interest charge – e.g. inter-company loans that are not at a market interest rate. The definition implies the lender expects to be compensated for extending credit which is not the case for interest-free or low-interest loans.

Question 7—integral and non-integral associates and joint ventures

- (a) The proposed new paragraphs 20A–20D of IFRS 12 would define ‘integral associates and joint ventures’ and ‘non-integral associates and joint ventures’; and require an entity to identify them.
- (b) Paragraph 60(b) of the Exposure Draft proposes to require that an entity present in the statement of profit or loss a subtotal for operating profit or loss and income and expenses from integral associates and joint ventures.
- (c) Paragraphs 53, 75(a) and 82(g)–82(h) of the Exposure Draft, the proposed new paragraph 38A of IAS 7 and the proposed new paragraph 20E of IFRS 12 would require an entity to provide information about integral associates and joint ventures separately from non-integral associates and joint ventures.

Paragraphs BC77–BC89 and BC205–BC213 of the Basis for Conclusions describe the Board’s reasons for these proposals and discuss approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board

- [Click here](#) to read the paragraphs referred to in Question 7.

Draft response to question 7

32. We do not agree with the proposal to classify associates and joint ventures accounted for using the equity method as integral or non-integral.
33. We have outlined our key reasons for disagreeing with the proposals below.
- (a) Our outreach with investors does not suggest there is a demand for this information.
- (b) The current disclosures required by IFRS 12 already require entities to disclose information about the nature, extent and financial effects of an entity’s interests in associates and joint ventures.
- (c) Preparers have suggested it would be more beneficial for the IASB to reconsider whether equity accounting for associates and joint ventures is appropriate or whether another method should be considered.
- (d) Any definition of ‘integral’ and ‘non-integral’ would require significant judgement and would be difficult to audit.
34. However, we have had feedback from investors that it would be useful to have an entity’s share of profit or loss of associates and joint ventures (JVs) accounted for using the equity method presented separately from operating profit or loss to avoid mixing post-tax and pre-tax amounts.
35. Although we do not agree with classifying associates and joint ventures as integral or non-integral, we do agree that separately presenting operating profit or loss and income and expenses from associates and joint ventures provides useful information to users of financial statements.

36. We suggest, for simplicity, the IASB consider requiring a line item immediately below operating profit (so effectively part of the investing category but as a separate line item). We would recommend requiring the presentation of two-line items to differentiate between
- (a) share of profit or loss from associates and JVs (for equity-accounted associates and JVs);
and
 - (b) FV movements for other associates/JVs measured at fair value (given the feedback from users).

Question 2 for the Board

Does the Board agree with the recommendation in paragraph 36?

Question 8—roles of the primary financial statements and the notes, aggregation and disaggregation

- (a) Paragraphs 20–21 of the Exposure Draft set out the proposed description of the roles of the primary financial statements and the notes.
- (b) Paragraphs 25–28 and B5–B15 of the Exposure Draft set out proposals for principles and general requirements on the aggregation and disaggregation of information.

Paragraphs BC19–BC27 of the Basis for Conclusions describe the Board’s reasons for these proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board

- [Click here](#) to read the paragraphs referred to in Question 8.

Draft response to question 8(a)

37. We agree that clarifying the role of the primary financial statements and the notes would:
- help entities decide what information to disclose in the notes to explain and supplement the primary financial statements; and
 - assist the IASB in deciding what information it should require to be presented in the primary financial statements or permit disclosure in the notes instead.
38. We agree with the proposed description of the roles of the primary financial statements and the notes.
39. In our view the notes form an integral part of the financial statements. It is the combination of the primary financial statements and the notes that meets the objective of financial statements. We would like the IASB to acknowledge in IFRS X *General Presentation and Disclosures* that while the primary financial statements and the notes do have separate roles to play, they are both equally important in meeting the objective of financial statements.

Draft response to question 8(b)

40. We are supportive of the IASB providing principles and guidance on aggregation and disaggregation. We have also received feedback from users of financial statements that financial statements do not always include information that is appropriately aggregated or disaggregated. Aggregating items that have shared characteristics makes large volumes of information understandable and avoids obscuring relevant information. Similarly, disaggregating items with dissimilar characteristics provides users of financial statements with relevant information and avoids obscuring material information.
41. While we generally agree with the principles and guidance for aggregation and disaggregation included in the ED, we have identified below some areas for further consideration by the IASB.

Materiality

42. We are of the view that the concept of materiality and materiality judgements play a critical role in the presentation and disclosure of information in financial statements. Because an entity makes materiality judgements when making decisions about recognition and measurement, as well as presentation and disclosure, we can understand the IASB's rationale to move the definition of material and associated guidance to IAS 8 as the concept of materiality is pervasive in the preparation of financial statements. However, we believe the IASB has missed an opportunity to embed the concept of materiality into a general presentation and disclosure standard.
43. We consider that materiality is well established as a concept in relation to recognition and measurement but is less so in relation to presentation and disclosure. In general, the application of recognition and measurement requirements results in quantitative information. Because recognition and measurement requirements result in quantitative information, materiality judgements are typically judgements about the magnitude of the amounts concerned, i.e. a quantitative assessment. Therefore, when applying materiality to recognition and measurement, it is often judgements about whether, and the extent to which, it is necessary to comply with the recognition and measurement requirements in standards.
44. In contrast, when applying materiality to presentation and disclosure, the following judgements are needed.
 - (a) Information might be qualitative rather than quantitative, especially information disclosed in the notes.
 - (b) Whether information is material might depend on the nature of the item, instead of (or in addition to) its magnitude (for example, the definition of unusual items considers not just the magnitude of the item but also its nature), so it's not simply a quantitative assessment.
 - (c) Materiality judgements don't merely relate to whether, and the extent to which, it's necessary to comply with the requirements of the standard, but also how to apply those requirements, so is a key driver in determining what information is disclosed (as is acknowledged in the guidance on aggregation and disaggregation in paragraph B9 "In the notes, it is the concept of materiality that drives aggregation and disaggregation. To achieve the objective of financial statements, items that have dissimilar characteristics shall be disaggregated into component parts when the resulting information is material").
45. All the above points mean that materiality is not only a very important concept for presentation and disclosure but also, it is much harder to apply in practice to presentation and disclosure. The reality is that it is easier for preparers and auditors to make materiality judgements when dealing with quantitative information, so it is an easier concept to apply to recognition and measurement requirements. So, it is sufficient to have materiality guidance in IAS 8 when dealing with recognition and measurement requirements. But with presentation and disclosure – and particularly disclosure – there are good reasons why a general presentation and disclosure standard should include specific guidance on applying materiality.

And by including such guidance in a general presentation and disclosure standard, that guidance could then be applied (via cross-reference) to all other standards containing disclosure requirements.

46. Section 8 of the IASB's POD DP included the New Zealand Accounting Standards Board staff's approach to drafting disclosure requirements in IFRS Standards. One of the main features of this approach was placing greater emphasis on the need to exercise judgement when deciding how and what to disclose to meet the disclosure objectives.
47. Below is an extract from section 8 of the POD DP. A lot of the guidance in the section below has been picked up by the IASB in the new guidance on aggregation and disaggregation, but not all – for example, the guidance on considering the extent and mix of quantitative and qualitative information. We have included this as it may be of some help when considering what specific guidance on materiality judgements to include in a general presentation and disclosure standard.

NZASB staff example 1—Guidance on the use of judgement

This is an example of clarifying paragraphs emphasising the need to use judgement and could be placed in each Standard that contains disclosure requirements or could be placed in a general disclosure standard, such as in IAS 1.

- X1.1 To achieve the [overall] disclosure objective in a Standard, an entity shall use its judgement to determine the extent and appropriate mix of quantitative and qualitative information to disclose, including the extent of aggregation or disaggregation of that information. Assessments about the amount of information to disclose depend on the relative importance of an item or transaction to the entity (taking into account the nature and/or size of that item or transaction) and the amount of judgement involved in accounting for that item or transaction. Therefore, assessments need to take into account the extent to which the entity's financial position, financial performance or cash flows are affected by:
- (a) the item or transaction; and
 - (b) risks and uncertainties associated with the item or transaction.
- X1.2 When using judgement to determine the information to be disclosed in accordance with a Standard, an entity considers:
- (a) how much emphasis to place on particular disclosures;
 - (b) the level of detail needed (taking into account the expectation that users of financial statements should have a reasonable knowledge of business and economic activities);
 - (c) how much aggregation or disaggregation to undertake; and
 - (d) whether users of the financial statements need additional information to meet the disclosure objective.
- X1.3 An entity aggregates or disaggregates disclosures in accordance with this Standard or another IFRS Standard so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

Materiality – other comments

48. The IASB is not proposing to carry forward paragraph 97 from IAS 1 “when items of income and expense are material, an entity shall disclose their nature and amount separately”. We believe that the IASB should include this paragraph in a new general presentation and disclosures standard.

The label 'other'

49. We have heard concerns from investors that some companies use the label 'other' when describing expenses, without providing information to help them understand what those items comprise.
50. We are in complete agreement that disaggregation of material items of income and expenses provides useful information to users. However, we would caution the IASB against requiring an entity to disaggregate an 'other expenses' line made up of immaterial items where the entity has made every effort to apply the principles set out in paragraphs 25 to 28 in the ED, and the resulting amount in the line item 'other expenses' is immaterial. We would recommend amending paragraph 28 to clarify this. We would also suggest including this scenario in the illustrative examples.

Question 9—analysis of operating expenses

Paragraphs 68 and B45 of the Exposure Draft propose requirements and application guidance to help an entity to decide whether to present its operating expenses using the nature of expense method or the function of expense method of analysis. Paragraph 72 of the Exposure Draft proposes requiring an entity that provides an analysis of its operating expenses by function in the statement of profit or loss to provide an analysis using the nature of expense method in the notes.

Paragraphs BC109–BC114 of the Basis for Conclusions describe the Board’s reasons for the proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Notes to the Board

- [Click here](#) to read the paragraphs referred to in Question 9.
- *We have received feedback that there is diversity in practice in the expense items that are included by entities in cost of sales/cost of goods sold (some include salary costs of employees in COGS and some do not). Based on this feedback, we considered whether we should request that the IASB develop a definition of cost of sales to further improve comparability between entities. On balance we decided that this point seems inconsistent with what we say earlier about the principles for aggregation and disaggregation being sufficient, without getting too prescriptive about how expenses are analysed.*

Draft response to question 9

51. We do not agree with the proposal that an entity shall present in the operating category of the statement of profit or loss an analysis of expenses using a classification based on either their nature or function. Our reasons are as follows.
- (a) In practice, we observe that it is common for companies to provide a mixed method of analysis based on the type of analysis that companies regard as providing the most useful information to users of their financial statements. Our view is that companies should be allowed the flexibility to determine the most appropriate analysis of expenses, even if that results in a mixed analysis.
 - (b) Additionally, we note that despite paragraph B46, which states that an entity shall not use a mixture of the nature of expense method and the function of expense method, paragraph B47 states that an entity shall present the line items required by paragraph 65 (which are by nature). Therefore, in practice, paragraph B47 is requiring a mixture of methods for an entity analysing operating expenses by function.
 - (c) Our outreach has shown that there is not a good understanding of what is meant by an analysis of expenses by nature or function.
52. We do not agree with the proposal that an entity presenting an analysis of expenses using the function of expense method shall also disclose in a single note an analysis of its total operating expenses using the nature of expense method. Our reasons are as follows.
- (a) Some may argue that the above is already required under the existing requirement in IAS 1, but in our experience the existing requirement is not interpreted as requiring a

comprehensive analysis in the notes. Rather, selected additional information is provided, for example, depreciation, amortisation and employee benefit expense (possibly because these items are individually listed in paragraph 104 of IAS 1).

- (b) We have concerns with the practical application of the requirement. Some entities may not have the ability to be able to analyse operating expenses by more than one method in their accounting/reporting systems. Therefore, these entities would need to incur additional costs to track operating expenses using another method outside of their current systems.
 - (c) As well as the practical application problem above, there is also a conceptual problem with requiring 'cost of goods sold' to be reanalysed. Conceptually, if this line item is just made up of inventory, then it is actually not a functional line item. Rather, it is the cost of an asset (inventory) that is expensed at the point that it is sold to another party. For a manufacturing entity, the analysis required under the proposals (and existing IAS 1, if you follow the illustrative example) involves a de-capitalisation process, to break down the cost of this asset into the original inputs (for example, raw materials, employee costs, etc) that were then capitalised into inventory under IAS 2. Then, to balance the total cost of inputs purchased back to the COGS expense, there is an adjusting line item for the movement in inventory. So, these input costs included in the analysis are not "expenses" as defined in the conceptual framework.
53. The IASB has acknowledged in the Basis for Conclusions that it did think about the costs to preparers when it developed this proposal. However, the IASB went ahead with the proposal due to the strong demand from users for this information to forecast future operating expenses. We do understand the driver for the proposal, but we suggest that the IASB consider alternatives. For example, given that users seem to be looking for information that is based on cash flows rather than accrual accounting, an alternative is to consider the presentation and disclosure requirements in IAS 7.

Other comments

54. We would like the IASB to consider the removal of paragraph 65 in the ED. Paragraph 65 of the ED requires the presentation in the statement of profit or loss of minimum line items. We would like to challenge the status quo here – why do we need to continue to have minimum line items in a general presentation and disclosure standard? The IASB has worked hard to develop new proposals, including principles and general requirements on the aggregation and disaggregation of information. The application of the IASB's proposals plus our recommendation in question 8 above to give greater emphasis to the concept of materiality should be sufficient for preparers to determine what information is presented and disclosed in the statement of profit or loss.
55. Further to the above, the requirements in paragraph 65 are an ad hoc collection of line items that have accumulated over the years, with no coherent rationale for singling out particular line items. A good illustration of this is the statement of profit and loss in Part I of the illustrative examples. The statement of profit or loss includes a line item for impairment losses on trade receivable (as this is a minimum line item required by paragraph 65) but does not have a separate line item for the impairment of property, plant and equipment.

Question 10—unusual income and expenses

- (a) Paragraph 100 of the Exposure Draft introduces a definition of ‘unusual income and expenses’.
- (b) Paragraph 101 of the Exposure Draft proposes to require all entities to disclose unusual income and expenses in a single note.
- (c) Paragraphs B67–B75 of the Exposure Draft propose application guidance to help an entity to identify its unusual income and expenses.
- (d) Paragraphs 101(a)–101(d) of the Exposure Draft propose what information should be disclosed relating to unusual income and expenses.

Paragraphs BC122–BC144 of the Basis for Conclusions describe the Board’s reasons for the proposals and discuss approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Notes for the Board

- [Click here](#) to read the paragraphs referred to in Question 10.
- We received mixed views from the Board at its April meeting on the proposals relating to unusual income and expenses. We have developed some alternative responses to this question for the Board to consider.

*Draft response to question 10**View 1 – agree to proceed with proposals but more work needed on definition*

- 56. The objective of financial statements includes providing financial information that is useful to users of financial statement in assessing the prospects for future net cash inflows to the entity. We acknowledge that providing information about items of income and expenses with limited predictive value would help users assess the company’s prospects for future cash flows.
- 57. We understand the rationale behind the IASB’s proposal to provide information to users about unusual income and expenses. However, we have concerns with the workability of the proposed definition of unusual income and expenses.
- 58. We have the following concerns with the proposed definition of unusual income and expenses.
 - (a) The proposed definition is highly subjective, particularly the references to “limited predictive value” and “several future annual reporting periods”.
 - (b) The subjectively involved in determining unusual income and expenses would place undue costs on preparers to identify all material unusual income and expenses.
 - (c) The subjectively involved would make it challenging for auditors to audit an entity’s disclosure of unusual income and expenses, particularly the completeness of the disclosure.

- (d) There could be an increase in litigation risk, for example, if an entity does not identify an item as unusual or does identify an item as unusual and it turns out not to be unusual.
- (e) In our view the definition is overly focused on the frequency of occurrence of the items and not what is unusual in the context of the business or circumstances. In other words, the lack of predictive value is only one reason why an item might be unusual.
- (f) Income or expenses are classified as unusual based on expectations about the future rather than past occurrences. Therefore, it is possible for income or expenses similar to income or expenses reported in a previous reporting period(s) to be classified as unusual

Application of the definition

59. The ED includes an example that considers different types of restructuring programmes and contrasts
- (a) those spanning several reporting periods or that occur regularly following an acquisition (The ED concludes that the expenses would be classified as usual).
- with
- (b) those that are not expected to create expenses of a similar type and amount in the next several reporting periods (The ED concludes that the expenses would be classified as unusual).

The example highlights that the definition focuses too much on the frequency of items of income and expenses, rather than what is unusual in the context of the business or circumstances.

60. Also, under the ED's restructuring example and proposed definition of unusual expenses, it remains unclear how an entity would classify restructuring expenses that it incurs in the final year of a programme that spanned several periods. An entity would classify the restructuring expenses as usual in the prior periods, but it is unclear how it would classify these expenses in the current period when it does not expect to incur them for several future periods. It is also unclear how the frequency of restructuring programmes would affect the classification of related expenses as unusual.
61. Under the proposals, an amount of income or expenses would be unusual if it is higher than its reasonably expected amount and is not expected to recur in several future annual reporting periods. However, it is unclear whether entities would classify the entire amount or only the portion in excess of the reasonably expected amount as unusual.

View 2 – do not proceed with trying to define unusual, rely on existing IAS 1 requirements

62. IAS 1 already includes a requirement to separately disclose the nature and amount of material income and expenses (paragraph 97). Paragraph 98 of IAS 1 includes examples of circumstances that would give rise to the separate disclosure of income and expenses.

Information to be presented in the statement(s) of profit or loss and other comprehensive income or in the notes

97 When items of income or expense are material, an entity shall disclose their nature and amount separately.

98 Circumstances that would give rise to the separate disclosure of items of income and expense include:

- (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
- (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
- (c) disposals of items of property, plant and equipment;
- (d) disposals of investments;
- (e) discontinued operations;
- (f) litigation settlements; and
- (g) other reversals of provisions.

63. The IASB has not carried forward paragraph 97. Paragraph 98 is carried forward into the application guidance as paragraph B15 (with minor amendments). In question 8 we commented that in our view the IASB has missed an opportunity to embed the concept of materiality into a general presentation and disclosure standard. An alternative to trying to refine the definition of unusual income and expenses is to focus on the existing requirements in IAS 1 (paragraph 97 and 98) and strengthen these requirements to ensure users receive information about material income and expenses to enable them to assess prospects for future cash flows.

View 3 Support views already expressed in the submission to the IASB on its POD DP

64. As we acknowledged in our comment letter to the IASB on DP/2017/1 Disclosure Initiative–Principles of Disclosure (POD DP) (see extract provided below) “information on unusual or infrequently occurring items is useful to users of financial statements, because it helps them to assess the recurring/sustainable performance and make assessments about the future, provided the items are genuinely unusual or infrequently occurring”.

65. In our comment letter to the IASB on the POD DP we did not support the development of definitions of, and requirements for, the presentation of unusual or infrequently occurring items. We suggested instead that the IASB develop principles for the fair presentation of these items.

Extract from our comment letter on DP/2017/1 Disclosure Initiative–Principles of Disclosure.

...

Question 8

The IASB should develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items in the statement(s) of financial performance, as described in paragraphs 5.26–5.28.

We believe it is entity and industry specific as to what is considered unusual or infrequent and it would be extremely difficult for the IASB to define these terms. We therefore do not agree the IASB should proceed with proposals to develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items. We suggest instead that the IASB develop principles for the fair presentation of these items. We have discussed this further in our response to question 8(c) below.

Question 8(b)

We do not believe that the IASB should prohibit the use of other terms to describe unusual and infrequently occurring items. Rather than focusing on the terms used, for which there could be many alternative terms, we suggest that the IASB establishes requirements for the fair presentation of these items. We have discussed this further in our response to question 8(c) below.

Question 8(c)

We acknowledge that information on unusual or infrequently occurring items is useful to users of financial statements, because it helps them to assess the recurring/sustainable performance and make assessments about the future, provided the items are genuinely unusual or infrequently occurring. We received feedback that sometimes entities adjusted only for those unusual or infrequently occurring items that had a negative effect on performance and did not adjust for those that had a positive effect. Users need insight into why management has made the adjustments – this will allow users to make informed decisions about these adjustments. We suggest that the IASB, rather than focusing on the terms used, should establish requirements for the fair presentation of these items. These requirements, at a minimum, should require an explanation of why the item is considered unusual or infrequently occurring and require entities to ensure consistency around the use of these terms. We note that unusual or infrequently occurring items are often used to derive performance measures. Therefore, we think that the fair presentation requirements for the use of unusual or infrequently occurring items should be a subset of the fair presentation requirements for performance measures in section 5 of the DP. This would avoid entities having to make somewhat repetitive disclosures.

Disclosures

66. If the IASB retains the proposals, we believe they should require disclosure of the entity's policy for determining if an item of income or expense is unusual.
67. We have had feedback that the illustrative example in the ED is very simplistic and would not be helpful for preparers to help them meet the requirements.

Other comments

68. Paragraph 87 of IAS 1 currently prohibits the presentation of extraordinary items. The IASB is not proposing to carry paragraph 87 forward into IFRS X *General Presentation and Disclosures*. We agree that the new structure would not allow a separate category for extraordinary items, however we believe an entity would still be able to label an item as extraordinary. We recommend the IASB carry forward paragraph 87 of IAS 1 into IFRS X.
69. Paragraph BC128 of the ED states that "unusual income and expenses, on the other hand, are classified in categories in the statement(s) of financial performance together with 'usual' income and expenses, according to their nature, function or other characteristics". We recommend that the IASB consider including this sentence in the ED.

Question 3 for the Board

- (a) Which alternative response does the Board prefer, view 1, 2 or 3?
- (b) If the IASB does retain the proposals does the Board agree they should require disclosure of the entity's policy for determining if an item of income or expense is unusual?

Question 11—management performance measures

- (a) Paragraph 103 of the Exposure Draft proposes a definition of ‘management performance measures’.
- (b) Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures.
- (c) Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures.

Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board’s reasons for the proposals and discuss approaches that were considered but rejected by the Board.

Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not?

Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?

Notes to the Board:

- [Click here](#) to read the paragraphs referred to in Question 11.
- At its April meeting the Board discussed suggesting to the IASB that they broaden the definition an MPM to possibly bring other measures into the FS.
- Under the ‘MPM definition’ section below we have included some options for the Board to consider. if the Board does want to suggest a broader definition for MPMs, exactly how much broader?

*Draft response to question 11**Overall*

- 70. We agree that MPMs can provide useful information to users of financial statements. We agree there is a demand from users for this information.
- 71. We agree information about MPMs should be included in the financial statements and subject to audit. We agree that that the proposals will bring more transparency and discipline to the reporting of these financial performance measures.
- 72. There is currently an audit expectation gap as users think that information about non-GAAP measures included in an entity’s annual report have been audited. Bringing MPMs into the financial statements will make it clear these measures have been subject to audit
- 73. We acknowledge that in cases of some MPMs (such as measures based on tailor-made accounting policies) the audit work may be restricted to checking that the measure has been calculated in accordance with the entity’s definition of the measure and that the entity has complied with the disclosure requirements for MPMs. However, we do not think that this should prevent these measures from being included in the audited financial statements.

MPM definition

- 74. This section is to assist the Board in forming a view on whether it should suggest to the IASB that it broaden the proposed definition of MPMs.

Option 1 – agree with definition as per IASB proposals

75. The IASB is proposing to limit MPMs to financial performance measures that are subtotals of income and expenses. This is in line with the IASB’s focus on improving the reporting of financial performance in the statement of profit and loss. Paragraph BC154 is the key paragraph that explains why the IASB is limiting MPMs.

BC154 Feedback from users of financial statements led the Board to focus on improvements to the reporting of financial performance in the statement(s) of financial performance and the related notes. Therefore, the Board’s proposed definition for management performance measures is limited to subtotals of income and expenses. Thus, other financial measures (such as currency adjusted revenue or return on capital employed) and non-financial measures (such as customer retention rate) are not management performance measures and would not be included in the proposed disclosure.

Option 2 – expand the definition to capture anything that might be viewed as some measure of “financial performance”

76. Expand the definition to capture financial performance measures that are not subtotals of income and expense, for example, free cash flow, return on equity, net debt and same store sales.

Option 3 – expand the definition to capture anything that can be reconciled to an IFRS amount

77. Expand the definition to capture anything that can be reconciled to any amount that appears in the financial statements, irrespective of whether that’s a “financial performance” measure for example, measures that relate to the entity’s financial position rather than its financial performance.

Option 4 – expand the definition to capture ‘non-financial performance’ measures

78. Expand the definition to capture “non-financial performance” measures, even though they cannot be reconciled back to the financial statements for example, subscriber churn, number of employees, customer satisfaction score. We would need to justify why these should be captured in the financial statements if they cannot be reconciled to an amount in the financial statements.

Option 5 – expand the definition to capture measures of financial performance that are used internally

79. Expand the definition to capture measures of financial performance that are used internally but not published, for example, for management remuneration purposes. We would need to justify why this information should appear in the financial statements, when the objective of the project is to provide greater transparency and clarity for users of the financial statements (as per paragraph BC147).

Summary

80. In summary, there are all kinds of “measures” used for all kinds of purposes – we need to be realistic and think about what the IASB proposals are trying to achieve. More specifically, we should think about whether we disagree (or are concerned) with the definition because we

disagree with the objective behind the proposals (as explained in the BC) OR the specific way in which the IASB has gone about meeting that objective.

Definition of an MPM

81. We believe that the IASB needs to provide guidance to clarify the intended scope of ‘public communications outside the financial statement’ used in the definition of MPMs for the following reasons.
- (a) The proposed guidance provides examples of public communications (management commentary, press releases and investor presentations). However, the guidance does not limit public communications to these forms of communication.
 - (b) Some constituents have questioned if public communications outside the financial statements would include posts on social media made by the company.
 - (c) Other constituents have raised concerns from an audit perspective, noting the challenges of having to review all of an entity’s public communications for possible MPMs.
 - (d) We also have concerns that the IASB has not provided guidance on the timeframe regarding public communications. It is not clear from the proposed definition of an MPM or associated guidance, whether an entity would need to consider all public communications during the year (such as quarterly investor communications) or only those communications relating to the interim/annual reporting period.
 - (e) Do financial statements meet the definition of public communications – if a measure is only in the financial statements does it meet the MPM definition?
82. We have received feedback that the purpose of paragraph 103(b) of the proposed definition of MPMs is not clear. This sub paragraph states that MPMs are subtotals of income and expenses that “complement totals or subtotals specified by IFRS Standards”. We believe that the requirement in paragraph 103(b) is needed in order for an MPM to be reconciled back to an IFRS specified subtotal. But we also question whether the IASB intended this sub paragraph to restrict MPMs to those that are subtotals of income and expense that cover the same reporting period as the financial statements (see previous comment on the scope of ‘public communications’). We recommend that the IASB consider adding an explanation for the purpose of this requirement (either in the application guidance or in the Basis for Conclusions).
83. We have concerns with paragraph 105(a) of proposed IFRS X which specifically restricts the disclosure of MPMs in the financial statements to those MPMs that “faithfully represent aspects of the financial performance of the entity to users of the financial statements”.
- (a) We acknowledge there is a general requirement in IFRS Standards that financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of information.
 - (b) Paragraph 2.13 of the *Conceptual Framework for Financial Reporting* states “To be a perfectly faithful representation, a depiction would have three characteristics. It would

be complete, neutral and free from error. Of course, perfection is seldom, if ever, achievable. The Board's objective is to maximise those qualities to the extent possible."

- (c) In our view there can be tension between:
 - (i) communicating to users of financial statements management's view of an aspect of an entity's financial performance; and
 - (ii) the restriction that MPMs must faithfully represent an aspect of an entity's financial performance.
 - (d) We note that IFRS 8 does not place a similar explicit restriction on the disclosure of segment information which reflects the views of management.
 - (e) The restriction in paragraph 105(a) does not prevent entities from using such MPMs outside of the financial statements.
 - (f) We believe that where entities are reporting such MPMs outside the financial statements, information about these MPMs is still useful to users of the financial statements and should be disclosed in the financial statements and subject to audit.
 - (g) Additionally, we have heard concerns from auditors and preparers about how to interpret 'faithfully represents' in the context of MPMs and subsequently how this will be audited.
84. Therefore, we recommend that the IASB remove this restriction. We consider that paragraph 105(b) of proposed IFRS X which requires MPMs to be described in a clear and understandable manner that does not mislead users will be sufficient.
85. We acknowledge that removing paragraph 105(a) will allow MPMs that might not faithfully represent an aspect of an entity's financial performance to be included in the financial statements. However, we believe that such MPMs should not be restricted from being included in the financial statements. Information about such MPMs could provide useful information to users, for example, why the MPM presents management's view of performance and a reconciliation back to a comparable total or subtotal specified by IFRS Standards.
86. If the IASB retains the restriction in paragraph 105(a), then we believe that further guidance is needed to clarify when an MPM faithfully represents aspects of the financial performance of the entity to users of the financial statements.

Proposed disclosures

87. Generally, agree with the proposed disclosure requirements.
88. We have received feedback that companies do not do a good job at explaining why a non-GAAP measure provides useful information to users (regardless of whether this non-GAAP information is inside or outside the financial statements). In the majority of cases companies are providing very generic explanations. We have also received feedback that the illustrative example in the ED is very generic.

89. We have heard concerns that the reconciling items between the MPM and the IFRS number may not be described in a useful manner. We note that paragraph B85 does include the requirement that reconciling items meet the requirements in paragraph 25-28, which includes a requirement that the description of the items in the financial statements shall faithfully represent the characteristics of those items. We recommend the IASB consider whether it should add to paragraph 106(b) that reconciling items must be described in a clear and understandable manner.

Other comments

90. We consider paragraph BC165 is helpful and should be included in the ED.

BC165 However, the Board expects that few management performance measures would meet the requirements for presentation as a subtotal in the statement(s) of financial performance. To meet the requirements, such subtotals must:

- (a) fit into the structure of the proposed categories (see paragraph BC28);
- (b) not disrupt the presentation of an analysis of expenses in the operating category using either the function of expense or nature of expense method (see paragraph BC109); and
- (c) comprise amounts recognised and measured applying IFRS Standards.

Question 12—EBITDA

Paragraphs BC172–BC173 of the Basis for Conclusions explain why the Board has not proposed requirements relating to EBITDA.

Do you agree? Why or why not? If not, what alternative approach would you suggest and why?

Notes to the Board:

- [Click here](#) to read the paragraphs referred to in Question 12.

Draft response to question 12

91. We agree with not proposing requirements relating to EBITDA. In our view the calculation of EBITDA is diverse in practice. It would be difficult for the IASB to come up with a globally accepted definition of EBITDA.
92. However, as EBITDA is one of the most commonly used measure (not just in financial statements), we would suggest that the IASB provides guidance to clarify when EBITDA would be able to be presented on the face of the statement of profit and loss. We suggest it would also be helpful to clarify that EBITDA can be presented in the notes to the financial statements as an MPM. In our response to Question 11 above we recommended the IASB consider including the content of paragraph BC165 in the ED, as this explains when the Board would expect that an MPM such as EBITDA would meet the requirements for presentation on the face of the statement of profit and loss.
93. We support the IASB's proposal to include operating profit before depreciation and amortisation in the list of IFRS specified subtotals.

Question 13—statement of cash flows

- (a) The proposed amendment to paragraph 18(b) of IAS 7 would require operating profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities.
- (b) The proposed new paragraphs 33A and 34A–34D of IAS 7 would specify the classification of interest and dividend cash flows.

Paragraphs BC185–BC208 of the Basis for Conclusions describe the Board’s reasons for the proposals and discusses approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Notes to the Board:

- [Click here](#) to read the paragraphs referred to in Question 13.

Draft response to question 13(a)

94. The indirect method of reporting cash flows from operating activities is not prevalent in New Zealand therefore we have not commented on this question.

Draft response to question 13(b)

95. We agree with the feedback received by the IASB that that diversity in how companies classify interest and dividend cash flows reduces comparability between companies, making analysis by investors/users difficult. Therefore, we support the proposal to remove the classification choice for interest and dividend cash flows for most entities.

Other comments

96. As highlighted in our response to question 5 above, we have received feedback that the use of similar labels to describe the categories in the statement of profit or loss and the classifications in the statement of cash flows will create confusion in practice. Therefore, we recommend that the IASB explore further the use of different labels between the two statements before finalising the proposals.
97. In line with our response to question 7 above, we do not agree with the proposal to separate cash flows from investments into those from integral and non-integral associates and joint ventures.

Question 14—other comments

Do you have any other comments on the proposals in the Exposure Draft, including the analysis of the effects (paragraphs BC232–BC312 of the Basis for Conclusions, including Appendix) and Illustrative Examples accompanying the Exposure Draft?

Notes to the Board

- *The Board agreed at its April meeting to use this comment letter as an opportunity to recommend that the IASB add a project on going concern to its work plan. We will also make these points again in the IASB agenda consultation.*
- *The Board agreed at its April meeting to use this comment letter as an opportunity to encourage the IASB to revisit OCI.*

Classification of foreign exchange differences

- *Would entities have a choice on where to present foreign exchange differences? No. Under the proposals, foreign exchange differences would be presented in the same category as the income/expense on which those differences arose. They would be presented as income or expenses from financing activities only in specific circumstances. Currently, some entities include the exchange differences as part of finance costs and some allocate the exchange differences to various line items, so the proposals could reduce this diversity in practice.*
- *We are not proposing to comment on these proposals unless we get feedback from our constituents that there is a problem. If we do receive any such feedback, then perhaps we ask the IASB to consider the need to include an “undue cost or effort” exception, similar to the treatment of derivatives not designated in a hedge accounting relationship.*

Classification of fair value gains and losses on derivatives and hedging instruments

- *Entities would classify fair value gains and losses on derivatives and hedging instruments depending on whether:*
 - *the financial instruments are used to manage risks; and*
 - *they are designated as hedging instruments under IAS 39 Financial Instruments: Recognition and Measurement or IFRS 9 Financial Instruments.*
- *We are not proposing to comment on these proposals unless we receive feedback from constituents that there is an issue with proposals. AS noted above the IASB has included an “undue cost or effort” exception, for derivatives not designated in a hedge accounting relationship.*

Going concern

98. The economic impact of the COVID-19 pandemic is expected to increase the level of uncertainty over the ability of many entities to continue as a going concern for financial reporting purposes. As a result, the NZASB recently issued domestic narrow-scope amendments¹ to improve going concern disclosures to provide better information to users of financial statements during this period of exceptional circumstances.
99. The issue of New Zealand specific disclosures is a short-term measure to deal with the most pressing need for improved disclosures. We strongly recommend that the IASB add a project

¹ *Improving Going Concern Disclosures* (proposed amendments to FRS-44) and *Improving Going Concern Disclosures* (Proposed amendments to PBE IPAS 1)

to its agenda to look at going concern issues more comprehensively. The major economic disruption from COVID-19 has highlighted this matter as an area where improvements are needed.

Statement presenting comprehensive income

- 100. IAS 1 requires income and expenses included in other comprehensive income (OCI) to be categorised into income and expenses that may be reclassified (recycled) to profit or loss in subsequent periods and items that are permanently reported outside profit or loss and will not be reclassified. This creates two categories of income and expenses included in other comprehensive income.
- 101. To increase the understandability of amounts included in other comprehensive income, the IASB proposes to create more descriptive labels for these two categories of other comprehensive income.

Categories of income and expenses included in other comprehensive income	
Current labels	Proposed labels
will not be reclassified subsequently to profit or loss.	remeasurements permanently reported outside profit or loss.
will be reclassified to subsequently to profit and loss when specific conditions are met.	income and expenses to be included in profit or loss in the future when specific conditions are met

- 102. We support the proposed new labels for the categories of income and expenses included in other comprehensive income. The new labels use plain English and are easier to understand.
- 103. We would encourage the IASB to undertake a specific project on OCI. We have received feedback that users do not understand the distinction between profit or loss and OCI and the role of recycling.

Appendix 1 Extracts from ED and Basis for Conclusions of paragraphs referred to in the Questions for respondents.

Extracts from the ED of the paragraphs referred to by the IASB in Question 1. [\[Back to memo\]](#)

...

Totals and subtotals presented in the statement of profit or loss

60 [IAS 1.81A partial] Subject to paragraph 64, an entity shall present the following totals or subtotals in the statement of profit or loss:

- (a) operating profit or loss;
- (b) operating profit or loss and income and expenses from integral associates and joint ventures (see paragraph 53);
- (c) profit or loss before financing and income tax (see paragraphs 63–64); and
- (d) profit or loss.

...

BC53 To increase comparability between entities, the Board proposes to require entities to classify specified income and expenses into an operating category and present an operating profit or loss subtotal in the statement of profit or loss. This may require some entities to change which income and expenses they include in operating profit or loss as they currently define it, as discussed in the effects analysis (see paragraphs BC232–BC312).

...

Extracts from the ED of the paragraphs referred to by the IASB in Question 2. [\[Back to memo\]](#)

...

Operating

46 **The operating category includes information about income and expenses from an entity's main business activities. An entity shall classify in the operating category all income and expenses included in profit or loss that are not classified in:**

- (a) **investing;**
- (b) **financing;**
- (c) **integral associates and joint ventures;**
- (d) **income tax; or**
- (e) **discontinued operations.**

...

BC54 The operating category comprises all income and expenses included in profit or loss that are not classified as income or expenses from integral associates and joint ventures, investing or financing, and those that are not classified in income taxes or discontinued operations—that is, operating profit or loss is defined as a default or a residual category. However, the Board considers that, because of the way in which amounts excluded from operating profit or loss are defined, the operating category would include income and expenses from an entity's main business activities.

BC55 Some stakeholders have told the Board that operating profit or loss is such an important measure of performance that it should be defined directly. However, the Board concluded that defining operating profit or loss as a default category would result in a faithful representation of an entity's activities, because:

- (a) the Board's view is that all income and expenses included in profit or loss, other than those related to financing, tax, some investments or discontinued operations, arise from an entity's operations. The definitions of financing and investing include exceptions for entities for which investing and financing are main business activities, resulting in an operating profit category that includes all income and expenses that relate to an entity's main business activities (see paragraphs BC58–BC76).
- (b) defining operating profit or loss as a default category is simpler than using a direct definition. This is because entities have various business activities making it difficult to arrive at a direct definition that

Extracts from the ED of the paragraphs referred to by the IASB in Question 2. [\[Back to memo\]](#)

could be applied consistently, even between entities in the same industry. Furthermore, the Board noted that previous attempts at developing a direct definition were not successful.

- (c) defining operating profit or loss as a default category is also simpler for entities to apply because determining which income and expenses are classified in the investing or financing categories is expected to require less judgement than applying a direct definition of operating. There is also likely to be more agreement on proposed classification in investing and financing categories than any direct definition of operating. Therefore, the proposed definition is more likely to be consistently applied, resulting in more comparable information to users of financial statements.

BC56 The operating category includes unusual income and expenses, which have limited predictive value. The Board does not view predictive value as a characteristic that differentiates whether income or expenses are operating (or any other category). However, the Board is aware that users of financial statements find information about unusual income and expenses useful; it has created a separate proposal to require entities to provide this information (see paragraphs BC122–BC144).

BC57 The operating category is designed to include all income and expenses from an entity's main business activities, even if such income or expenses meet the definitions of income or expenses from investing or financing activities. For example, a bank would classify interest expense used to finance lending to its customers in the operating category, even when such expense meets the definition of expense from financing activities. The Board has, therefore, specified circumstances in which an entity would not classify income or expenses in the financing or investing categories and instead classify them as operating. These circumstances are as follows:

- (a) income and expenses from investments are classified in the operating category, when an entity, in the course of its main business activities, invests in assets that generate returns individually and largely independently of the entity's other resources (see paragraphs BC58–BC61); and
- (b) some income and expenses from the financing category are classified in the operating category when:
- (i) an entity provides financing to customers as a main business activity (see paragraphs BC62–BC69);
- (ii) an entity's cash and cash equivalents are closely linked to income and expenses from investments included in operating profit or loss (see paragraphs BC70–BC72);
- (iii) an entity recognises insurance finance income or expenses as defined by IFRS 17 *Insurance Contracts* (see paragraph BC73); and
- (iv) an entity incurs expenses related to liabilities arising from investment contracts with participation features that are in the scope of IFRS 9 *Financial Instruments* (see paragraphs BC74–BC76).

Extracts from the ED of the paragraphs referred to by the IASB in question 3 [Back to memo]

...

Investing

47 The objective of the investing category is to communicate information about returns from investments that are generated individually and largely independently of other resources held by an entity. Except as required by paragraph 48, an entity shall classify in the investing category:

- (a) *income and expenses from investments, including from non-integral associates and joint ventures (see paragraphs B32–B33).*
- (b) **incremental expenses incurred generating income and expenses from investments. Incremental expenses are expenses that the entity would not have incurred had the investments giving rise to the income and expenses from investments not been made.**

48 An entity shall not classify in the investing category income and expenses specified in paragraphs 47(a)–47(b) generated in the course of its main business activities. Such income and expenses are instead classified in the operating category. An entity shall not classify income and expenses from non-integral associates and joint ventures in the operating category.

...

Investing

B32 Paragraph 47 requires an entity to classify income and expenses from investments in the investing category except when paragraph 48 requires the entity to classify them in the operating category. Income and expenses from investments would typically include:

- (a) income and expenses from financial assets, except for income and expenses from cash and cash equivalents, such as:
 - (i) interest revenue;
 - (ii) impairment losses and reversals of impairment losses;
 - (iii) gains and losses on disposal;
 - (iv) fair value gains and losses;
 - (v) dividends from equity investments;
 - (vi) the share of profit or loss of non-integral associates and joint ventures; and
 - (vii) income and expenses from associates and joint ventures not accounted for using the equity method; and
- (b) income and expenses from other investments such as:
 - (i) income and expenses on investment property;
 - (ii) impairment losses and reversals of impairment losses;
 - (iii) income or expenses from speculative investments, such as investments in artwork held for capital appreciation; and
 - (iv) gains and losses on disposal.

B33 Income and expenses from investments do not include income and expenses from assets used by an entity in the production of goods and delivery of services. Income and expenses derived from such assets result from the combination of those assets with other resources of the entity, such as employees, raw materials or intangible assets, and not from the individual assets on their own. Examples of such income and expenses not from investments include:

- (a) interest revenue from trade receivables, which would be classified in the operating category;
- (b) income and expenses from property, plant and equipment and intangible assets, including depreciation, amortisation, impairment and disposal gains and losses, which would be classified in the operating category; and
- (c) gains or losses on disposal of a discontinued operation, which would be classified in the discontinued operations category.

...

Appendix A

Defined terms

This appendix is an integral part of the [draft] IFRS Standard.

...

income and expenses from investments

Income and expenses from assets except for income and expenses from cash and cash equivalents that generate a return individually and largely independently of other resources held by an entity.

...

Income and expenses from investments classified in the operating category (paragraph 48)

BC58 The Board proposes that an entity classify in the operating category income and expenses from investments made in the course of its main business activities.

BC59 When an entity, in the course of its main business activities, invests in assets that generate a return individually and largely independently of its other resources, the investment returns are an important indicator of operating performance. For some entities, presenting investment returns separately from operating profit or loss would mean that operating profit or loss would only include expenses. For example, an investment property entity's operating profit or loss would exclude rental income and remeasurements of investment properties. For such

entities, a subtotal of operating profit or loss that excludes returns from those investments would not faithfully represent that entity's main business activities. The Board's proposals are designed so that operating profit or loss provides useful information in such circumstances.

- BC60 For some entities, such as insurers, investing in assets that generate returns individually and largely independently of entity's other resources is an important activity performed in the course of their main business activities although it may not be their main business activity. For example, an insurer's main business activity may be underwriting, but it may invest in assets that generate returns individually and largely independently of its other resources in the course of its underwriting business activity. To classify income and expenses from such assets in the operating category, the proposals refer to 'activities that are conducted in the course of an entity's main business activities' rather than to an entity's main business activities. This proposal would also capture entities for whom such activities are their main business activity, for example, investment entities.
- BC61 The Board's proposal relates only to returns from investments made in the course of an entity's main business activities. Entities with such investments may also have investments that are not made in the course of their main business activities. Income or expenses arising from such investments are classified in the investing category. The Board recognises that this would require entities to separate returns from investments made in the course of their main business activities from those that are not. However, the Board concluded that this would not cause significant incremental costs as entities are likely to have this information to manage their business. Also, users of financial statements would benefit from separate information about returns from investments that are unrelated to an entity's main business activities for all entities.

Extracts from the ED of the paragraphs referred to by the IASB in question 4 [\[Back to memo\]](#)

- ...
- 51 If an entity provides financing to customers as a main business activity, it shall make an accounting policy choice to not classify in the financing category either (see paragraphs B28–B29):
- (a) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or
 - (b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.
- Such income and expenses are instead classified in the operating category.

- ...
- B28 Applying paragraph 51, when an entity provides financing to customers as a main business activity it is required to make an accounting policy choice to classify in the operating category either income and expenses from financing activities, and from cash and cash equivalents relating to the provision of financing to customers or all income and expenses from financing activities and all income and expenses from cash and cash equivalents.
- B29 Whether an entity provides financing to customers as a main business activity is a matter of judgement. In general, providing financing to customers is likely to be a main business activity when the difference between interest income and the related interest expense is an important indicator of operating performance. Examples of entities that provide financing to customers as a main business activity may include:
- (a) banks;
 - (b) entities that provide financing to customers to enable those customers to purchase the entity's products; and
 - (c) lessors that provide finance leases to customers.

...

Income and expenses from financing activities classified in the operating category (paragraph 51)

- BC62 The Board proposes to require entities with a main business activity of providing financing to customers to classify in the operating category income and expenses from financing activities and income and expenses from cash and cash equivalents.
- BC63 When an entity provides financing to customers as a main business activity, the difference between the interest revenue from that activity and the related interest expense—a cost of earning that income—is an important indicator of operating performance. For example, in the lending business, a main business activity is earning interest revenue from providing financing to customers. The difference between interest revenue and interest expense incurred to obtain some or all of the financing needed for that main business activity is

a key performance measure for financial institutions and is used by users of financial statements when analysing the performance of such entities. The Board's proposal would enable entities such as banks to continue presenting a net interest income subtotal.

- BC64 When an entity that provides financing to customers has more than one main business activity, it may have financing activities that are unrelated to the provision of financing to customers. In some such situations, the entity may be unable to identify which income and expenses from financing activities and income and expenses from cash and cash equivalents relate to the provision of financing to customers and which do not without undue cost or effort.
- BC65 For example, an entity with a central treasury that raises funding for all of the entity's activities and allocates those costs internally may not be able to identify a non-arbitrary basis for allocating financing expenses between those that do or do not relate to the provision of financing to customers.
- BC66 Some entities both provide financing to customers and invest in the course of their main business activities. It may be difficult to allocate expenses from financing activities to these two activities. For example, a bank that provides financing to customers, but also invests in equity instruments, may not be able to identify a non-arbitrary basis for allocating interest expense from its financing activities between these two activities.
- BC67 Therefore, the Board proposes that when an entity provides financing to customers, it should make an accounting policy choice between classifying in the operating category:
- (a) only income and expenses that arise from financing activities and income and expenses from cash and cash equivalents relating to its provision of financing to customers; or
 - (b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.
- BC68 The Board recognised that permitting an accounting policy choice may result in some loss of comparability between entities and that classifying in the operating category only the income and expenses arising from financing activities related to providing financing to customers would provide more useful information. However, because of the difficulty in some cases in allocating income or expenses between the categories, the Board concluded that allocation should not be required but should be permitted.
- BC69 The Board concluded that presenting a subtotal of profit or loss before financing and income tax would be misleading if all of an entity's expenses from financing activities were included in that subtotal. The Board, therefore, proposes that an entity that classifies all expenses from financing activities in the operating category shall not present a subtotal of profit or loss before financing and income tax.

Extracts from the ED of the paragraphs referred to by the IASB in question 5 [\[Back to memo\]](#)

Investing

- 47 **The objective of the investing category is to communicate information about returns from investments that are generated individually and largely independently of other resources held by an entity. Except as required by paragraph 48, an entity shall classify in the investing category:**
- (a) ***income and expenses from investments, including from non-integral associates and joint ventures (see paragraphs B32–B33).***
 - (b) **incremental expenses incurred generating income and expenses from investments. Incremental expenses are expenses that the entity would not have incurred had the investments giving rise to the income and expenses from investments not been made.**
- 48 An entity shall not classify in the investing category income and expenses specified in paragraphs 47(a)–47(b) generated in the course of its main business activities. Such income and expenses are instead classified in the operating category. An entity shall not classify income and expenses from non-integral associates and joint ventures in the operating category.

...

Investing

- B32 Paragraph 47 requires an entity to classify income and expenses from investments in the investing category except when paragraph 48 requires the entity to classify them in the operating category. Income and expenses from investments would typically include:
- (a) income and expenses from financial assets, except for income and expenses from cash and cash equivalents, such as:
 - (i) interest revenue;

- (ii) impairment losses and reversals of impairment losses;
 - (iii) gains and losses on disposal;
 - (iv) fair value gains and losses;
 - (v) dividends from equity investments;
 - (vi) the share of profit or loss of non-integral associates and joint ventures; and
 - (vii) income and expenses from associates and joint ventures not accounted for using the equity method; and
- (b) income and expenses from other investments such as:
- (i) income and expenses on investment property;
 - (ii) impairment losses and reversals of impairment losses;
 - (iii) income or expenses from speculative investments, such as investments in artwork held for capital appreciation; and
 - (iv) gains and losses on disposal.

B33 Income and expenses from investments do not include income and expenses from assets used by an entity in the production of goods and delivery of services. Income and expenses derived from such assets result from the combination of those assets with other resources of the entity, such as employees, raw materials or intangible assets, and not from the individual assets on their own. Examples of such income and expenses not from investments include:

- (a) interest revenue from trade receivables, which would be classified in the operating category;
- (b) income and expenses from property, plant and equipment and intangible assets, including depreciation, amortisation, impairment and disposal gains and losses, which would be classified in the operating category; and
- (c) gains or losses on disposal of a discontinued operation, which would be classified in the discontinued operations category.

...

Appendix A Defined terms

This appendix is an integral part of the [draft] IFRS Standard.

...

income and expenses from investments	Income and expenses from assets except for income and expenses from cash and cash equivalents that generate a return individually and largely independently of other resources held by an entity.
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...

Investing category (paragraphs 47–48 and B32–B33)

BC48 The Board proposes to require entities to present an investing category in the statement of profit or loss. This category would include income and expenses from investments and incremental expenses related to those investments. Income and expenses from investments comprise income and expenses from assets that generate a return individually and largely independently of other resources held by the entity.

BC49 The objective of the investing category is to identify returns from investments that are not part of the entity's main business activities. For example, equity or debt investments typically generate dividend or interest returns individually and largely independently of an entity's other assets. Information about the income or expenses arising from such assets would provide useful information to users of financial statements who often analyse returns from an entity's investments separately from the entity's operations.

BC50 The Board proposes that the investing category include incremental expenses related to the investments only—expenses that would not have been incurred had the investment not been made. The Board considered whether it should include all expenses directly related to investments in this category. However, it rejected this approach because it would result in expense allocations that could be complex and costly. For example, expenses directly related to an investment may include an allocation of labour costs if some employees of an entity are engaged in both operating and investing activities. The Board's objective for the investing category is not to present the profit from an entity's investing activities, but to separate investing income and expenses

from operating income and expenses without imposing undue cost or effort on preparers of financial statements. Therefore, the Board decided to limit the allocation to the investing category to incremental expenses related to the investments.

- BC51 The investing category in the statement of profit or loss is different from investing activities as defined in IAS 7. The objective of the IAS 7 classification is to identify investments made in long-term assets that will generate future returns. Some of these investments may include assets whose returns would be classified in the investing category in the statement of profit or loss. However, the definition of investing activities in IAS 7 would also include investments in operating assets, such as property, plant and equipment. Because income and expenses related to such assets reflect an entity's main business activities, they would be classified in the operating category of the statement of profit or loss.
- BC52 The Board also proposes that income and expenses from non-integral associates and joint ventures are classified in the investing category. The Board's proposals for the presentation of information about associates and joint ventures are discussed in paragraphs BC77–BC89 and BC209–BC213.

Extracts from the ED of the paragraphs referred to by the IASB in question 6 [\[Back to memo\]](#)

Financing

- 49 The objective of the financing category is to communicate information about income and expenses from assets and liabilities related to an entity's financing. Except as required by paragraphs 51–52, an entity shall classify in the financing category:**
- (a) **income and expenses from cash and cash equivalents (see paragraph B34);**
 - (b) **income and expenses on liabilities arising from *financing activities* (see paragraphs B35–B36); and**
 - (c) **interest income and expenses on other liabilities (see paragraph B37).**
- 50 Financing activities are those involving the receipt or use of a resource from a provider of finance with the expectation that:
- (a) the resource will be returned to the provider of finance; and
 - (b) the provider of finance will be compensated through the payment of a finance charge that is dependent on both the amount of the credit and its duration.
- 51 If an entity provides financing to customers as a main business activity, it shall make an accounting policy choice to not classify in the financing category either (see paragraphs B28–B29):
- (a) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or
 - (b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.
- Such income and expenses are instead classified in the operating category.
- 52 An entity also excludes the following income and expenses from the financing category and classifies them in the operating category:
- (a) income and expenses from cash and cash equivalents if the entity, in the course of its main business activities, invests in financial assets that generate a return individually and largely independently of other resources held by the entity (see paragraph B30);
 - (b) income and expenses on liabilities arising from issued investment contracts with participation features recognised applying IFRS 9 *Financial Instruments*; and
 - (c) insurance finance income and expenses included in profit or loss applying IFRS 17 *Insurance Contracts*.
- ...
- 60 [IAS 1.81A partial] Subject to paragraph 64, an entity shall present the following totals or subtotals in the statement of profit or loss:
- (a) operating profit or loss;
 - (b) operating profit or loss and income and expenses from integral associates and joint ventures (see paragraph 53);

- (c) profit or loss before financing and income tax (see paragraphs 63–64); and
- (d) profit or loss.

...

- 64 An entity shall not present the subtotal profit or loss before financing and income tax if, applying paragraph 51, it classifies all income and expenses from financing activities and all income and expenses from cash and cash equivalents in the operating category. This applies even when such an entity presents interest income or expense on other liabilities in the financing category applying paragraph 49(c).

Financing category and the subtotal of profit or loss before financing and income tax (paragraphs 49–52 and B34–B37)

- BC33 Many users of financial statements seek to analyse an entity's performance independently of how that entity is financed. To facilitate such analysis, the Board proposes to require an entity to classify specified income and expenses into a financing category and to present a profit or loss before financing and income tax subtotal in its statement of profit or loss.
- BC34 To meet the objective of providing a useful basis for comparing an entity's performance independently of how that entity is financed, the proposed subtotal would present profit or loss of the entity before income and expenses classified in the following categories:
- (a) financing (see paragraphs BC35–BC47);
 - (b) income tax; and
 - (c) discontinued operations.
- BC35 The financing category includes:
- (a) income and expenses on liabilities arising from financing activities (see paragraph BC37);
 - (b) income and expenses from cash and cash equivalents (see paragraphs BC38–BC41); and
 - (c) interest income and expenses on liabilities that do not arise from financing activities (see paragraphs BC42–BC45).
- BC36 The Board proposes to require some entities, depending on their main business activities, to classify some or all income and expenses that meet the definition of income and expenses from financing activities in the operating category instead of the financing category in the statement of profit or loss. This is discussed in paragraphs BC62–BC69.

Income and expenses from financing activities

- BC37 To describe which income and expenses arise from financing activities, the Board proposes to expand and clarify the definition of financing activities in IAS 7 and apply it to the statement of profit or loss. The Board based its proposed definition on the work of the IFRS Interpretations Committee in March 2013. The Committee explored how the definitions in IAS 7 of financing activities and borrowing could be clarified, and thus achieve greater consistency in their application. Providing a clear definition of financing activities is also expected to result in more transparency about the classification of items in the financing category.

Income and expenses from cash and cash equivalents

- BC38 The Board proposes that income and expenses from cash and cash equivalents should be classified in the financing category (see paragraphs BC39–BC41), except for in some cases, depending on an entity's main business activities, as discussed in paragraphs BC70–BC72.
- BC39 Typically, users of an entity's financial statements treat excess cash and temporary investments of excess cash as part of the entity's financing. This treatment is typical because how an entity manages such assets is interrelated with its decisions about debt and equity financing. Excess cash can, for instance, be used to pay dividends, repay debt or buy back shares.
- BC40 The Board proposes to classify income and expenses from cash and cash equivalents in the financing category because:
- (a) cash and cash equivalents represent a reasonable proxy for excess cash and the temporary investments of excess cash for many entities (see paragraphs BC70–BC72 for a discussion of the Board's proposal when this is not the case).

- (b) cash and cash equivalents are defined in IAS 7. Using existing definitions that are well understood helps to ensure that the requirement is applied consistently and that the amounts classified in the financing category are comparable.
- (c) while most entities require some cash for operational purposes (for example, as a part of working capital) requiring entities to split cash and cash equivalents between amounts used for operational purposes and excess cash would impose undue cost or effort.

BC41 The Board acknowledges that some users of financial statements view investments other than cash and cash equivalents as part of an entity's financing—for example, some liquid financial assets. However, the Board's proposal to require an entity to provide information about income and expenses from investments in the investing category should enable users to make adjustments in their analysis if they regard a particular investment as part of the entity's financing. For example, a user could reclassify items of income from the investing category and include them in the financing category.

Interest income and expenses on liabilities that do not arise from financing activities

BC42 The Board proposes that the unwinding of a discount on liabilities that do not arise from financing activities be classified in the financing category.

BC43 This proposal is intended to capture income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities. These include, for example, net defined benefit liabilities (or assets) and decommissioning liabilities. Many users of financial statements consider such income and expenses to be similar to income or expenses from financing activities.

BC44 The Board recognises that not all users of financial statements consider such income or expenses to be similar to income or expenses from financing activities. However, the Board's proposal provides a consistent basis for the presentation of information related to financing and the related disclosures should enable users that disagree with the classification of these income and expenses as financing to adjust the profit or loss before financing and income tax subtotal if they wish to do so.

BC45 The Board's proposed subtotal of profit or loss before financing and income tax precedes the financing category. The financing category incorporates definitions of items that users of financial statements commonly regard as part of an entity's financing. This approach provides a consistent basis for the presentation of the information related to an entity's financing, resulting in a comparable subtotal. The requirements for separate presentation of items classified in the financing category enable users, when doing their own analyses, to adjust the amounts classified in this category if they have different views about whether those items form part of an entity's financing.

Extracts from the ED of the paragraphs referred to by the IASB in question 7 above [\[Back to memo\]](#)

20A An entity shall classify its associates and joint ventures accounted for using the equity method as either integral associates and joint ventures or as non-integral associates and joint ventures on initial recognition.

20B An entity shall change the classification of an associate or joint venture as integral or non-integral if and only if the relationship between the reporting entity and the associate or joint venture changes.

20C When an integral or non-integral associate or joint venture is reclassified in the period, an entity shall disclose how the entity's relationship with the associate or joint venture has changed and the amount reclassified.

20D When assessing whether an associate or joint venture accounted for using the equity method is integral or non-integral to an entity's main business activities, the entity shall consider all facts and circumstances. A significant interdependency between an entity and an associate or joint venture would indicate that the associate or joint venture is integral to the main business activities of the entity. Examples of a significant interdependency between an entity and an associate or joint venture include:

- (a) having integrated lines of business with the associate or joint venture;
- (b) sharing a name or brand with the associate or joint venture so that externally it may appear as one business in relation to the activities of the associate or joint venture (although the reporting entity may have other, separate businesses); and

- (c) having a supplier or customer relationship with the associate or joint venture that the entity would have difficulty replacing without significant business disruption.

...

Totals and subtotals presented in the statement of profit or loss

60 [IAS 1.81A partial] Subject to paragraph 64, an entity shall present the following totals or subtotals in the statement of profit or loss:

- (a) operating profit or loss;
- (b) operating profit or loss and income and expenses from integral associates and joint ventures (see paragraph 53);
- (c) profit or loss before financing and income tax (see paragraphs 63–64); and
- (d) profit or loss.

...

53 An entity shall classify in the integral associates and joint ventures category income and expenses from integral associates and joint ventures (see paragraph B38).

...

75 [IAS 1.82A partial] An entity shall, in each of the categories of the statement presenting comprehensive income, present line items for:

- (a) **the share of other comprehensive income of associates and joint ventures accounted for using the equity method, presenting separately:**
 - (i) **integral associates and joint ventures; and**
 - (ii) **non-integral associates and joint ventures; and**
- (b) **other items of other comprehensive income classified by their nature.**

...

Line items to be presented in the statement of financial position

82 [IAS 1.54] In addition to items required by other IFRS Standards, an entity shall present in the statement of financial position line items for (see paragraphs B12–B14):

- (a) **property, plant and equipment;**
- (b) **investment property;**
- (c) **intangible assets;**
- (d) **goodwill;**
- (e) **financial assets (excluding amounts shown under (g), (h), (k) and (l));**
- (f) **groups¹ of contracts within the scope of IFRS 17 that are assets, disaggregated as required by paragraph 78 of IFRS 17;**
- (g) **investments in integral associates and joint ventures;**
- (h) **investments in non-integral associates and joint ventures; ...**

¹ Exposure Draft ED/2019/4 *Amendments to IFRS 17* proposes amending this paragraph to change groups of contracts to portfolios of contracts.

...

38A An entity shall classify cash flows from the acquisition and disposal of investments in associates and joint ventures applying paragraphs 16(c)–16(d). An entity shall classify as cash flows from investing activities dividends received from associates and joint ventures accounted for using the equity method. An entity shall present cash flows in respect of its investments in integral associates and joint ventures separately from cash flows in respect of its investments in non-integral associates and joint ventures.

...

20E When applying paragraph 20 to associates and joint ventures accounted for using the equity method an entity shall disclose the information required separately for integral associates and joint ventures and non-integral associates and joint ventures.

...

Classification of income and expenses from associates and joint ventures accounted for using the equity method (paragraphs 53, 60, 62–63 and B38)

- BC77 As discussed in paragraph BC8, the Board has observed significant diversity in practice in the presentation of an entity's share of the profit or loss of associates and joint ventures accounted for using the equity method. Therefore, the Board considered specifying where in the statement of profit or loss an entity should present its share of the profit or loss of associates and joint ventures accounted for using the equity method.
- BC78 The Board considered requiring entities to present their share of the profit or loss of associates and joint ventures in a single location in the statement of profit or loss—the investing category. However, stakeholder feedback suggests some associates and joint ventures may have important differences in characteristics in that:
- (a) the activities of some associates and joint ventures are integral to the reporting entity's main business activities. Feedback suggests this characteristic is common in joint ventures.
 - (b) the activities of some associates and joint ventures are not integral to the reporting entity's main business activities, that is they have little or no effect on those activities.
- BC79 Therefore, the Board proposes to require entities to classify their associates and joint ventures as either integral or non-integral associates and joint ventures and present separately the share of profit or loss of these different types of associates and joint ventures. To achieve this the Board proposes to amend IFRS 12 to define integral and non-integral associates and joint ventures and to provide indicators to help entities apply those definitions, as well as requirements for when a change in classification may be appropriate (see paragraphs BC209–BC213).
- BC80 The Board concluded that the share of profit or loss of non-integral associates and joint ventures meets the definition of income and expenses from investments and therefore proposes to classify it in the investing category.
- BC81 In contrast, the Board concluded that an entity should not classify the share of profit or loss of integral associates and joint ventures in the investing category because such income and expenses are not largely independent from income and expenses classified in the operating category. In other words, they do not meet the definition of income or expenses from investments.
- BC82 The Board considered whether to require entities to classify the share of profit or loss of integral associates and joint ventures in the operating category. Such an approach would be a response to the views of some stakeholders that entities may invest in integral associates and joint ventures in the course of their main business activities. However, it rejected this approach because many users of financial statements analyse the results of investments in associates and joint ventures accounted for using the equity method separately from the results of an entity's operating activities. Users explain that this is because:
- (a) the equity method of accounting combines income and expenses that users would normally analyse separately, including financing expenses and income taxes.
 - (b) classifying the share of profit or loss of associates and joint ventures in the operating category would significantly disrupt users' analyses of operating margins. For example, the revenue line does not include revenue from associates and joint ventures.
 - (c) the entity does not control the activities of associates and joint ventures as it controls the other activities giving rise to income and expenses classified in the operating category and only exercises joint control over the activities of joint ventures.
- BC83 Instead of classifying the share of profit or loss of integral associates and joint ventures in the operating category, the Board proposes to create a separate category for income and expenses from integral associates and joint ventures and to require entities to:
- (a) classify income and expenses from integral associates and joint ventures in this proposed category; and
 - (b) present an operating profit or loss and income and expenses from integral associates and joint ventures subtotal.
- BC84 The Board discussed whether, in addition to the share of profit or loss of integral associates and joint ventures, the integral associates and joint ventures category should include:

	(a)	impairment losses and reversals of impairment losses on integral associates and joint ventures; and
	(b)	gains or losses on disposals of integral associates and joint ventures.
BC85		One view was that integral associates and joint ventures contribute in combination with other assets to an entity's main business activities, creating synergies that have an impact on the entity's operating profit or loss. Consequently, any income and expense relating to these investments should, in principle, be classified as operating. According to this view, presentation of the share of profit or loss of integral associates and joint ventures separately from the operating category should be regarded as an exception (justified in paragraph BC82). However, that exception should not be extended to income and expenses listed in paragraph BC84.
BC86		The Board proposes, however, to classify the income and expenses from integral associates and joint ventures listed in paragraph BC84 in the integral associates and joint ventures category because:
	(a)	this is consistent with the Board's general approach to classifying related income and expenses in the statement of profit or loss. Including such income and expenses in separate categories could lead to accounting mismatches.
	(b)	this would respond to the views of users of financial statements who do not want to include any income and expenses relating to associates and joint ventures in the operating category because they would analyse returns on these investments separately from operating profit or loss.
	(c)	although investments in integral associates and joint ventures may give rise to economic benefits arising from synergies with an entity's main business activities, classifying income and expenses from these investments in the operating category would nevertheless disrupt users' analyses of operating margins. This is because the revenue line, for example, does not include revenue from associates and joint ventures.
BC87		The Board noted that some users of financial statements have said that, for reasons similar to those described in paragraph BC82, they would not use the proposed subtotal of operating profit or loss and income and expenses from integral associates and joint ventures. The Board however concluded that the proposed presentation and the subtotal requirement balance the needs for:
	(a)	an operating profit or loss that excludes any income or expenses from financing, investing and income taxes, and provides a comparable basis for calculating operating margins; and
	(b)	separate presentation of income and expenses from associates and joint ventures that are integral to the entity's main business activities.
BC88		Some stakeholders have asked the Board to require entities to disaggregate the share of profit or loss of integral associates and joint ventures between different categories in the statement of profit or loss. The Board, however, concluded that such a proposal would go beyond the scope of this project because it would involve a fundamental reconsideration of the requirements of IFRS 11 <i>Joint Arrangements</i> , IFRS 12 and IAS 28 <i>Investments in Associates and Joint Ventures</i> .
BC89		Consistent with its proposal to require entities to present the share of profit or loss of integral associates and joint ventures separately from the share of profit or loss of non-integral associates and joint ventures, the Board also proposes to amend:
	(a)	IAS 7 to require that cash flows from investments in integral associates and joint ventures are presented separately from cash flows from investments in non-integral associates and joint ventures (see paragraphs BC205–BC208).
	(b)	IFRS 12 to, in addition to requirements relating to the definition of integral and non-integral associates and joint ventures (see paragraph BC79), require separate disclosures about integral and non-integral associates and joint ventures. See paragraphs BC209–BC213 for discussion about proposed amendments to IFRS 12.
...		
		IFRS 12 <i>Disclosure of Interests in Other Entities</i>
BC209		As discussed in paragraph BC79, the Board proposes to require an entity to classify its investments in associates and joint ventures accounted for using the equity method as either integral to an entity's main business activities or non-integral to those activities.
BC210		To achieve this, the Board proposes to amend IFRS 12 to introduce a definition of integral and non-integral associates and joint ventures. The proposed definition is based on the proposed definition of income and expenses from investments. The purpose of this approach is for income and expenses from associates and joint ventures to be classified in the investing category only when they would meet the definition of income

	and expenses from investments. This approach is also easier and more understandable than developing a definition for integral and non-integral associates and joint ventures that is not based on an existing definition.
BC211	The Board further proposes introducing a set of indicators to help an entity determine which associates and joint ventures are integral to an entity's main business activities. Given the wide range of possible business relationships between an entity and its associate or joint venture, the Board concluded that it is not possible to develop an exhaustive list of criteria that could encompass all possible business scenarios and has instead proposed a list of indicators. During Board deliberations concerns were expressed whether, given the importance of the consistent classification of income and expenses, the proposed definitions and indicators would be sufficient to enable an entity to distinguish between integral and non-integral associates and joint ventures on a consistent basis.
BC212	The Board also proposes amending IFRS 12 to require separate disclosures about integral and non-integral associates and joint ventures.
BC213	To help users of financial statements understand the judgements made by an entity, the Board further proposes requiring an entity to disclose significant judgements and assumptions it made to assess whether associates and joint ventures accounted for using the equity method are integral or not, and disclosure requirements relating to any changes in classification.

Extracts from the ED of the paragraphs referred to by the IASB in question 8(a) [\[Back to memo\]](#)

- 20 The role of the primary financial statements is to provide a structured and comparable summary of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows, which is useful for:
- (a) obtaining an overview of the entity's assets, liabilities, equity, income, expenses and cash flows;
 - (b) making comparisons between entities, and between reporting periods for the same entity; and
 - (c) identifying items or areas about which users of financial statements may wish to seek additional information in the notes.
- 21 The role of the notes is to:
- (a) provide further information necessary for users of financial statements to understand the items included in the primary financial statements; and
 - (b) supplement the primary financial statements with other information that is necessary to meet the objective of financial statements.

...

Objective and roles of the primary financial statements and the notes

- B3 Applying paragraph 21(a), an entity provides in the notes further information necessary for users of financial statements to understand the items included in the *primary financial statements*. Examples of such information include:
- (a) *disaggregation* of the line items presented in primary financial statements;
 - (b) descriptions of the nature of the items included in the primary financial statements; and
 - (c) information about the methods, assumptions and judgements used in recognising and measuring the items included in the primary financial statements.
- B4 Applying paragraph 21(b), an entity supplements the primary financial statements with other information that is necessary to meet the objective of financial statements. Examples of such supplementary information include:
- (a) information about the nature and extent of an entity's unrecognised assets, liabilities, equity, income and expenses (the elements of the financial statements); and
 - (b) information about an entity's exposure to various types of risks, such as market risk or credit risk, arising from both recognised and unrecognised elements of the financial statements.

...

Objective and roles of the primary financial statements and the notes (paragraphs 19–24 and B3–B4)

BC19 The Board proposes to describe the roles of the primary financial statements and the notes. The proposed descriptions are based on those in Section 3 of the 2017 Discussion Paper *Disclosure Initiative—Principles of Disclosure*. The feedback received on the Discussion Paper was broadly supportive. Respondents commented that the descriptions would help preparers of financial statements decide whether information should be provided in an entity's primary financial statements or in the notes.

BC20 Such descriptions would also help the Board when developing new or revised IFRS Standards.

Extracts from the ED of the paragraphs referred to by the IASB in question 8(b) [\[Back to memo\]](#)

Aggregation and disaggregation (see paragraphs B5–B15)

25 [IAS 1.29 and IAS 1.30A] **An entity shall present in the primary financial statements or disclose in the notes the nature and amount of each material class of assets, liabilities, income or expense, equity or cash flow. To provide this information an entity shall aggregate transactions and other events into the information it discloses in the notes and the line items it presents in the primary financial statements. Unless doing so would override specific aggregation or disaggregation requirements in IFRS Standards, an entity shall apply the principles that (see paragraphs B5–B15):**

- (a) **items shall be classified and aggregated on the basis of shared characteristics;**
- (b) **items that do not share characteristics shall not be aggregated (see paragraph 27); and**
- (c) **aggregation and disaggregation in the financial statements shall not obscure relevant information or reduce the understandability of the information presented or disclosed.**

26 **When presenting information in the primary financial statements or disclosing information in the notes, the description of the items shall faithfully represent the characteristics of those items.**

27 An entity may aggregate immaterial items that do not share characteristics. However, using a non-descriptive label such as 'other' to describe a group of such items would not faithfully represent those items without additional information. Except as described in paragraph 28, to faithfully represent aggregated items, an entity shall either:

- (a) aggregate immaterial items with other items that share similar characteristics and can be described in a manner that faithfully represents the characteristics of the aggregated items; or
- (b) aggregate immaterial items with other items that do not share similar characteristics but which may be described in a way that faithfully represents the dissimilar items.

28 If the steps set out in paragraphs 27(a)–27(b) do not lead to descriptions that result in a faithful representation, an entity shall disclose in the notes information about the composition of the aggregated items, for example, by indicating that an aggregated item consists of several unrelated immaterial amounts and by indicating the nature and amount of the largest item in the aggregation.

...

Aggregation and disaggregation

B5 Financial statements result from entities processing large numbers of transactions and other events. These transactions and other events give rise to assets, liabilities, equity, income and expenses. Information about an entity's total assets, total liabilities, total equity, total income and total expenses provides some information about the financial position and financial performance of an entity. However, that information is likely to be too summarised to be useful on its own because it combines items that may have different characteristics. Disaggregated information about the elements of the financial statements arising from individual transactions or other events provides more detailed information. However, if its volume and the amount of detail make it difficult to understand, then the information about individual transactions and other events may not provide useful information about the financial position or financial performance of an entity. Consequently, an entity applies judgement about the amount of detail required to provide useful information to users of financial statements.

- B6 To determine the line items presented in the primary financial statements or the items disclosed in the notes, an entity shall apply the principles of *aggregation* and disaggregation described in paragraph 25 to identify items that share characteristics. In applying the principles of aggregation an entity shall:
- (a) identify the assets, liabilities, equity, income and expenses that arise from individual transactions or other events;
 - (b) classify assets, liabilities, equity, income and expenses into groups based on their characteristics (for example, their nature, their function, their measurement basis or another characteristic) resulting in the presentation in the primary financial statements of line items that share at least one characteristic; and
 - (c) separate the line items presented in the primary financial statements on the basis of further characteristics resulting in the disclosure of items in the notes, if those items are material.
- Other *IFRS Standards* include additional requirements for disclosing different types of information in the notes including information about items that do not qualify for recognition in the financial statements.
- B7 Applying the principles of aggregation does not necessarily mean following steps B6(a)–B6(c) sequentially. However, an entity shall consider all these steps in determining whether items that share characteristics have been classified and aggregated appropriately and ensuring that items that do not share characteristics have not been aggregated.
- B8 Because the role of the primary financial statements is to provide a structured and comparable summary, the line items in the primary financial statements are likely to combine some material items that have some dissimilar characteristics. However, to be useful to users of financial statements, the items aggregated and presented as line items in the primary financial statements must share at least one characteristic other than meeting the definition of a particular element of the financial statements.
- B9 In the notes, it is the concept of materiality that drives aggregation and disaggregation. To achieve the objective of financial statements, items that have dissimilar characteristics shall be disaggregated into component parts when the resulting information is material.
- B10 For example, an entity may hold material amounts of *financial assets* that are equity instruments and material amounts of financial assets that are debt instruments that share the characteristic of being measured at fair value through *profit or loss*. That being so, a single line item in the entity's statement of financial position for financial assets measured at fair value through profit or loss may provide users of financial statements with a useful summary of the entity's financial assets. However, financial assets that are equity instruments are dissimilar to financial assets that are debt instruments in that they each expose the entity to different risks. Therefore, in the notes to the financial statements, the entity may need to disclose its financial assets that are equity instruments separately from its financial assets that are debt instruments if the resulting information would be material. The entity should also consider whether aggregating all of its financial assets that are equity instruments and separately aggregating all that are debt instruments would result in the loss of material information about the characteristics of those assets. If this would be the case, the entity should further disaggregate those financial assets.
- B11 Aggregating items that result from individual transactions and other events into line items presented in the primary financial statements and items disclosed in the notes requires judgement about the information that will be useful. In making this judgement, an entity shall consider the balance of similar and dissimilar characteristics between aggregated items. The more characteristics items have in common the more likely it is that aggregating them will result in useful information and the more dissimilar characteristics items have the less likely it is that aggregating them will result in useful information.

Disaggregation in the statement of financial position

- B12 [IAS 1.58] Applying paragraph 83(a) an entity makes the judgement about whether to present additional items separately on the basis of an assessment of:
- (a) the nature and liquidity of assets;
 - (b) the function of assets within the entity; and
 - (c) the amounts, nature and timing of liabilities.
- B13 [IAS 1.59] The use of different measurement bases for different classes of assets suggests that their nature or function differs and, therefore, that an entity presents them as separate line items. For example, different classes of property, plant and equipment can be carried at cost or at revalued amounts in accordance with IAS 16 *Property, Plant and Equipment*.

- B14 [IAS 1.78] In addition to the disclosure requirements of other IFRS Standards, an entity uses the characteristics set out in paragraph B12 to disaggregate items presented in the statement of financial position or disclosed in the notes. The disclosures vary for each item, for example:
- (a) items of property, plant and equipment are disaggregated into classes in accordance with IAS 16;
 - (b) receivables are disaggregated into amounts receivable from trade customers, receivables from related parties, prepayments and other amounts;
 - (c) inventories are disaggregated, in accordance with IAS 2 *Inventories*, into items such as merchandise, production supplies, materials, work in progress and finished goods;
 - (d) provisions are disaggregated according to their nature, such as, provisions for employee benefits, decommissioning liabilities, or other items; and
 - (e) equity capital and reserves are disaggregated into various classes, such as paid-in capital, share premium and reserves.

Disaggregation in the statement(s) of financial performance

- B15 [IAS 1.98] Circumstances that would give rise to the separate presentation in the statement(s) of financial performance or disclosure in the notes of items of income and expense include:
- (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
 - (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
 - (c) disposals of items of property, plant and equipment;
 - (d) disposals of investments;
 - (e) litigation settlements; and
 - (f) reversals of provisions.

...

Aggregation and disaggregation (paragraphs 25–28 and B5–B15)

- BC21 The Board's proposals include principles for aggregation and disaggregation, supporting definitions and specific requirements. The principles state, in summary, that items with shared characteristics should be grouped together and those that do not share characteristics should be separated.
- BC22 These principles are derived from the descriptions of classification and aggregation in the *Conceptual Framework* which emphasise the existence of shared characteristics as a condition for classifying and aggregating items. Aggregating items that have shared characteristics makes large volumes of information understandable and avoids obscuring relevant information. Similarly, disaggregating items with dissimilar characteristics provides users of financial statements with relevant information and avoids obscuring material information.
- BC23 Definitions of classification, aggregation and disaggregation are proposed to support the principles of aggregation. These definitions are based on the definitions in the *Conceptual Framework*. To help entities apply the principles, the Board also proposes requirements on the steps involved in deciding whether to aggregate or disaggregate the effects of transactions or other events.
- BC24 The proposals respond to feedback from users of financial statements in the 2015 Agenda Consultation that financial statements do not always include information that is appropriately aggregated or disaggregated. For example, an entity might present in the statement of profit or loss all its operating expenses as a single line item, or an entity might disclose in the notes large 'other' expenses with no information provided to help users understand what these items comprise. In contrast, some users were concerned that some entities disclose too much detail, thereby obscuring material information. Providing the appropriate amount of detail will better enable users to compare information for the same entity between reporting periods and across different entities.
- BC25 The Board also recognised that an entity may need to aggregate immaterial items with dissimilar characteristics to avoid obscuring relevant information and that aggregation in this way may result in items that cannot be faithfully represented without further information. In response to the concerns of users of financial statements about such items, which are often described as 'other', the Board proposes specific requirements to provide more useful information about aggregations of dissimilar immaterial items.

BC26 The Board considered providing quantitative thresholds for disaggregation, for example, requiring separate disclosure of any balances over 10% of an entity's revenue or requiring entities to review whether balances exceeding such threshold should be disaggregated. However, it rejected this approach to avoid conflict with the definition of materiality and the guidance that an entity's judgement of materiality should include a qualitative assessment. Also, the Board concluded that it would be difficult to determine an appropriate threshold that would apply in all cases.

BC27 The Board considered introducing mandatory templates that would require specified line items. However, it rejected this approach because it would not be possible to develop templates applicable to all types of entities or business activities or to all methods of reporting. Additionally, mandatory templates may conflict with local laws and regulations in some jurisdictions. The Board has, however, developed a set of draft non-mandatory illustrative examples to help stakeholders understand the proposals and illustrate how they could be applied.

Extracts from the ED of the paragraphs referred to by the IASB in question 9 [\[Back to memo\]](#)

Analysis of expenses classified in the operating category

68 [IAS 1.99] An entity shall present in the operating category of the statement of profit or loss an analysis of expenses using a classification based on either their nature—the nature of expense method—or their function within the entity—the function of expense method. The entity shall present the analysis using the method that provides the most useful information to users of their financial statements (see paragraphs B45–B47).

69 The nature of expense method provides information about operating expenses arising from the inputs that are consumed to accomplish an entity's activities—such as information about expenses related to materials (raw materials, employees (employee benefits), equipment (depreciation) or intangible assets (amortisation))—without reference to how expenses are allocated to functions within the business.

70 The function of expense method allocates and combines operating expenses according to the activity to which the item relates. For example, cost of sales is a functional line item that combines expenses that relate to an entity's production or other revenue generating activities such as: raw materials, employee benefit expense, depreciation or amortisation.

71 An entity applying the function of expense method shall present its cost of sales separately from other expenses.

72 [IAS 1.104] An entity presenting an analysis of expenses classified in the operating category using the function of expense method shall also disclose in a single note an analysis of its total operating expenses using the nature of expense method (see paragraph B48).

...

Analysis of expenses classified in the operating category

B45 Paragraph 68 requires an entity to present an analysis of expenses classified in the operating category using either the nature of expense method or the function of expense method, whichever provides the most useful information. An entity shall consider, in deciding which method of expense analysis provides the most useful information:

- (a) which method provides the most useful information to users of financial statements about the key components or drivers of the entity's profitability. For example, for a retail entity a key component or driver of profitability could be cost of sales. Presenting a cost of sales line item can provide relevant information about whether the revenue generated from the sale of goods covers what, for retailers, are mainly direct costs, and by what margin. However, cost of sales is unlikely to provide relevant information about the key components or drivers of profitability when the link between revenue and costs is less direct. For example, for a service entity, information about the expenses presented using a nature of expense analysis, such as employment costs, may be more relevant to users.
- (b) which method most closely represents the way the business is managed and how management reports internally. For example, a manufacturing entity managed on the basis of major functions might use a function of expense method for internal reporting. However, an entity that has a single predominant function, such as a financing activity, may find a more detailed analysis of expenses using a nature of expense method provides more useful information.

- (c) industry practice. The use of similar methods for an analysis of expenses would enable users to more easily compare expenses across entities in the same industry.
- (d) whether the allocation of expenses to functions would be arbitrary and therefore would not provide a sufficiently faithful representation of the line items presented. In such cases, the nature of expense method shall be used.

B46 An entity shall not provide an analysis of expenses classified in the operating category using a mixture of the nature of expense method and the function of expense method except when required to do so by paragraph B47.

B47 An entity shall present in the statement of profit or loss the line items required by paragraph 65 regardless of the method of analysis of expenses used.

B48 An entity applying paragraph 72 discloses in the notes an analysis of total operating expenses using the nature of expense method and is not required to disclose an analysis of each functional line item.

...

Presentation of operating expenses (paragraphs 68–72 and B45–B48)

BC109 The Board proposes that an entity present in the statement of profit or loss an analysis of expenses included in operating profit or loss based on either the nature or the function of the expenses, using whichever method provides the most useful information.

BC110 Both the nature of expense and the function of expense methods of analysis can provide useful information. Information about the nature of expenses allows users of financial statements to analyse the detailed components of an entity's operating expenses, helping them to forecast those expenses for future periods. Information that aggregates expenses by function facilitates the calculation of some performance metrics and margins. However, users have raised concerns that useful information can be lost because entities choose which method to use and because, in practice, many entities use a mixture of both methods. IAS 1 requires an entity to choose a method that is reliable and more relevant. The Board proposes to strengthen this by requiring an entity to use the single method that would provide the most useful information to the users of its financial statements, considering the entity's particular circumstances. To help entities assess which method is most useful in their circumstances, the Board proposes to provide a set of factors for entities to consider when making this assessment.

BC111 IAS 1 requires an entity presenting an analysis of expenses using the function of expense method to provide information about the nature of its expenses. The Board proposes to strengthen this by requiring such entities to, in a single note to the financial statements, disclose an analysis of its total operating expenses using the nature of expense method. This proposal reflects feedback from users of financial statements that analysing expenses using the function of expense method can lead to a loss of useful information. Information is lost because functional line items combine expense items with different natures that respond differently to changes in the economic environment, making it difficult for users to forecast future operating expenses. Information about the nature of operating expenses also enables direct comparison with information provided in the statement of cash flows.

BC112 The Board considered requiring an entity that presents its primary analysis of expenses using the function of expense method to disclose an analysis of each functional line item by nature. Requiring this analysis would provide users of financial statements with information to help them better forecast an entity's functional line items. However, feedback from preparers of financial statements suggested that this approach would be significantly more complex and costly to apply than the Board's proposed approach. Therefore, the Board decided to limit the requirement to an analysis of total operating expenses using the nature of expense method.

BC113 The Board heard from some preparers of financial statements that even the proposed requirement may be costly for entities to implement, particularly for those that operate multiple purchase systems making it difficult to track information about the nature of the total costs incurred. Such entities may not always retain information about the nature of the costs capitalised and, therefore, may find it difficult to disclose an analysis of expenses by nature. Other preparers, however, either provide this analysis today or could provide it with limited costs. The strong support for this proposal from users of financial statements has led the Board to conclude that the benefits of having information about operating expenses by nature would be likely to exceed the costs. The Board intends to seek further feedback on the likely costs and benefits of this proposal during consultation on the Exposure Draft.

BC114 The Board considered requiring an entity that presents its primary analysis of expenses using the nature of expense method to disclose in the notes an analysis of expenses using the function of expense method. However, it rejected such a requirement because there was no evidence of demand from users of financial statements for this disclosure.

Relationship between required line items and the requirements for presentation of operating expenses

BC115 The Board noted that expense line items required to be presented in the statement of profit or loss by paragraph 68 are expenses analysed by nature applying the Board's description of the nature of expense method.

BC116 To ensure that these line items continue to be presented prominently, the Board proposes to require entities to present them separately in the statement of profit or loss whichever method of analysis of operating expenses is used.

Extracts from the ED of the paragraphs referred to by the IASB in question 10 [\[Back to memo\]](#)

Unusual income and expenses

100 *Unusual income and expenses are income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods.*

101 **An entity shall, in a single note that includes all unusual income and expenses, disclose (see paragraphs B67–B75):**

- (a) **the amount of each item of unusual income or expense recognised in the reporting period;**
- (b) **a narrative description of the transactions or other events that gave rise to that item and why income or expenses that are similar in type and amount are not expected to arise for several future annual financial reporting periods;**
- (c) **the line item(s) in the statement(s) of financial performance in which each item of unusual income or expense is included; and**
- (d) **an analysis of the included expenses using the nature of expense method, when an entity presents an analysis of expenses in the statement of profit or loss using the function of expense method.**

102 Income and expenses from the recurring remeasurement of items measured at a current value are expected to change from period to period. They would not normally be classified as unusual income and expenses (see paragraph B72).

...

Unusual income and expenses

B67 Paragraph 101 requires an entity to disclose information in the notes about unusual income and expenses. An entity classifies income and expenses as unusual if and only if they have limited predictive value. Hence, income and expenses cannot be classified as unusual if it is reasonable to expect that income or expenses similar in type and amount will arise in any of several future annual reporting periods.

B68 In determining whether income or expenses are unusual, an entity shall consider both the type of the income or expense and its amount. For example, an impairment loss resulting from a fire at an entity's factory is normally an unusual type of expense and hence would be classified as an unusual expense because in the absence of other indicators of impairment another similar expense would not reasonably be expected to recur for several future annual reporting periods.

B69 Income and expenses that are not unusual by type may be unusual in amount. Whether an item of income or expense is unusual in amount is determined by the range of outcomes reasonably expected to arise for that income or expense in several future annual reporting periods. For example, an entity that incurs regular litigation costs that are all of a similar amount would not generally classify those litigation expenses as unusual. However, if in one reporting period, that entity incurred higher litigation costs than reasonably expected, because of a particular action, it would classify the costs from that action as unusual if litigation costs in several future annual reporting periods were not expected to be of a similar amount. The higher litigation costs are outside the range of reasonably expected outcomes and not predictive of future litigation costs.

B70 Income or expenses are classified as unusual based on expectations about the future rather than past occurrences. Hence, it is possible for income or expenses similar to income or expenses reported in previous reporting period(s) to be classified as unusual. For example, an entity may incur an impairment loss resulting

from a fire at one of its factories in one period. At the end of that period, the entity classifies the impairment as an unusual expense because it has a reasonable expectation that it will not suffer an impairment loss for several future annual reporting periods. In the next period, the entity once again incurs an impairment loss resulting from a fire at another one of its factories. If the two fires in close succession are not indicative of a developing pattern of fires and impairments, it may be possible for the entity to have a reasonable expectation at the end of the second reporting period that similar expenses will not arise for several future annual reporting periods. If this is the case, the second impairment is also classified as unusual.

- B71 Expectations about the future will depend on the facts and circumstances of an entity. For example, an entity that undertakes a restructuring programme spanning several reporting periods or that makes regular acquisitions that result in restructuring expenses would not classify these expenses as unusual. However, an entity that undertakes a restructuring programme and that does not expect to incur expenses of a similar type and amount in the next several reporting periods would classify these expenses as unusual.
- B72 Income and expenses from the recurring remeasurement of items measured at current value would not normally be classified as unusual. Income and expenses from the remeasurement of such items are expected each reporting period and are expected to vary from period to period.
- B73 When an entity identifies unusual income or expenses it does not classify related income or expenses as unusual unless those related income and expenses are themselves unusual. For example, an entity may identify a sale that gives rise to unusual revenue. In earning that revenue, the entity may incur several related costs, including employee benefit expense, inventory cost and taxes. An entity would only identify as unusual those related costs that meet the definition of unusual.
- B74 When an entity discloses comparative information about unusual income and expenses it shall only classify amounts that met the definition of unusual income and expenses in the comparative period as unusual income and expenses.
- B75 An entity's management performance measure(s) may include some, or all, of its unusual income and expenses. In such cases, the entity may disclose the required information about those unusual income and expenses in the same note that it uses to disclose information about management performance measures provided the entity either:
- (a) includes in that note all of the information required by paragraph 101 for unusual income and expenses; or
 - (b) provides a separate note that includes all of the information required for unusual income and expenses.

...

Unusual income and expenses

BC122 The Board observed that many entities disclose unusual or similarly described expenses (and a few disclose unusual income). However, the way entities provide this information varies significantly and it is often not clear how or why items have been identified as unusual.

BC123 Stakeholders commented on the use of the terms 'unusual' and 'infrequent' and discussed possible definitions in feedback on the 2017 Discussion Paper *Disclosure Initiative—Principles of Disclosure*:

- (a) many users of financial statements agreed that the Board should develop requirements for the disclosure of unusual income and expenses because the separate presentation or disclosure of unusual or infrequent income and expenses provides information that is useful in making forecasts about future cash flows. Also, definitions and requirements developed by the Board could make such income and expenses more transparent and comparable across entities and could reduce entities' opportunistic classification of expenses as unusual. However, a few users commented that defining unusual or infrequent income and expenses may be difficult because they are entity-specific and identifying them would involve significant judgement.
- (b) many respondents that are not users said that the Board should not develop definitions for unusual or infrequent income and expenses because those items vary across entities and industries and their identification involves significant judgement. They suggested that the Board could consider instead developing general requirements for the disclosure and faithful representation of such items, for example, requiring them to be classified and presented consistently over time or labelled in a clear and non-misleading way.

BC124 The Board acknowledges that any requirement to disclose unusual income and expenses would require entities to exercise judgement in deciding which income and expenses are unusual. However, the Board proposes to define and require entities to disclose unusual income and expenses to provide information to users of financial statements about the persistence of income and expenses. The proposed disclosure would

enable users to identify income and expenses which may not persist and to analyse them separately when predicting an entity's future cash flows.

BC125 The Board proposes that information about unusual income and expenses should be disclosed in the notes rather than presented in the statement(s) of financial performance. The Board concluded that disclosure in the notes would enable entities to provide a more complete description and analysis of such income and expenses. Disclosure in the notes also provides users of financial statements with a single location to find information about such income and expenses and addresses some stakeholders' concerns that unusual income and expenses may be given more prominence than other information in the statement(s) of financial performance.

BC126 Some stakeholders suggested that, given the importance some users of financial statements attach to the disclosure of unusual income and expenses, operating profit before unusual income and expenses should be added to the list of subtotals specified by IFRS Standards and the requirements relating to analysis of operating expenses by function or by nature adjusted accordingly. In their view, no longer being able to present an operating profit subtotal before unusual items would be a significant step back from current practice. The Board has not proposed adding this subtotal because, in some cases, presentation of an operating profit before unusual income and expenses subtotal could result in a presentation that mixes natural and functional line items. Users have told the Board that they do not find mixed presentation useful and want to see all operating expenses analysed by one characteristic (nature or function).

BC127 In developing its proposals for unusual income and expenses, the Board considered:

- (a) how to define unusual income and expenses (see paragraphs BC129–BC136);
- (b) whether remeasurements are unusual income and expenses (see paragraphs BC137–BC139);
- (c) what information an entity should provide about unusual income and expenses and where that information should be provided (see paragraphs BC140–BC144); and
- (d) how unusual income and expenses relate to management performance measures (see paragraph BC180).

BC128 The Board noted that its proposal for unusual income and expenses is different from the requirement for presentation of extraordinary items that was removed from IAS 8 in 2003. Extraordinary items were defined as clearly distinct from the ordinary activities of an entity and were presented in their own category after tax, separately from profit or loss from ordinary activities. Unusual income and expenses, on the other hand, are classified in categories in the statement(s) of financial performance together with 'usual' income and expenses, according to their nature, function or other characteristics. The notion of extraordinary items is not referred to in the Exposure Draft. The Board noted that, as a result of proposals for categories in the statement of profit or loss, entities would be required to classify all income and expenses in one of the categories and would be prohibited from creating a separate category for extraordinary items.

Definition of unusual income and expenses (paragraph 100)

BC129 The Board proposes to define unusual income and expenses as income and expenses with limited predictive value. The Board decided that defining unusual items in this way would:

- (a) address the need of users of financial statements for information about income and expenses that are unlikely to persist and so have limited predictive value (see paragraph BC124); and
- (b) help preparers of financial statements identify unusual income and expenses by providing them with a concept that underpins the identification of unusual income and expenses.

BC130 Though most unusual items currently disclosed are unusual expenses, entities can have unusual income. Disclosure of both unusual income and unusual expenses contributes to a faithful representation of an entity's performance, helping to ensure that entities provide information that is neutral and complete. Therefore, the definition of unusual items refers to both income and expenses. The Board considered specifying that information about unusual items should be neutral but rejected this as unnecessary because neutrality applies to all items included in the financial statements.

BC131 The proposed definition of unusual income and expenses requires an entity to assess whether it is reasonable to expect that income and expenses similar in type or amount will not arise for several future annual reporting periods. The Board proposes using the term 'reasonable to expect' because this term is used in other IFRS Standards and so should be familiar to entities applying the requirement.

BC132 The Board did not indicate a specific period over which an entity should assess whether it is reasonable to expect that similar income or expenses will not arise. However, it did not intend to require an entity to consider all possible future reporting periods nor to consider only a short period. Considering all possible future reporting periods would be impractical and would result in few cases of income or expenses being identified as unusual and resulting in a loss of potentially useful information. Considering only a short period could

result in income and expenses that have predictive value being identified as unusual. Specifying the period over which an entity should consider whether a similar income or expense will arise would be arbitrary and might not lead to the identification of all income and expenses that have limited predictive value.

BC133 The Board recognises that, when assessing whether income and expenses are unusual, it may be helpful to consider the nature of transactions or other events that gave rise to the income or expenses. For example, an entity might conclude that income or expenses (for example, impairment losses) are:

- (a) not reasonably expected to arise for several future annual reporting periods and, therefore, should be classified as unusual income and expenses, and the transactions or other events that gave rise to the income or expenses are unusual in nature (for example, an earthquake in a non-earthquake prone zone); and
- (b) reasonably expected to arise for several future annual reporting periods and, therefore, should not be classified as unusual income or expenses and the transactions or other events that gave rise to the income or expenses are usual in nature (for example, a drop in product prices).

BC134 However, the Board concluded that although unusual income or expenses often result from transactions or other events that are unusual in nature, this is not always the case. Transactions or other events that are unusual in nature can give rise to 'usual' income or expenses. For example, an earthquake may give rise to increased costs that are expected to arise for a number of years, and as such are not unusual expenses. Therefore, the Board did not include reference to the nature of underlying transactions and other events in the definition of unusual income and expenses.

BC135 The Board noted that an entity need not consider individual transactions when assessing whether income or expenses are unusual. A type of income or expense arising from a group of transactions may be assessed as unusual income or expense.

BC136 The proposed definition requires entities to consider whether similar income or expense will recur in the future. It does not require entities to consider whether a similar income or expense has occurred in the past. The occurrence of income or expense in the past does not necessarily indicate that similar income or expense will occur in the future. Therefore, an item of income or expense that occurred in a previous period but is not reasonably expected to recur for several future reporting periods would be identified as an unusual income or expense.

Remeasurements (paragraphs 102 and B72)

BC137 The Board proposes that recurring measurements of assets or liabilities measured at current value would not normally be classified as unusual. This is the case even when amounts of income or expense recognised are expected to vary from period to period.

BC138 Some users of financial statements view gains or losses arising from changes in current value measurements (including fair value measurements) as having limited predictive value. However, current values are likely to change each reporting period and therefore gains or losses from remeasurement are expected to arise in each reporting period. Consequently, such gains or losses are likely to be similar in type to gains or losses expected in future reporting periods and would not normally meet the definition of unusual income and expenses.

BC139 Because of the potential volatility of gains or losses from remeasurements, the range of the amount reasonably expected to arise in future reporting periods may be wider than that for other categories of income or expense. Consequently, a wide range of gains or losses may be considered similar in amount.

Information to be disclosed about unusual income and expenses (paragraph 101)

BC140 The Board proposes that, in the note disclosure about unusual income and expenses, an entity attribute unusual income and expenses to the line items presented in the statement(s) of financial performance, thus enabling users of financial statements to assess the effect of unusual income and expenses on those line items and on subtotals.

BC141 Some unusual expenses—for example, unusual restructuring costs—can include expenses with different natures (for example, staff costs, impairments and legal costs). Users of financial statements said they find the information provided by the nature of expense method useful. Therefore, the Board proposes that an entity also attribute unusual expenses to the line items using the nature of expense method it presents in the statement of profit or loss or discloses in the notes (see paragraphs BC109–BC114).

BC142 The Board proposes that an entity provide a description of the underlying transactions or other events that gave rise to unusual income or expenses. Information about the underlying transactions or other events that

gave rise to unusual income or expenses is useful because it enables users of financial statements to understand what caused the unusual income or expense and to assess the entity's classification of the income or expense as unusual.

BC143 The Board considered requiring entities to identify income and expenses related to unusual income and expenses. Transactions or other events that give rise to unusual income and expenses may also give rise to related income or expenses that do not meet the proposed definition of unusual income and expenses. For example, a sale may give rise to unusual revenue. In earning that revenue, the entity may incur related costs, including staff costs, inventory cost and taxes, which may not meet the definition of unusual expenses. Users of financial statements may find information about the related income and expenses useful even though they do not meet the definition of unusual income and expenses.

BC144 However, the Board rejected this approach because it may be difficult for preparers of financial statements to identify related income and expenses and it may be costly to track them. Such difficulties and costs may lead to inconsistent application of the requirement, making the resulting information less useful. Therefore, the Board does not propose to require an entity to provide information about income and expenses related to unusual income or expenses unless the related income or expenses are themselves unusual.

Extracts from the ED of the paragraphs referred to by the IASB in question 11 [\[Back to memo\]](#)

Management performance measures

103 *Management performance measures* are subtotals of income and expenses that (see paragraphs B76–B81):

- (a) are used in public communications outside financial statements;
- (b) complement totals or subtotals specified by IFRS Standards; and
- (c) communicate to users of financial statements management's view of an aspect of an entity's financial performance.

104 Subtotals specified by IFRS Standards that are not management performance measures include:

- (a) a total or subtotal required by paragraphs 60 and 73;
- (b) gross profit or loss (revenue less cost of sales) and similar subtotals (see paragraph B78);
- (c) operating profit or loss before depreciation and amortisation;
- (d) profit or loss from continuing operations; and
- (e) profit or loss before income tax.

105 Management performance measures shall:

- (a) faithfully represent aspects of the financial performance of the entity to users of financial statements; and
- (b) be described in a clear and understandable manner that does not mislead users.

106 An entity shall disclose information about any management performance measures in a single note to the financial statements. That note shall include a statement that the management performance measures provide management's view of an aspect of the entity's financial performance and are not necessarily comparable with measures sharing similar descriptions provided by other entities. In addition, for each management performance measure an entity shall disclose in the notes (see paragraphs B82–B85):

- (a) a description of why the management performance measure communicates management's view of performance, including an explanation of:
 - (i) how the management performance measure is calculated; and
 - (ii) how the measure provides useful information about the entity's performance;
- (b) a reconciliation between the management performance measure and the most directly comparable subtotal or total included in paragraph 104;

- (c) **the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation required by paragraph 106(b); and**
 - (d) **how the entity determined the income tax effect required by paragraph 106(c).**
- 107 An entity shall determine the income tax effect required by paragraph 106(c) on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned or by another method that achieves a more appropriate allocation in the circumstances.
- 108 If an entity changes the calculation of its management performance measures, introduces a new management performance measure or removes a previously disclosed management performance measure from its financial statements, it shall:
- (a) disclose sufficient explanation for users of financial statements to understand the change, addition or removal and its effects;
 - (b) disclose the reasons for the change, addition or removal; and
 - (c) restate its comparative information, including in the required note disclosures, to reflect the change, addition or removal.
- 109 A subtotal included in the statement(s) of financial performance applying paragraph 42 may be a management performance measure (see paragraph B81).
- 110 An entity shall not use columns to present management performance measures in the statement(s) of financial performance.
- ...

Management performance measures

Identifying management performance measures

- B76 Paragraph 103 defines management performance measures. Some entities may have more than one management performance measure. However, not all entities will have management performance measures. For example, if an entity publicly communicates its financial performance to users of its financial statements, using only totals and subtotals specified by IFRS Standards, it will not have a management performance measure.
- B77 Paragraph 104 specifies subtotals that are not management performance measures. An entity is not required to provide the disclosures specified in paragraph 106 for these subtotals.
- B78 In accordance with paragraph 104(b) subtotals similar to gross profit are not management performance measures. A subtotal is similar to gross profit when it represents the difference between a type of revenue and directly related expenses incurred in generating that revenue. Examples include:
- (a) net interest income;
 - (b) net fee and commission income;
 - (c) insurance service result;
 - (d) net financial result (investment income minus insurance finance expenses); and
 - (e) net rental income.
- B79 Only subtotals that management uses in public communications outside financial statements, for example, in management commentary, press releases or in investor presentations, meet the definition of management performance measures.
- B80 A management performance measure is a subtotal of income and expenses. Examples of measures that are not management performance measures include:
- (a) individual items or subtotals of only income or expenses (for example, adjusted revenue as a stand-alone measure);
 - (b) assets, liabilities, equity or combinations of these elements;
 - (c) financial ratios (for example, return on assets);
 - (d) measures of growth;
 - (e) measures of liquidity or cash flows (for example, free cash flow); or
 - (f) non-financial performance measures.

- B81 A subtotal presented in the statement(s) of financial performance to comply with paragraph 42 may meet the definition of a management performance measure. When such a subtotal meets that definition, an entity shall disclose all the information required by paragraph 106.

Management performance measures note disclosure

- B82 All information required to be disclosed about management performance measures shall be included in a single note.
- B83 In some cases, one or more of an entity's management performance measures may be the same as part of the operating segment information disclosed by the entity in applying IFRS 8. In such cases, the entity may disclose the required information about those management performance measures in the same note that it uses to disclose information about its operating segments provided the entity either:
- (a) includes in that note all of the information required by paragraph 106 for management performance measures; or
 - (b) provides a separate note that includes all of the information required for management performance measures.
- B84 Paragraph 106(a)(i) requires an explanation of how a management performance measure is calculated. To comply with this requirement an entity shall explain the specific principles, bases, conventions, rules and practices it applies in calculating its management performance measures.
- B85 Paragraph 106(b) requires an entity to reconcile its management performance measure(s) to the most directly comparable subtotal or total specified by IFRS Standards. For example, an entity that discloses in the notes adjusted operating profit or loss as a management performance measure would reconcile to operating profit or loss as the most directly comparable subtotal. In aggregating or disaggregating the reconciling items disclosed an entity shall apply the requirements in paragraphs 25–28.

...

Management performance measures

- BC145 When an entity provides one or more performance measures that meet the definition of management performance measures, the Board proposes to require entities to disclose information about such measures in their financial statements.
- BC146 Research undertaken as part of the Primary Financial Statements project, feedback received on the 2017 Discussion Paper *Disclosure Initiative—Principles of Disclosure* and the 2015 Agenda Consultation indicated that:
- (a) many entities disclose financial information outside the financial statements by providing management-defined performance measures in communications with users of financial statements; and
 - (b) users consider that information provided by such measures can be useful because it provides insight into:
 - (i) how management views the entity's financial performance;
 - (ii) how a business is managed; and
 - (iii) the persistence or sustainability of an entity's financial performance.
- BC147 However, users of financial statements expressed concerns about the quality of disclosures provided about these measures. According to users, in some cases, the disclosures:
- (a) lack transparency in how the management-defined performance measures are calculated;
 - (b) lack clarity regarding why these measures provide management's view of the entity's performance;
 - (c) create difficulties for users trying to reconcile the measures to the related measures specified by IFRS Standards; and
 - (d) are reported inconsistently from period to period.
- BC148 Including disclosures about these measures in the financial statements could help address some of the concerns expressed by users of financial statements. However, some stakeholders raised concerns about including management-defined performance measures in financial statements prepared applying IFRS Standards, which were that:

- (a) management-defined performance measures may be incomplete or biased and therefore including them in the financial statements may be misleading to users of financial statements;
- (b) management-defined performance measures may be given undue prominence or legitimacy by including them in the financial statements; and
- (c) some adjustments made in calculating management-defined performance measures may be difficult to audit—for example, adjustments made when an entity calculates its performance measures using accounting policies that do not comply with IFRS Standards.

BC149 The Board considered the concerns raised, noting that management-defined performance measures that meet the definition of management performance measures, and would thus be included in the financial statements:

- (a) would be subject to the general requirement for information to faithfully represent what it purports to represent, which would not be met if measures were misleading (see paragraph BC158).
- (b) would rarely be presented in the statement(s) of financial performance (see paragraphs BC163–BC166).
- (c) are similar to segment measures of profit or loss in that they are based on management’s view. Segment measures of performance are included in the financial statements and are audited.

BC150 Some stakeholders also expressed concerns that management performance measures may proliferate if they are included in the financial statements. The Board noted that it is difficult to predict the effect of the proposals on the number of management performance measures an entity would use. While it is possible that the use of such measures would increase as a result of the Board’s proposals, it is also possible that the use of management performance measures would decline if entities choose to use the proposed new subtotals to communicate their performance instead. Paragraphs BC304–BC307 include further discussion of the expected effects of the proposals for management performance measures on the use of performance measures defined by management.

BC151 The Board acknowledges the concerns of some stakeholders, but concluded that management performance measures can complement measures specified by IFRS Standards, providing users of financial statements with useful insight into management’s view of performance and its management of the business. Including these measures in the financial statements would make them subject to the same requirements regardless of the entity’s jurisdiction and would improve the discipline with which they are prepared and improve their transparency.

BC152 In developing the requirements for management performance measures, the Board considered:

- (a) how to define management performance measures (see paragraphs BC153–BC162);
- (b) where in the financial statements to include information about management performance measures (see paragraphs BC163–BC166); and
- (c) what information an entity should be required to provide about management performance measures (see paragraphs BC167–BC179).

Definition and restrictions (paragraphs 103–105 and B76–B81)

BC153 The Board proposes to define management performance measures as subtotals of income and expenses that:

- (a) are used in public communications, outside financial statements;
- (b) complement totals or subtotals specified by IFRS Standards (see paragraphs BC168–BC173 for discussion of the proposed specified subtotals); and
- (c) in management’s view, communicate to users of financial statements an aspect of an entity’s financial performance.

BC154 Feedback from users of financial statements led the Board to focus on improvements to the reporting of financial performance in the statement(s) of financial performance and the related notes. Therefore, the Board’s proposed definition for management performance measures is limited to subtotals of income and expenses. Thus, other financial measures (such as currency adjusted revenue or return on capital employed) and non-financial measures (such as customer retention rate) are not management performance measures and would not be included in the proposed disclosure.

BC155 To address concerns that management performance measures might be misleading, the Board considered whether any specific restrictions should be applied to the calculation of these measures, such as restricting measures to those based on amounts recognised and measured in accordance with IFRS Standards. Such a restriction would have prohibited measures based on accounting policies that do not comply with IFRS

Standards, such as measures that apply proportionate consolidation. However, the Board rejected imposing such specific restrictions on how management performance measures are calculated because:

- (a) such restrictions might prevent entities from disclosing measures that users of financial statements find useful, for example, measures that adjust for some effects of acquisition accounting to facilitate trend analysis;
- (b) such restrictions might prevent entities from disclosing industry-defined performance measures;
- (c) such restrictions might create conflict with regulatory guidance that permits or requires some or all of these measures; and
- (d) the requirement would be inconsistent with the objective of providing management's view of performance.

BC156 The Board's view is that performance measures used in public communications outside the financial statements should be consistent with the performance measures disclosed in the financial statements because:

- (a) it is hard to justify that a measure, in management's view, communicates performance if an entity is not using it in communicating performance; and
- (b) it would be confusing if one entity were to provide two sets of management-defined measures, one within and one outside the financial statements.

BC157 The Board considered defining management performance measures as all subtotals of income and expense included in an entity's annual report. The Board rejected such an approach because:

- (a) consistent with the feedback received in response to the Exposure Draft on proposed amendments to IFRS 8 *Operating Segments*, it may not be clear what constitutes an annual report; and
- (b) management may include performance measures in an entity's annual report to comply with regulatory or other requirements.

BC158 The Board noted that management performance measures disclosed in the notes to the financial statements would need to comply with the general requirements for information included in financial statements. That is:

- (a) the management performance measure must faithfully represent the aspect of financial performance of the entity it purports to represent;
- (b) the disclosures supporting the management performance measure must comply with the proposed guidance on aggregation and disaggregation, for example, when disclosing reconciling items;
- (c) comparative information should be provided for the management performance measure and related disclosures; and
- (d) the management performance measure should be calculated consistently from one period to the next and be subject to change only if the new measure provides more useful information.

BC159 Some stakeholders argue that there should be no restriction on when an entity can disclose information about its management performance measures. In their view, one of the main objectives of the management performance measure proposals is to provide users of financial statements with enough information to prevent them from being misled by these measures. They argue that restricting the disclosure of information about management performance measures to situations when those measures faithfully represent an aspect of an entity's performance is inconsistent with that objective because:

- (a) the requirements of IFRS Standards cannot prevent disclosure of potentially misleading measures outside the financial statements. While in some jurisdictions local law or regulation may prevent the disclosure of such measures, this is not always the case.
- (b) the requirement that a management performance measure must faithfully represent an aspect of an entity's performance would prevent the disclosure of useful information about such measures in circumstances when users are most likely to be misled.
- (c) entities wishing to avoid the proposed disclosure requirements could do so by disclosing performance measures outside the financial statements that they believe would be assessed by their auditors or regulators as not providing a faithful representation.

BC160 These stakeholders also note that IFRS 8 does not place a similar explicit restriction on the disclosure of segment information which reflects the views of management.

BC161 The Board acknowledges that including information about such measures in the financial statements may increase transparency about these measures. However, the Board thinks that all information included in the financial statements should provide a faithful representation of what it purports to represent. A management-

defined performance measure that does not faithfully represent an aspect of an entity's performance should not be included in the financial statements as a management performance measure.

BC162 The Board also considered whether it should specifically state that management performance measures should not be misleading. The Board rejected such a proposal as unnecessary because misleading measures would not provide a faithful representation of the financial performance of the entity.

Location of information about management performance measures (paragraphs 106, 110 and B82–B85)

BC163 The Board proposes that an entity disclose management performance measures and all related information in a single note. Disclosing management performance measures and the related information in a single location improves the transparency of those measures by:

- (a) providing management performance measures together with the information needed to understand those measures; and
- (b) helping users of financial statements to identify and locate the related information.

BC164 To address the concerns of some stakeholders that management performance measures could be misleading and should not be given prominence, the Board considered prohibiting entities from presenting management performance measures in the statement(s) of financial performance. However, paragraphs the Board proposes to move from IAS 1 to the draft IFRS [X] require entities to present line items, headings and subtotals in the statement(s) of financial performance that are not required by IFRS Standards if that information is relevant to an understanding of the entity's financial performance. Prohibiting an entity from presenting management performance measures in the statement(s) of financial performance may prevent them from complying with this requirement. Therefore, the Board does not propose prohibiting an entity from presenting management performance measures in the statement(s) of financial performance.

BC165 However, the Board expects that few management performance measures would meet the requirements for presentation as a subtotal in the statement(s) of financial performance. To meet the requirements, such subtotals must:

- (a) fit into the structure of the proposed categories (see paragraph BC28);
- (b) not disrupt the presentation of an analysis of expenses in the operating category using either the function of expense or nature of expense method (see paragraph BC109); and
- (c) comprise amounts recognised and measured applying IFRS Standards.

BC166 The Board is, however, proposing to prohibit entities from using columns to present a management performance measure in the statement(s) of financial performance. Prohibiting the use of columns further restricts the circumstances in which such measures may be presented in the statement(s) of financial performance, which helps address the concerns of some stakeholders that doing so would give them undue prominence. Additionally, this restriction is consistent with the Board's objective of improving the comparability of information provided in the statement(s) of financial performance.

Information to be disclosed about management performance measures (paragraphs 106–108)

BC167 Transparency is enhanced by an entity clearly stating the purpose and limitations of management performance measures. In presenting management's view, a management performance measure is entity-specific and requires management's judgements about what is useful to users of financial statements. Users require sufficient information about those judgements to understand the information the management performance measure provides and how it provides a faithful representation of an aspect of an entity's performance. Therefore, the Board proposes that an entity disclose a description of each management performance measure, explaining how it has been calculated, and why and how it communicates information about an entity's performance. An entity would also be required to explain that the management performance measure is entity-specific by disclosing that the measure provides a management view of financial performance and stating that it is not necessarily comparable with measures used by other entities.

BC168 The Board proposes that an entity provide a reconciliation to the most directly comparable total or subtotal specified by IFRS Standards for each management performance measure, making these measures more transparent. The Board also noted that, because the Board's proposals increase the number of subtotals specified by IFRS Standards, these reconciliations would contain fewer reconciling items than today making them more understandable.

- BC169 Because a management performance measure is complementary to the totals or subtotals in IFRS Standards, it is important for users of financial statements to understand how such measures relate to these totals or subtotals. A reconciliation provides users with information about how the management performance measure is calculated and how the measure compares to similar measures provided by other entities. The reconciliation also provides users with the information required to make their own adjustments to the management performance measure, should they decide that adjustments are needed.
- BC170 However, the Board recognises that some subtotals currently not specified by IFRS Standards are commonly used in the financial statements and are well understood by users of financial statements. Providing a reconciliation for such measures would not provide additional information because their purposes and relationship to totals or subtotals specified by IFRS Standards are well understood and would usually be apparent from their presentation in the statement(s) of financial performance.
- BC171 Therefore, the Board proposes to specify a list of subtotals that are not considered management performance measures including gross profit or loss (revenue less cost of sales) and similar subtotals, operating profit or loss before depreciation and amortisation, profit or loss from continuing operations, and profit or loss before income tax. These subtotals would thus be specified by IFRS Standards and management performance measures could be reconciled to these subtotals.
- BC172 The Board also considered whether to define earnings before interest, tax, depreciation and amortisation (EBITDA). However, the Board noted that, although EBITDA is one of the most commonly used measures in communications with users of financial statements, it is not used in some industries such as finance. Furthermore, users have no consensus about what EBITDA represents, other than it being a useful starting point for various analyses. Its calculation is diverse in practice. Consequently, EBITDA measures may meet the definition of management performance measures.
- BC173 The Board also considered whether a measure calculated as operating profit or loss before depreciation and amortisation would provide similar information to many of the EBITDA measures that are currently provided. However, the Board concluded it should not describe operating profit or loss before depreciation and amortisation as EBITDA. To do so would imply that operating profit or loss is the same as earnings before interest and tax which is not the case because operating profit or loss does not include, for example, income from investments or from equity-accounted associates and joint ventures. In other words, the Board was concerned about the difference between what the measure represents and the meaning of the EBITDA acronym. However, as discussed in paragraph BC171, the Board has included operating profit or loss before depreciation and amortisation in the list of IFRS specified subtotals. Consequently, an EBITDA measure equal to that amount would not be a management performance measure.
- BC174 The Board proposes an entity provide sufficient explanation to help users of financial statements understand any changes in management performance measures or in how they are calculated; the entity would also quantify the effect of such changes. Comparability from period to period is enhanced by the provision of information about changes in these measures.
- BC175 The Board considered whether it should require a five-year historical summary of management performance measures. However, it rejected this requirement because changes in accounting standards may make it difficult or costly for entities to disclose comparable measures beyond the time frame set out in those changes.
- BC176 IAS 33 requires some entities to disclose their earnings per share and permits an entity to disclose adjusted earnings per share measure(s). The Board considered whether an adjusted earnings per share that is based on the entity's management performance measures should be required. It rejected this approach because it would introduce complexity when entities have more than one management performance measure, if these measures are not calculated consistently.
- BC177 However, the Board considered feedback that earnings per share information was important to users of financial statements and that one of the benefits of management performance measures to users is the detailed information that can be used to calculate a related earnings per share figure. To calculate such an earnings per share figure, users need information about the earnings adjustments attributable to the parent and the tax effects of those adjustments. Therefore, the Board proposes an entity should disclose separately the effect of income tax and the amount attributable to non-controlling interests for each reconciling item between a management performance measure and the most directly comparable total or subtotal specified by IFRS Standards. The Board decided to propose this disclosure at the level of individual adjustments made in calculating a management performance measure rather than at the level of the total adjustment because it gives users information needed to select which adjustments they want to consider in arriving at an adjusted earnings per share measure used in their analysis.
- BC178 The Board noted that some preparers of financial statements have said the disclosure of the tax and non-controlling interest effects for individual adjustments may be complex and costly. To alleviate the costs of preparing disclosures about the tax effect of management performance measure adjustments, the Board proposes a simplified approach for calculating the income tax effect of the reconciling items. The Board

concluded that this simplified approach would provide users of financial statements with a reasonable estimate of the income tax effect of adjustments, making it clear when the tax effect of an adjustment is materially different to the effect calculated applying the entity's effective tax rate. The Board noted that this approach is similar to the approach for determining the income tax effect on items of other comprehensive income set out in IAS 12 *Income Taxes*.

BC179 The Board considered, but rejected, requiring an entity to disclose the reasons for any differences between its management performance measures and its operating segment measures of performance. The Board concluded that, based on evidence of current practice and feedback from outreach meetings, such disclosure would not provide useful information, might result in boilerplate disclosures and would add unnecessary complexity to the proposals.

Relationship of unusual income and expenses with management performance measures (paragraph B75)

BC180 The Board noted that entities often adjust for unusual income and expenses when disclosing management-defined performance measures and that, in some cases, such an adjustment may make the separate disclosure of unusual income or expenses unnecessary. However, the Board proposes to require all entities to disclose information about unusual income and expenses because:

- (a) not all entities communicate performance using management-defined performance measures. Therefore, not all entities would be required to provide the proposed disclosures for management performance measures. Such entities would have no management performance measures and, hence, would not provide information about unusual income and expenses unless the Board required such information.
- (b) the proposals for management performance measures do not require entities to adjust for unusual income and expenses. Therefore, users would not be provided with the information that they need about such income and expenses on a consistent basis.

Extracts from the ED of the paragraphs referred to by the IASB in question 12 [\[Back to memo\]](#)

BC172 The Board also considered whether to define earnings before interest, tax, depreciation and amortisation (EBITDA). However, the Board noted that, although EBITDA is one of the most commonly used measures in communications with users of financial statements, it is not used in some industries such as finance. Furthermore, users have no consensus about what EBITDA represents, other than it being a useful starting point for various analyses. Its calculation is diverse in practice. Consequently, EBITDA measures may meet the definition of management performance measures.

BC173 The Board also considered whether a measure calculated as operating profit or loss before depreciation and amortisation would provide similar information to many of the EBITDA measures that are currently provided. However, the Board concluded it should not describe operating profit or loss before depreciation and amortisation as EBITDA. To do so would imply that operating profit or loss is the same as earnings before interest and tax which is not the case because operating profit or loss does not include, for example, income from investments or from equity-accounted associates and joint ventures. In other words, the Board was concerned about the difference between what the measure represents and the meaning of the EBITDA acronym. However, as discussed in paragraph BC171, the Board has included operating profit or loss before depreciation and amortisation in the list of IFRS specified subtotals. Consequently, an EBITDA measure equal to that amount would not be a management performance measure.

Extracts from the ED of the paragraphs referred to by the IASB in question 13 [\[Back to memo\]](#)

Reporting cash flows from operating activities

- 18 An entity shall report cash flows from operating activities using either:
- (a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
 - (b) the indirect method, whereby ~~profit or loss~~ operating profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items reflecting classification differences between income or expenses classified in operating profit or loss and cash flows classified as cash flows from operating activities ~~of income or expense associated with investing or financing cash flows~~.
- ...
- 33A An entity shall classify dividends paid as cash flows from financing activities.
- 34 ~~[Deleted] Dividends paid may be classified as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, dividends paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of an entity to pay dividends out of operating cash flows.~~
- 34A An entity, other than those entities described in paragraph 34B, shall classify:
- (a) interest paid as cash flows from financing activities. This includes interest that is capitalised as part of the cost of an asset applying IAS 23.
 - (b) interest and dividends received as cash flows from investing activities.
- 34B An entity that provides financing to customers as a main business activity or invests in the course of its main business activities in assets that generate a return individually and largely independently of other resources held by the entity shall classify the following cash flows each in a single category of the statement of cash flows (that is, either as operating, investing or financing activities):
- (a) dividends received (other than those described in paragraph 38A);
 - (b) interest paid; and
 - (c) interest received.
- 34C When applying paragraph 34B, an entity shall refer to the classification of the income or expenses corresponding to such cash flows in the statement of profit or loss:
- (a) if the entity classifies related income or expenses in a single category of the statement of profit or loss, the entity shall classify the cash flows in the corresponding category in the statement of cash flows;
or
 - (b) if the entity classifies related income or expenses in more than one category of the statement of profit or loss, the entity shall make an accounting policy choice to classify the cash flows in one of the corresponding categories of the statement of cash flows.
- 34D For example, an entity applying paragraph 34C would classify interest paid:
- (a) as cash flows from financing activities if the entity classifies all its interest expenses in the financing category of the statement of profit or loss; or
 - (b) in accordance with its accounting policy as either cash flows from operating activities or cash flows from financing activities if the entity classifies some of its interest expenses in the operating category and some of its interest expenses in the financing category of the statement of profit or loss.
- ...

Proposed amendments to other IFRS Standards

IAS 7 *Statement of Cash Flows*

BC185 As discussed in paragraph BC12, the Board proposes only limited changes to the statement of cash flows. Those changes include:

- (a) specifying a consistent starting point for the indirect method of reporting cash flows from operating activities (see paragraphs BC186–BC188);
- (b) eliminating options for the classification of interest and dividend cash flows (see paragraphs BC189–BC204); and
- (c) introducing new requirements for the classification of cash flows from investments in associates and joint ventures (see paragraphs BC205–BC208).

Starting point for the indirect method

BC186 The Board observed that entities use different starting points for the indirect method for reporting operating cash flows such as profit or loss, profit or loss from continuing operations, profit or loss before tax or operating profit or loss.

BC187 The Board proposes to require all entities to use the same starting point for the indirect method because users of financial statements have indicated that the diversity in practice reduces comparability between entities, making their analyses more difficult.

BC188 The Board proposes to use operating profit or loss as the starting point rather than profit or loss because:

- (a) using operating profit or loss, an entity needs to present fewer adjustments to the starting point, which simplifies the presentation of the operating cash flows category. This is because, compared to profit or loss, operating profit or loss includes fewer income and expenses for which the cash effects are classified as investing or financing cash flows. For example, operating profit or loss does not include the share of profit or loss of associates and joint ventures.
- (b) the difference between cash flows from operating activities and operating profit or loss provides a measure of operating accruals. Some users of financial statements find such a measure useful because it helps them understand how operating profit or loss is converted into cash flows.

Classification of interest and dividend cash flows

BC189 IAS 7 permits entities to choose an accounting policy for classifying interest and dividend cash flows in the statement of cash flows. As a result, classification varies, even among entities in the same industry.

BC190 The Board proposes to remove this classification choice for most entities, because users of financial statements have indicated that the diversity in classification between entities in the same industry:

- (a) reduces comparability, making their analysis more difficult; and
- (b) is often not meaningful—that is, the different classifications of these cash flows do not necessarily convey information about the role of interest and dividends in the entity’s business activities.

Dividends paid

BC191 The Board proposes that all entities should classify dividends paid as cash flows from financing activities because dividends paid are a price of obtaining financing.

BC192 IAS 7 currently allows classification of dividends paid as cash flows from operating activities. Paragraph 34 of IAS 7 explains that classifying dividends paid as cash flows from operating activities may assist users of financial statements with determining an entity’s ability to pay dividends out of operating cash flows. However, the Board no longer supports that rationale for classifying dividends paid as cash flows from operating activities because:

- (a) classifying dividends paid in this way does not provide a faithful representation of the operating cash flows. Dividend payments are financing in nature.
- (b) when assessing cash flows available to pay dividends, users tend to use other measures, such as free cash flow, which take into account cash needed for capital expenditure.

- (c) users can continue comparing dividends paid with cash flows from operating activities if they wish, because IAS 7 requires the disclosure of dividends paid.

Dividends received and interest paid and received

BC193 The Board considered two approaches for classifying dividends received and interest paid and received:

- (a) seeking to align, to the extent possible, the classification in the statement of profit or loss with the classification in the statement of cash flows. Doing so would mean the classification of dividends received and interest paid and received would depend on the entity's main business activities (see paragraphs BC194–BC202).
- (b) requiring all entities to classify dividends received, interest paid and interest received as operating cash flows (see paragraphs BC203–BC204).

BC194 The Board proposes the approach described in paragraph BC193(a) because, when alignment can be achieved, it can increase the understandability of the resulting information. However, the Board is not proposing full alignment between the categories in the statement of profit or loss and the statement of cash flows (see paragraph BC30).

BC195 As it did for classification in the statement of profit or loss, the Board distinguished the following types of entities in developing its proposed approach for the statement of cash flows:

- (a) entities that provide financing to customers as a main business activity or invest in the course of their main business activities in assets that generate a return individually and largely independently of other entity resources (see paragraphs BC198–BC202); and
- (b) entities whose main business activities do not include any of those described in (a) (see paragraphs BC196–BC197).

BC196 The Board proposes that the entities described in paragraph BC195(b) classify:

- (a) cash receipts from interest and dividends as cash flows from investing activities. The Board proposes this classification because, in most cases, the related income is expected to be classified in the investing category in the statement of profit or loss.
- (b) cash payments arising from interest incurred as cash flows from financing activities. The Board proposes this classification because interest paid represents the cost of obtaining financing. The related interest expenses are classified in the financing category in the statement of profit or loss by such entities (see paragraph BC37).
- (c) cash payments arising from interest capitalised applying IAS 23 *Borrowing Costs* as part of the cost of an asset as cash flows from financing activities. The Board proposes this classification to avoid requiring potentially arbitrary allocations between operating and investing activities and because this approach would result in the consistent classification of interest paid, regardless of whether it has been capitalised.²

BC197 The Board expects the proposed approach in paragraph BC196 to align the classification of interest and dividends in the statement of cash flows with the classification in the statement of profit or loss in most cases. The Board acknowledges that this approach does not achieve full alignment. For example:

- (a) interest revenue from cash and cash equivalents is classified in the financing category in the statement of profit or loss, whereas all interest received is classified as cash flows from investing activities in the statement of cash flows; and
- (b) interest capitalised as part of the cost of an item of property, plant and equipment would be recognised in profit or loss through depreciation expenses, which would be included in operating profit or loss, whereas capitalised interest paid would be included in cash flows from financing activities.

However, the Board concluded that classification of interest or dividend cash flows in a single category in the statement of cash flows is more useful than full alignment.

BC198 The Board noted that the proposed approach described in paragraph BC196 could not be applied without modification to the entities described in paragraph BC195(a). This is because applying the approach to such entities without modification:

² The Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle* issued in May 2012 proposed to amend IAS 7 *Statement of Cash Flows* to require that interest paid that is capitalised be classified either as operating or investing in line with the nature of the underlying asset to which those payments were capitalised—for example, inventory (operating), and property, plant and equipment (investing). The Board did not proceed with the amendments because of concerns raised about the implementation of the amendment, including concerns that applying the requirements would result in arbitrary allocations.

- (a) would result in cash flows that are operating in nature being classified as investing or financing cash flows (for example, interest paid on deposits would be classified as financing by a bank); and
- (b) may not result in alignment with the classification of related dividend and interest income and expenses in the statement of profit or loss.

BC199 The Board considered whether to require the entities described in paragraph BC195(a) to fully align the classification of dividends received and interest paid and received with the classification of the related income and expenses in the statement of profit or loss. However, the Board rejected this approach because it may be costly for entities to split dividends received and interest paid and received between different categories of the statement of cash flows when the related income and expenses are classified in multiple categories of the statement of profit or loss. The Board also understands that some users of financial statements question the usefulness of the statement of cash flows for entities of the type described in paragraph BC195(a) and, therefore, the benefits of such an approach may not outweigh the costs.

BC200 Instead, the Board proposes to require the entities described in paragraph BC195(a) to classify each type of cash flow (dividends received, interest paid and interest received) in a single category of the statement of cash flows, even if related income and expenses are in more than one category in the statement of profit or loss. The Board prefers this approach over full alignment because:

- (a) the presentation of cash flows is simplified, in that each type of cash flow is classified in a single category of the statement of cash flows; and
- (b) the classification of each type of cash flow in a single category is consistent with current practice and with the Board's proposed approach in paragraph BC196.

BC201 Applying the Board's proposed approach described in paragraph BC200, the Board considered requiring an entity to determine the single category for classification of each type of cash flow either by making an accounting policy choice or by reference to the category in the statement of profit or loss that includes most of the related income or expenses. The Board proposes the first approach because the second approach could result in the inconsistent classification of cash flows over time.

BC202 Applying the proposed approach, the Board expects that, in most cases, interest payments would be classified in the same category of the statement of cash flows as repayment of the principal. Consequently, the Board proposes to delete the example in paragraph 12 of IAS 7 that illustrates when an entity might classify cash flows from a single transaction in multiple categories in the statement of cash flows.

BC203 The Board also considered an alternative approach described in paragraph BC193(b), which would be requiring all entities to classify dividends received, interest paid and interest received as operating cash flows. This approach would have had some advantages:

- (a) it would have achieved the Board's objective of eliminating options for the classification of interest and dividend cash flows.
- (b) it would have allowed users of financial statements to easily identify where in the statement of cash flows interest received and paid and dividends received had been classified, because they would all have been classified as operating cash flows. This would have been particularly beneficial to users comparing a large number of companies using electronic reports.
- (c) it would have been consistent with the principle in IAS 7 that cash flows from transactions and other events that enter into the determination of profit or loss should be classified in operating activities.
- (d) unlike the Board's proposed approach, it would not have required amending the definition of investing activities to include the receipt of interest and dividends.
- (e) it would have been less costly for preparers of financial statements to apply because:
 - (i) classifying these cash flows would have been less complex than applying the Board's proposed approach; and
 - (ii) for many entities this approach would not have resulted in a change to existing practice.

BC204 However, the Board rejected the approach described in paragraph BC193(b) because:

- (a) the approach would be inconsistent with the proposed definition of financing activities in IAS 7. The definition in IAS 7 captures interest paid, but applying this approach interest paid would be classified as cash flows from operating activities.
- (b) the approach would not align operating profit or loss with the operating cash flows category of the statement of cash flows (see paragraph BC194). As a consequence, the difference between cash flows from operating activities and operating profit or loss would be a poorer measure of operating accruals than the difference that would result from applying the Board's proposed approach (see paragraph BC188(b)).

Classification of cash flows from investments in associates and joint ventures

BC205 The Board proposes to require an entity to present the share of profit or loss of integral associates and joint ventures separately from the share of profit or loss of non-integral associates and joint ventures in the statement of profit or loss. The Board also proposes to require a split between integral and non-integral associates and joint ventures in the statement of cash flows because the link between income and expenses and their related cash flows is important to many users of financial statements.

BC206 The Board proposes that an entity should classify, as cash flows from investing activities, cash flows from the acquisition and sale of investments in associates and joint ventures. This is consistent with the IAS 7 definition of cash flows from investing activities. The Board proposes that all entities should classify as cash flows from investing activities dividends received from associates and joint ventures accounted for using the equity method. This is consistent with its proposal to require all entities to exclude the share of profit or loss of associates and joint ventures from the operating profit or loss subtotal in the statement of profit or loss (see paragraph BC83).

BC207 The Board considered alternative approaches for classifying cash flows from the acquisition and disposal of, and dividends received from, integral associates and joint ventures. The approaches would be to present the cash flows:

- (a) as operating activities to respond to the views of some stakeholders that the operating category better represents the nature of these transactions.
- (b) in a separate category of the statement of cash flows closer to operating activities. This would be similar to the Board's approach for integral associates and joint ventures in the statement of profit or loss.

BC208 However, the Board rejected the approach in paragraph BC207(a) because classifying these cash flows in the operating category would be inconsistent with the definitions of investing and operating cash flows in IAS 7. It would also be inconsistent with the Board's proposal to exclude the share of profit or loss of integral associates and joint ventures from the operating profit or loss subtotal. The Board rejected the approach in paragraph BC207(b) because it would result in investing cash flows, as defined in IAS 7, being presented outside the investing category. A new category would also result in increased complexity in the statement of cash flows.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Joanne Scott

Subject: *Reference to the Conceptual Framework*

Action required¹

1. The Board is asked to:
 - (a) APPROVE for issue *Reference to the Conceptual Framework*, which amends NZ IFRS 3 *Business Combinations*;
 - (b) APPROVE the accompanying signing memo; and
 - (c) AGREE not to revoke the 2010 NZ *Framework*,² pending completion of the IASB's project on Rate-regulated Activities.
2. This memo is more detailed than the signing memo because we have explained why the titles and dates of New Zealand's conceptual frameworks differ from those of the IASB.

Background

3. The International Accounting Standards Board (IASB) issued Exposure Draft ED/2019/3 *Reference to the Conceptual Framework* (the ED) in May 2019. The ED proposed to remove a reference, in IFRS 3 *Business Combinations*, to outdated definitions of assets and liabilities in an earlier conceptual framework.
4. The NZASB issued the ED for comment in New Zealand around the same time. Comments were due to the NZASB on 16 August 2019 and to the IASB on 27 September 2019. The NZASB did not receive any comments on the ED and did not comment on the ED. The IASB received 47 comment letters from its world-wide constituents.
5. The IASB issued *Reference to the Conceptual Framework* in May 2020. The amendments are effective for annual periods beginning on or after 1 January 2022. Earlier application is permitted if an entity also applies all amendments to standards related to the issue of a new conceptual framework in 2018.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

² The full title of the older conceptual framework referred to in NZ IFRS 3 is the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* 2010. The official short title of that document is *NZ Framework*. In this memo we have referred to it as the 2010 NZ *Framework*.

Reasons for the amending standard

6. IFRS 3 *Business Combinations* specifies how an entity should account for assets and liabilities acquired when it obtains control of a business. Although the IASB issued the *Conceptual Framework for Financial Reporting* in March 2018 (2018 *Conceptual Framework*), IFRS 3 still contained a reference to the older *Framework for the Preparation and Presentation of Financial Statements* issued in 1989 (see extract below).

Extract from IFRS 3 (prior to the IASB's recent amendments)

Recognition principle

- 10 As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 11 and 12.**

Recognition conditions

- 11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements*¹ at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other IFRSs.

¹ For this Standard, acquirers are required to apply the definitions of an asset and a liability and supporting guidance in the IASC's *Framework for the Preparation and Presentation of Financial Statements* adopted by the IASB in 2001 rather than the *Conceptual Framework for Financial Reporting* issued in 2018.

7. The IASB did not amend paragraph 11 of IFRS 3 in 2018 because updating the reference, without making any other changes to IFRS 3, could have changed the accounting requirements for business combinations. The definition of a liability in the 2018 *Conceptual Framework* is broader than that in the older framework. Updating the reference without making any other changes to IFRS 3 could have increased the population of assets and liabilities qualifying for recognition in a business combination. However, some assets and liabilities recognised in a business combination might not have qualified for recognition (under other applicable IFRS Standards) after that date. That is, an acquirer might have been required to (i) recognise the assets or liabilities at the time of the business combination; and (ii) derecognise them immediately afterwards.
8. The IASB was of the view that the resulting 'day 2' gain or loss would not depict an economic gain or loss, and therefore would not faithfully represent any aspect of the acquirer's financial performance. In order to avoid such day 2 gains and losses, the IASB left paragraph 11 unchanged until it could consult on narrow scope amendments to IFRS 3.
9. The IASB outlined its proposals to address this issue in the 2019 ED. The ED proposed:
- (a) to amend paragraph 11 of IFRS 3, to refer to the 2018 *Conceptual Framework* instead of the 1989 Framework;

- (b) to add an exception to the recognition principle in IFRS 3 to avoid unintended changes to the requirements for business combinations. The ED proposed that, for liabilities and contingent liabilities that would be within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IFRIC 21 *Levies* if incurred separately, an acquirer should apply the relevant standard, instead of the 2018 *Conceptual Framework*, to identify the obligations it assumes in a business combination; and
 - (c) to add to IFRS 3 an explicit statement that an acquirer should not recognise contingent assets acquired in a business combination.
10. As discussed in the next section of this memo, the IASB has finalised the amendments, largely as proposed in the ED. The IASB has indicated that the revised requirements are likely to remain in place until it decides whether and how to align IAS 37 with the 2018 *Conceptual Framework*.
11. Now that the IASB has finalised these amendments we need to make similar amendments to NZ IFRS 3 *Business Combinations*. There is a slight difference between the IASB's amendment to IFRS 3 paragraph 11 and the amendment required to NZ IFRS 3 paragraph 11. This is because much of the material in the IASB's 1989 *Framework* was incorporated in, and issued as part of, the 2010 NZ *Framework*. Therefore, up until now, NZ IFRS 3 paragraph 11 has referred to the definitions of assets and liabilities in the 2010 NZ *Framework* (rather than the IASB's 1989 *Framework*).

Key issues considered by the IASB

- 12. Comments from respondents were considered at the IASB's November 2019 and December 2019 meetings.
- 13. Respondents were broadly supportive of the proposals in the ED. A few disagreed with aspects of the proposals and suggested alternative ways of dealing with the issue but, as outlined in the IASB's Basis for Conclusions on the ED, the IASB had already considered and rejected these alternative solutions.
- 14. The IASB considered a suggestion to add a further exception to the recognition requirements in IFRS 3 (for current tax assets and liabilities within the scope of IFRIC 23 *Uncertainty over Income Tax Treatments*) but decided not to do so.

RDR concessions and consistency with Australian accounting standards

- 15. The amendments do not change disclosure requirements. Accordingly there is no need to consider RDR concessions.
- 16. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard in the near future.³

³ If the ASSB has approved the amending standard before this NZASB meeting we will update the signing memo.

Due process

17. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of the ED and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB's January 2020 meeting.⁴
18. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in our view, meets the requirements of section 22 of the Financial Reporting Act 2013.
19. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the amending standard is likely to require the disclosure of personal information. In our view the amending standard does not include requirements that would result in the disclosure of personal information, and therefore no consultation with the Privacy Commissioner is required.

Draft amending standard and signing memo

20. Attached as agenda item 6.2 is a copy of *Reference to the Conceptual Framework*. A paragraph has been added to limit the application of the amending standard to Tier 1 and Tier 2 for-profit entities only.
21. Attached as agenda item 6.3 is a draft certificate signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

Questions for the Board

- Q1. Does the Board approve for issue *Reference to the Conceptual Framework*?
- Q2. Does the Board approve the signing memorandum?

Other references to the 2010 NZ Framework in NZ IFRS

22. The completion of this project raises the question of when we should revoke the 2010 NZ Framework. We recommend waiting until the IASB completes its Rate-regulated Activities project and withdraws IFRS 14 *Regulatory Deferral Accounts*. This section explains why.
23. When we checked all standards and interpretations for references to the 2010 NZ Framework we identified a further reference to the 2010 NZ Framework in NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraph 54G (see Table 1 below). We do not think that this reference should be removed until the IASB completes its Rate-regulated Activities project and withdraws IFRS 14 *Regulatory Deferral Accounts*. There are also some references to the 2010 NZ Framework in interpretations, but they merely note which conceptual framework was in existence at the time the interpretation was issued.

⁴ A summary of the IASB's January 2020 meeting is available at:
<https://www.ifrs.org/news-and-events/updates/iasb-updates/january-2020/>

Table 1 Extracts from NZ IAS 8 and IAS 8

<p>Extract from NZ IAS 8</p> <p>54G If an entity does not apply NZ IFRS 14 <i>Regulatory Deferral Accounts</i>, the entity shall, in applying paragraph 11(b) to regulatory account balances, continue to refer to, and consider the applicability of, the definitions, recognition criteria, and measurement concepts in the New Zealand Equivalent to the IASB <i>Conceptual Framework for Financial Reporting 2010 (NZ Framework)</i> instead of those in the 2018 <i>NZ Conceptual Framework</i>. A regulatory account balance is the balance of any expense (or income) account that is not recognised as an asset or a liability in accordance with other applicable NZ IFRSs but is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. A rate regulator is an authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.</p>
<p>Extract from IAS 8</p> <p>54G If an entity does not apply IFRS 14 <i>Regulatory Deferral Accounts</i>, the entity shall, in applying paragraph 11(b) to regulatory account balances, continue to refer to, and consider the applicability of, the definitions, recognition criteria, and measurement concepts in the <i>Framework for the Preparation and Presentation of Financial Statements</i>³ instead of those in the <i>Conceptual Framework</i>. A regulatory account balance is the balance of any expense (or income) account that is not recognised as an asset or a liability in accordance with other applicable NZ IFRSs but is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. A rate regulator is an authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.</p> <p>3 The reference is to the IASC's <i>Framework for the Preparation and Presentation of Financial Statements</i> adopted by the Board in 2001.</p> <p>[Editor's note: An extract from the IASC's <i>Framework for the Preparation and Presentation of Financial Statements</i>, adopted by the Board in 2001, is available on the IAS 8 page of the 'Supporting Implementation' area of the Foundation's website, under 'Supporting Implementation by IFRS Standard'.]</p>
<p>Extract from IASB Basis for Conclusions on IAS 8</p> <p>Application by rate-regulated entities</p> <p>BC38 While assessing possible effects of updating the reference to the <i>Framework</i> in IAS 8, the Board identified a potential disadvantage for entities that conduct rate-regulated activities and develop their accounting policies for regulatory account balances by reference to the <i>Framework</i> rather than by applying IFRS 14 <i>Regulatory Deferral Accounts</i>. If the reference to the <i>Framework</i> had been updated, such entities might have needed to revise those accounting policies twice within a short period of time—first, when the 2018 <i>Conceptual Framework</i> comes into effect; and, later, when a new IFRS Standard on rate-regulated activities is issued. In the absence of specific guidance, there might have been uncertainty about what would be acceptable if the 2018 <i>Conceptual Framework</i> was applied. Establishing what would be acceptable might have been costly and the outcome might have been diversity in practice and a loss of trend information for users.</p> <p>BC39 To prevent unhelpful and unnecessary disruption for users of the financial statements of entities that conduct rate-regulated activities and for the entities themselves, the Board provided a temporary exception: paragraph 54G prohibits entities from applying the 2018 <i>Conceptual Framework</i> to accounting policies relating to regulatory account balances. Instead, entities are required to continue to apply the <i>Framework</i> when developing or revising those accounting</p>

policies. Once the Board issues a new IFRS Standard on rate-regulated activities, that prohibition is likely to become unnecessary.

BC40 The Board based the definition of ‘a regulatory account balance’ on the definition of ‘a regulatory deferral account balance’ in IFRS 14, with one difference: the definition of a regulatory account balance does not mention qualifying for deferral. The reference to deferral in IFRS 14 reflects the fact that IFRS 14 permits continued recognition of some regulatory deferral account balances that an entity previously recognised as assets or liabilities immediately before it adopted IFRS Standards for the first time. In contrast, paragraph 54G of IAS 8 applies only when an entity is not applying IFRS 14 but is instead developing an accounting policy after considering paragraph 11 of IAS 8. Paragraph 54G applies regardless of whether that accounting policy results in recognition of any assets or liabilities, and regardless of whether such recognition could be viewed as deferral.

24. Table 2 is for information only. It documents how the IASB and the AASB have dealt with the continuing reference to the previous conceptual framework. These other approaches are not available to us, as our previous framework is a legislative instrument and is still ‘live’.
25. Although we are not aware of any New Zealand entities using the temporary exception for rate-regulated activities in NZ IAS 8, we do not want to create any differences between NZ IAS 8 and IAS 8. We therefore think the best approach is to leave NZ IAS 8 paragraph 54G as it is until the IASB completes its project on rate-regulated activities and issues a standard that supersedes IFRS 14. At that point we should seek to revoke the 2010 NZ *Framework*. The IASB is planning to issue an ED on rate-regulated activities later this year.

Table 2 IASB, AASB and NZ

	IASB	AASB	NZ
Effective date	2018 <i>Conceptual Framework</i> Effective 1 January 2020 (for entities applying IFRS Standards). ⁵ Effective immediately for the IASB and IFRIC.	<i>Conceptual Framework</i> Effective 1 January 2020.	2018 NZ <i>Conceptual Framework</i> Effective 1 January 2020.
When the 2018 CF was issued, did it supersede earlier CFs?	No superseding statement	Yes Aus1.3 When applicable, this <i>Conceptual Framework</i> supersedes: (a) the <i>Framework for the Preparation and Presentation of Financial Statements</i> (July 2004); ⁶ and (b) Statement of Accounting Concepts	No However, the front page of the 2010 NZ <i>Framework</i> alerts readers to the limited applicability of that framework and the existence of the 2018 NZ <i>Conceptual Framework</i> .

⁵ Unlike the AASB and NZ frameworks, the IASB document does not have an effective date paragraph. The IASB established the effective date via amendments to IFRS Standards.

⁶ New Zealand and Australia incorporated the IASB 2010 *Conceptual Framework* in different ways. New Zealand issued a new conceptual framework. In 2013 the AASB amended the *Framework for the Preparation and Presentation of Financial Statements* (July 2004) to include Chapters 1 and 3 of the September 2010 IASB *Conceptual Framework*. Consistent with the AASB’s IFRS-adoption policy, those chapters were applicable to for-profit entities.

	IASB	AASB	NZ
		SAC 1 <i>Definition of the Reporting Entity</i> (August 1990); except as otherwise required by Australian Accounting Standards.	
Legislative instrument?	No	No	Yes
Footnote(s) to IAS 8.54G or equivalent	IAS 8 paragraph 54G 3 The reference is to the IASC's <i>Framework for the Preparation and Presentation of Financial Statements</i> adopted by the Board in 2001. [Editor's note: An extract from the IASC's <i>Framework for the Preparation and Presentation of Financial Statements</i> , adopted by the Board in 2001, is available on the IAS 8 page of the 'Supporting Implementation' area of the Foundation's website, under 'Supporting Implementation by IFRS Standard'.]	AASB 108 paragraph 54G 4 The reference is to the <i>Framework for the Preparation and Presentation of Financial Statements</i> adopted by the AASB in 2004.	NZ IAS 8 paragraph 54G —
Access to CF material referred to in IAS 8?	Yes. Extract available on IASB website for all users. Complete document is available online for subscribers.	Yes Complete document is available online.	Yes Complete document is available online (as part of the 2010 NZ <i>Framework</i>). The website states: From the point at which the 2018 NZ <i>Conceptual Framework</i> becomes effective, you can refer to this NZ <i>Framework</i> in the limited circumstances that you are required to do so by the relevant NZ IFRS.

Question for the Board

Q3. Does the Board agree not to revoke the 2010 NZ *Framework* until the IASB has completed its project on Rate-regulated Activities?

Recommendations

26. We recommend that the Board:

- (a) APPROVES for issue *Reference to the Conceptual Framework*, which amends NZ IFRS 3;
- (b) APPROVES the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board requesting approval to issue the amending standard;

- (c) AGREES not to revoke the 2010 NZ *Framework* pending completion of the IASB's project on Rate-regulated Activities; and
- (d) NOTES the PBE Policy Approach memo at agenda item 6.4.

Attachments

Agenda item 6.2: Draft *Reference to the Conceptual Framework*

Agenda item 6.3: Draft signing memorandum

Agenda item 6.4: Memo: PBE Policy Approach

REFERENCE TO THE CONCEPTUAL FRAMEWORK



Reference to the Conceptual Framework

Issued June 2020

This Standard was issued on 25 June 2020 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 23 July 2020.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date set out in Part D.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Tier 1 and Tier 2 For-profit Accounting Standard is based on amendments issued by the International Accounting Standards Board to update IFRS 3 *Business Combinations* by replacing a reference to an older conceptual framework with a reference to the most recent conceptual framework.

REFERENCE TO THE CONCEPTUAL FRAMEWORK

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REFERENCE TO THE CONCEPTUAL FRAMEWORK

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The following is available within New Zealand on the XRB website as additional material

APPROVAL BY THE IASB OF *REFERENCE TO THE CONCEPTUAL FRAMEWORK*
ISSUED IN MAY 2020

AMENDMENTS TO THE IASB BASIS FOR CONCLUSIONS ON IFRS 3 *BUSINESS COMBINATIONS*

Part A – Introduction

This Standard sets out amendments to update NZ IFRS 3 *Business Combinations* by replacing a reference to an older conceptual framework with a reference to the most recent conceptual framework. Tier 2 entities are required to comply with all the requirements in this Standard.

Part B – Scope

This Standard applies to Tier 1 and Tier 2 for-profit entities.

Part C – Amendments to NZ IFRS 3 *Business Combinations*

Paragraph 11 is amended and the footnote to the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* in paragraph 11 is deleted. Paragraphs 14, 21, 22 and 23 are amended and paragraphs 21A, 21B, 21C, 23A and 64Q are added. A heading is added above paragraph 21A and the headings below paragraph 21 and above paragraph 22 are amended. New text is underlined and deleted text is struck through. Paragraph 10 is unamended but is included for ease of reference.

The acquisition method

...

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition principle

- 10 **As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 11 and 12.**

Recognition conditions

- 11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the ~~New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements*~~^{*} *Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework)* at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other NZ IFRSs.

^{*}— For this Standard, acquirers are required to apply the definitions of an asset and a liability and supporting guidance which were in the ~~New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements*~~ rather than the ~~New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting*~~ issued in 2018 (2018 ~~NZ *Conceptual Framework*~~). These definitions of assets and liabilities and supporting guidance were incorporated in Chapter 4 of the ~~New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010*~~.

REFERENCE TO THE CONCEPTUAL FRAMEWORK

...

- 14 Paragraphs B31–B40 provide guidance on recognising intangible assets. Paragraphs ~~22~~21A–28B specify the types of identifiable assets and liabilities that include items for which this IFRS provides limited exceptions to the recognition principle and conditions.

...

Exceptions to the recognition or measurement principles

- 21 This NZ IFRS provides limited exceptions to its recognition and measurement principles. Paragraphs ~~22~~21A–31A specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs ~~22~~21A–31A, which will result in some items being:
- (a) recognised either by applying recognition conditions in addition to those in paragraphs 11 and 12 or by applying the requirements of other NZ IFRSs, with results that differ from applying the recognition principle and conditions.
 - (b) measured at an amount other than their acquisition-date fair values.

~~Exception~~ Exceptions to the recognition principle**Liabilities and contingent liabilities within the scope of NZ IAS 37 or NZ IFRIC 21**

- 21A Paragraph 21B applies to liabilities and contingent liabilities that would be within the scope of NZ IAS 37 Provisions, Contingent Liabilities and Contingent Assets or NZ IFRIC 21 Levies if they were incurred separately rather than assumed in a business combination.
- 21B The 2018 NZ Conceptual Framework defines a liability as ‘a present obligation of the entity to transfer an economic resource as a result of past events’. For a provision or contingent liability that would be within the scope of NZ IAS 37, the acquirer shall apply paragraphs 15–22 of NZ IAS 37 to determine whether at the acquisition date a present obligation exists as a result of past events. For a levy that would be within the scope of NZ IFRIC 21, the acquirer shall apply NZ IFRIC 21 to determine whether the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date.
- 21C A present obligation identified in accordance with paragraph 21B might meet the definition of a contingent liability set out in paragraph 22(b). If so, paragraph 23 applies to that contingent liability.

Contingent liabilities and contingent assets

- 22 NZ IAS 37 ~~Provisions, Contingent Liabilities and Contingent Assets~~ defines a contingent liability as:
- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
 - (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) the amount of the obligation cannot be measured with sufficient reliability.
- 23 ~~The requirements in NZ IAS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the~~ The acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to paragraphs 14(b), 23, 27, 29 and 30 of NZ IAS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Paragraph 56 of this NZ IFRS provides guidance on the subsequent accounting for contingent liabilities.
- 23A NZ IAS 37 defines a contingent asset as ‘a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity’. The acquirer shall not recognise a contingent asset at the acquisition date.

...

Effective date and transition

Effective date

...

64Q Reference to the Conceptual Framework, issued in June 2020, amended paragraphs 11, 14, 21, 22 and 23 and added paragraphs 21A, 21B, 21C and 23A. An entity shall apply those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2022. Earlier application is permitted if at the same time or earlier an entity also applies all the amendments made by Amendments to References to the Conceptual Framework in NZ IFRS, issued in May 2018.

Part D – Effective Date

This Standard shall be applied to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2022. Earlier application is permitted if at the same time or earlier an entity also applies all the amendments made by *Amendments to References to the Conceptual Framework in NZ IFRS*, issued in May 2018.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 17 June 2020

To: Michele Embling, Chair External Reporting Board

From: Kimberley Crook, Chair NZASB

Subject: *Reference to the Conceptual Framework*

Introduction¹

1. In accordance with the protocols established by the XRB Board, NZASB seeks your approval to issue *Reference to the Conceptual Framework*, which amends NZ IFRS 3 *Business Combinations*.
2. The amendments are required because NZ IFRS 3 still contains references to the definitions of assets and liabilities in an older conceptual framework.

Background

3. The IASB did not update the outdated references to assets and liabilities in IFRS 3 *Business Combinations* when it issued a new conceptual framework in 2018, because this could have led to some liabilities being recognised and then immediately derecognised. The IASB kept the references to the older definitions of assets and liabilities in IFRS 3 until it could consult on proposals for dealing with this issue.
4. The IASB has now consulted on these proposals and finalised the amendments to IFRS 3. The amendments add an exception to the recognition principle in IFRS 3. For liabilities and contingent liabilities that would be within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IFRIC 21 *Levies* if incurred separately, an acquirer will now apply the relevant pronouncement, rather than the 2018 *Conceptual Framework*, to identify the obligations it assumes in a business combination.
5. The IASB has indicated that the revised requirements are likely to remain in place until it decides whether and how to align IAS 37 with the 2018 *Conceptual Framework*.
6. The proposed amendments to NZ IFRS 3 (the footnote to paragraph 11) differ slightly from the amendments to IFRS 3 but have the same effect. The IASB's amendments update a reference to definitions in the IASB's 1989 *Framework*. The amendments to NZ IFRS 3 update a reference to definitions in the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements 2010* (NZ *Framework*). This is because much of the

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material in the IASB's 1989 *Framework* was incorporated in, and issued as part of, the NZ *Framework*.

Due process

7. The International Accounting Standards Board (IASB) issued Exposure Draft ED/2019/3 *Reference to the Conceptual Framework* (the ED) in May 2019.
8. The NZASB issued the ED for comment in New Zealand around the same time. Comments were due to the NZASB on 16 August 2019 and to the IASB on 27 September 2019.
9. The NZASB did not receive any comments from New Zealand constituents and did not comment on the ED. The IASB received 47 comment letters from its world-wide constituents.
10. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2019/3 and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB meeting in January 2020.²
11. The IASB issued *Reference to the Conceptual Framework* in May 2020. The amendments are effective for annual periods beginning on or after 1 January 2022. Earlier application is permitted if an entity also applies all amendments to standards related to the issue of a new conceptual framework in 2018.
12. The NZASB has approved *Reference to the Conceptual Framework*, which amends NZ IFRS 3 *Business Combinations*. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in the NZASB's view, meets the requirements of section 22 of the Financial Reporting Act 2013.
13. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the amending standard is likely to require the disclosure of personal information. In the NZASB's view the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Consistency with XRB Financial Reporting Strategy

14. The amending standard is a standard in its own right. *Reference to the Conceptual Framework* is identical to *Reference to the Conceptual Framework* except for (i) the New Zealand-specific introduction; (ii) the addition of a scope paragraph limiting the application of the Standard to Tier 1 and Tier 2 for-profit entities; and (iii) the fact that the outdated definitions of assets and liabilities being replaced by the amendments are located in a conceptual framework with a different title than the international version.
15. The amendments do not change disclosure requirements. Accordingly there is no need to consider RDR concessions.

² An update on the IASB meeting in January 2020 is available at:
<https://www.ifrs.org/news-and-events/updates/iasb-updates/january-2020/>

16. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard in the near future.
17. The issue of this amending standard is consistent with all three elements of the Financial Reporting Strategy: it adopts the international standard, retains a harmonised position with Australia and is consistent with the Accounting Standards Framework.

Effective date

18. The amending standard will be applicable to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2022. Earlier application is permitted, subject to the application of other conceptual framework amendments issued in 2018.

Other matters

19. There are no other matters relating to the issue of this amending standard that the NZASB considers to be pertinent or that should be drawn to your attention.

Recommendation

20. The NZASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

Reference to the Conceptual Framework

Certificate of determination

Kimberley Crook
Chair NZASB



**NZ ACCOUNTING
STANDARDS
BOARD**

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Joanne Scott

Subject: *PBE Policy Approach – Reference to the Conceptual Framework*

Recommendations¹

1. The Board is asked to:
 - (a) NOTE the application of the *Policy Approach to the Development of PBE Standards* (the [Policy](#)) to *Reference to the Conceptual Framework*; and
 - (b) NOTE that no amendments are required to PBE Standards.

Background

2. *Reference to the Conceptual Framework* amends NZ IFRS 3 *Business Combinations*. It replaces a reference in NZ IFRS 3 to the definitions of assets and liabilities in the 2010 NZ *Framework* with a reference to the definitions in the 2018 NZ *Conceptual Framework*. This memo explains why there is no need to consider making equivalent amendments to PBE Standards.

PBE Policy Approach

3. The Policy identifies triggers for considering whether to amend PBE Standards. In this case the IASB has amended an IFRS Standard that the IPSASB has used as the basis for an IPSAS. IFRS 3 *Business Combinations* was used as the starting point for developing IPSAS 40 *Public Sector Combinations*.
4. PBE IPSAS 40, which is based on IPSAS 40, was issued in July 2019. The recognition requirements for acquisitions in PBE IPSAS 40 (paragraph 65) refer to the most recent definitions of assets and liabilities in the *Public Benefit Entities' Conceptual Framework*. The IASB's amendments are therefore not relevant for PBE Standards.
5. PBE IPSAS 40 superseded PBE IFRS 3 *Business Combinations*. Even if PBE IFRS 3 had still been effective there would have been no need to amend it, as it also referred to the definitions of assets and liabilities in the *Public Benefit Entities' Conceptual Framework*.

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NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Gali Slyuzberg

Subject: ***Onerous Contracts – Cost of Fulfilling a Contract***

Action required¹

1. The Board is asked to:
 - (a) APPROVE for issue *Onerous Contracts – Cost of Fulfilling a Contract*, which amends NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
 - (b) APPROVE the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board, requesting approval to issue the amending standard.

Introduction

2. The amendments specify which costs an entity includes in determining the cost of fulfilling a contract, for the purpose of determining whether the contract is onerous under NZ IAS 37. That is, the cost to fulfil a contract includes all costs that relate directly to the contract – including both costs that are incremental to the contract and an allocation of other costs that are directly related to fulfilling contracts (including this contract).

Background

3. The International Accounting Standards Board (IASB) issued Exposure Draft ED/2018/2 *Onerous Contracts – Cost of Fulfilling a Contract* (ED/2018/2) in December 2018.
4. The NZASB issued the ED for comment in New Zealand around the same time. Constituents were asked to comment directly to the IASB and send a copy of their comments to the NZASB. Comments were due to the IASB on 15 April 2019.
5. The NZASB did not comment on ED/2018/2. The NZASB received no comment letters from New Zealand constituents. The IASB received 68 comment letters from its world-wide constituents. The IASB did not receive any comments from New Zealand constituents.
6. The IASB issued *Onerous Contracts – Cost of Fulfilling a Contract* in May 2020, which is effective for annual periods beginning on or after 1 January 2022, with early application permitted.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Reasons for the amending standard

7. In 2017, the IFRS Interpretation Committee (IFRS IC) was asked to clarify which costs an entity considers when assessing whether a contract is onerous under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. IAS 37 defines an onerous contract as a contract in which the unavoidable costs exceed the expected economic benefits. Unavoidable costs are the lower of the cost to fulfil the contract and the penalty for failing to fulfil it. However, at the time, IAS 37 did not contain guidance on which costs to include when measuring the cost to fulfil a contract.
8. The IFRS IC recommended that the IASB clarify which costs an entity includes in determining the cost of fulfilling a contract for the purpose of assessing whether the contract is onerous under IAS 37. The IFRS IC noted the following reasons for this recommendation.
 - (a) Differing views on which costs to include could lead to material differences in the financial statements of entities that enter into some types of contracts.
 - (b) The need for clarification was urgent. Following the withdrawal of IAS 11 *Construction Contracts* (which was superseded by IFRS 15 *Revenue from Contracts with Customers*), entities are required to apply IAS 37 instead of IAS 11 to assess whether construction contracts are onerous. IAS 11 specified which costs to include, but IAS 37 did not.

Key issues

Costs of fulfilling a contract

9. The amendments specify that for the purpose of assessing whether a contract is onerous, the cost to fulfil a contract includes all the costs that relate directly to a contract. This includes:
 - (a) the incremental costs of fulfilling that contract (e.g. direct labour and materials); and
 - (b) an allocation of other costs that relate directly to fulfilling contracts (e.g. an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract and other contracts).
10. The IASB had considered whether costs to fulfil a contract should include only incremental costs. However, the IASB decided that including all costs that relate directly to the contract would result in a more faithful representation of the effect of the contract on the entity's financial position, and therefore would provide more useful information to users of financial statements.
11. Furthermore, in the IASB's view, the term 'unavoidable costs' in the definition of an onerous contract refers to costs an entity cannot avoid because it has the contract (as opposed to the costs the entity could avoid if it did not have the contract). On this basis, costs to fulfil a contract for the purpose of calculating unavoidable costs should include not just incremental costs but all costs that directly relate to the contract (including an allocation of costs that relate directly to fulfilling this and other contracts).
12. Most respondents agreed with the proposal to include all costs that relate directly to a contract in the calculation of the cost to fulfil a contract.

13. Some respondents noted that the amendments will require a change in practice for entities that currently take an incremental costs approach to assessing onerous contracts. This change in practice could be costly. The IASB noted that this possible consequence was mentioned in the ED, and that nevertheless most respondents supported the amendments. The IASB considered that the benefits of the amendment outweigh the costs.

Examples of costs that relate directly to a contract

14. The ED included a list of examples of costs that do and do not relate directly to a contract. These examples were based on paragraphs 97–98 of IFRS 15, which list examples of costs that do and do not relate directly to a contract for the purpose of that standard. Some respondents to the ED asked for additional examples for contracts outside the scope of IFRS 15. Other respondents asked for clarifications regarding the examples in the ED.
15. As a result, the IASB replaced the list of examples with a more general description of the types of costs that relate directly to a contract (i.e. the incremental costs of fulfilling the contract and an allocation of other costs that relate directly to fulfilling contracts). The IASB concluded that this general description can be applied to all types of contracts and avoids unintended consequences.

Interaction with impairment requirements

16. Some respondents noted that paragraph 69 of IAS 37 requires an entity to recognise any impairment loss that has occurred on assets “dedicated to that contract”. In response to feedback from respondents, the IASB replaced the words “dedicated to that contract” with “used in fulfilling the contract” (which would include an asset used to fulfil this contract as well as other contracts). This is consistent with the requirement to include all costs that relate directly to a contract when assessing whether it is onerous.

Transitional provisions

17. The amendments apply only to those contracts where the entity has not yet fulfilled all of its obligations as at the date of initial application. Restatement of comparatives is not allowed. Rather, entities need to recognise the cumulative effect of initially applying the amendments as an adjustment to opening retained earnings (or another component of equity) at the date of initial application.

RDR concessions and consistency with Australian Accounting Standards

18. The amendments do not change disclosure requirements. Accordingly, there is no need to consider RDR concessions.
19. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard in the near future.

Due process

20. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2018/2 and concluded that the

applicable due process steps had been completed. This review of due process occurred at the IASB's December 2019 meeting.²

21. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in our view, meets the requirements of section 22 of the Financial Reporting Act 2013.
22. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the standard is likely to require the disclosure of personal information. In our view the standard does not include requirements that would result in the disclosure of personal information, and therefore no consultation with the Privacy Commissioner is required.

Draft amending standard and signing memorandum

23. Attached as agenda item 7.2 is a copy of *Onerous Contracts – Cost of Fulfilling a Contract*. A paragraph has been added to limit the application of the standard/amending standard to Tier 1 and Tier 2 for-profit entities only.
24. Attached as agenda item 7.3 is a draft certificate signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

Question for the Board

- Q1. Does the Board APPROVE for issue *Onerous Contracts – Cost of Fulfilling a Contract*, which amends NZ IAS 37?
- Q2. Does the Board APPROVE the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board, requesting approval to issue the standard?

Attachments

- Agenda item 7.2: Draft *Onerous Contracts – Cost of Fulfilling a Contract*
- Agenda item 7.3: Draft signing memorandum
- Agenda item 7.4: PBE Policy Approach

² A summary of the IASB's December 2019 meeting is available at: <https://www.ifrs.org/news-and-events/updates/iasb-updates/december-2019/>



NZ ACCOUNTING
STANDARDS
BOARD

Onerous Contracts—Cost of Fulfilling a Contract

Issued June 2020

This Standard was issued on 25 June 2020 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 23 July 2020.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date set out in Part D.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Tier 1 and Tier 2 For-profit Accounting Standard is based on amendments issued by the International Accounting Standards Board. This Standard amends NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to specify which costs an entity includes in determining the cost of fulfilling a contract, for the purpose of assessing whether the contract is onerous.

ONEROUS CONTRACTS—COST OF FULFILLING A CONTRACT

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ONEROUS CONTRACTS—COST OF FULFILLING A CONTRACT

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The following is available within New Zealand on the XRB website as additional material

APPROVAL BY THE IASB OF *ONEROUS CONTRACTS—COST OF FULFILLING A CONTRACT* ISSUED IN MAY 2020

ADDITION OF A BASIS FOR CONCLUSIONS ON IAS 37 *PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS*

ONEROUS CONTRACTS—COST OF FULFILLING A CONTRACT

Part A – Introduction

This Standard sets out amendments to clarify which costs an entity includes in determining the cost of fulfilling a contract, for the purpose of assessing whether the contract is onerous. Tier 2 entities are required to comply with all the requirements in this Standard.

Part B – Scope

This Standard applies to Tier 1 and Tier 2 for-profit entities.

Part C – Amendments to NZ IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Paragraphs 68A, 94A and 105 are added and paragraph 69 is amended. Paragraph 68 is not amended, but is included for ease of reading. New text is underlined and deleted text is struck through.

Application of the recognition and measurement rules

...

Onerous contracts

...

68 This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

68A The cost of fulfilling a contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract consist of both:

- (a) the incremental costs of fulfilling that contract—for example, direct labour and materials; and
- (b) an allocation of other costs that relate directly to fulfilling contracts—for example, an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract among others.

69 Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets ~~dedicated to that~~ used in fulfilling the contract (see NZ IAS 36).

...

Transitional provisions

...

94A Onerous Contracts—Cost of Fulfilling a Contract, issued in June 2020, added paragraph 68A and amended paragraph 69. An entity shall apply those amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments (the date of initial application). The entity shall not restate comparative information. Instead, the entity shall recognise

ONEROUS CONTRACTS—COST OF FULFILLING A CONTRACT

the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application.

Effective date

...

105 *Onerous Contracts—Cost of Fulfilling a Contract*, issued in June 2020, added paragraphs 68A and 94A and amended paragraph 69. An entity shall apply those amendments for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Part D – Effective Date

This Standard shall be applied for annual periods beginning on or after 1 January 2022. Earlier application is permitted.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 17 June 2020

To: Michele Embling, Chair External Reporting Board

From: Kimberley Crook, Chair NZASB

Subject: ***Onerous Contracts – Cost to Fulfil a Contract***

Introduction¹

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue *Onerous Contracts – Cost of Fulfilling a Contract* which amends NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
2. The purpose of the amendments is to specify which costs an entity includes in determining the cost of fulfilling a contract, for the purpose of assessing whether the contract is onerous under NZ IAS 37.
3. The amendments clarify that the cost to fulfil a contract includes all the costs that relate directly to the contract. This includes both:
 - (a) the incremental costs of fulfilling that contract (e.g. direct labour and materials); and
 - (b) an allocation of other costs that relate directly to fulfilling contracts (e.g. an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract and other contracts).
4. The IASB had proposed these amendments following a recommendation from the IFRS Interpretations Committee (IFRS IC), who in turn received a query from a constituent on this subject. The IFRS IC noted the following.
 - (a) Differing views on which costs to include could lead to material differences in the financial statements of entities that enter into some types of contracts.
 - (b) The need for clarification was urgent. Following the withdrawal of IAS 11 *Construction Contracts* (which was superseded by IFRS 15 *Revenue from Contracts with Customers*), entities are required to apply IAS 37 instead of IAS 11 to assess whether construction contracts are onerous. IAS 11 specified which costs to include, but IAS 37 did not.

Due process

5. The International Accounting Standards Board (IASB) issued Exposure Draft ED/2018/2 *Onerous Contracts – Cost to Fulfil a Contract* (ED/2018/2) in December 2018.

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6. The NZASB issued the ED for comment in New Zealand around the same time. Constituents were asked to comment directly to the IASB and send a copy of their comments to the NZASB. Comments were due to the IASB on 15 April 2019.
7. The NZASB did not comment on ED/2018/2. The NZASB received no comment letters from New Zealand constituents. The IASB received 68 comment letters from its world-wide constituents. The IASB did not receive any comments from New Zealand constituents.
8. Most respondents agreed with the IASB's proposal that the cost to fulfil a contract should include all costs that relate directly to the contract. In response to feedback from respondents, the IASB replaced the proposed list of examples of costs that relate directly to a contract with a more general description of such costs.
9. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2018/2 and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB meeting in December 2019.²
10. The IASB issued *Onerous Contracts – Cost of Fulfilling a Contract* in May 2020. This amending standard is effective for annual periods beginning on or after 1 January 2022 with early application permitted.
11. The NZASB has approved *Onerous Contracts – Cost of Fulfilling a Contract*. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in the NZASB's view, meets the requirements of section 22 of the Financial Reporting Act 2013.
12. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the amending standard is likely to require the disclosure of personal information. In the NZASB's view the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Consistency with XRB Financial Reporting Strategy

13. The amending standard is a standard in its own right. *Onerous Contracts – Cost of Fulfilling a Contract* is identical to the IASB standard *Onerous Contracts – Cost of Fulfilling a Contract*, except for the New Zealand specific introduction and a scope paragraph limiting the application of the standard to Tier 1 and Tier 2 for-profit entities.
14. The amendments do not change disclosure requirements. Accordingly, there is no need to consider RDR concessions.
15. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard in the near future.

² An update on the IASB meeting in December 2019 is available at:
<https://www.ifrs.org/news-and-events/updates/iasb-updates/december-2019/>

16. The issue of this amending standard is consistent with all three elements of the Financial Reporting Strategy: it adopts the international standard, retains a harmonised position with Australia and is consistent with the Accounting Standards Framework.

Effective date

17. The amending standard will be applicable for annual reporting periods beginning on or after 1 January 2022, with early application permitted.

Other matters

18. There are no other matters relating to the issue of this amending standard that the NZASB considers to be pertinent or that should be drawn to your attention.

Recommendation

19. The NZASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

Onerous Contracts – Cost of Fulfilling a Contract

Certificate of determination

Kimberley Crook
Chair NZASB

Date: 5 June 2020

To: NZASB Members

From: Gali Slyuzberg

Subject: **PBE Policy Approach: *Onerous Contracts – Cost of Fulfilling a Contract***

Recommendations¹

1. The Board is asked to:
 - (a) CONSIDER the application of the [Policy Approach to the Development of PBE Standards](#) (the PBE Policy Approach) to *Onerous Contracts – Cost of Fulfilling a Contract*; and
 - (b) AGREE to wait for the IPSASB to propose adopting the amendments into IPSAS.

Background

2. The IASB issued *Onerous Contracts – Cost of Fulfilling a Contract* to specify which costs an entity includes in determining the cost of fulfilling a contract, for the purpose of assessing whether the contract is onerous under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Refer to agenda item 7.1 for further detail.
3. The next step is to consider whether the amendments should be incorporated in PBE Standards, and if so, when. In this memo we have applied the relevant parts of the PBE Policy Approach to *Onerous Contracts – Cost of Fulfilling a Contract*.

PBE Policy Approach

4. The relevant triggers for considering whether to amend PBE Standards are set out in section 4.2 of the PBE Policy Approach. In this case, the IASB has issued amendments to an existing IFRS Standard (IAS 37) which the IPSASB has used as the basis for an IPSAS (IPSAS 9 *Provisions, Contingent Liabilities and Contingent Assets*). PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* is in turn based on IPSAS 19.
5. Paragraphs 28–31 of the PBE Policy Approach set out the matters to be considered. Paragraphs 28–29 highlight the need to consider whether the IPSASB will address the change in an acceptable timeframe and the need to balance this against the costs and benefits of getting ahead of the IPSASB. Paragraph 30 establishes a rebuttable presumption that the NZASB will not get ahead of the IPSASB if the amendments are minor. Table 1 sets out our thoughts on these matters.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Table 1 Applying the PBE Policy Approach

<p>Will the IPSASB consider these issues in an acceptable timeframe?</p> <p>The most recent <i>IPSAS–IFRS Alignment Dashboard</i>, to be included on the IPSASB’s June 2020 meeting agenda, lists <i>Onerous Contracts – Cost of Fulfilling a Contract</i> as an “active alignment project”. We expect that the IPSASB will consider these amendments as part of the next <i>Improvements to IPSAS</i> project, which IPSASB staff propose to defer to 2021.</p> <p>We also note that the impetus for the IASB’s amendments was the withdrawal of IAS 11 <i>Construction Contracts</i>, which was superseded by IFRS 15 <i>Revenue from Contracts with Customers</i>. Entities that previously applied IAS 11 now need to refer to IAS 37 when assessing whether a contract is onerous. While IAS 11 included requirements on what costs to include when making this assessment, IAS 37 did not. The IASB therefore decided that it was urgent to clarify which costs are included when assessing whether a contract is onerous under IAS 37. By contrast, we note that PBE IPSAS 11 <i>Construction Contracts</i>, which is ultimately based on IAS 11, is still applicable to PBEs. This standard will eventually be superseded by the IPSASB’s new standards on revenue, but these standards are still under development. Therefore, at least with respect to construction contract, the clarification of what costs to include in assessing whether a contract is onerous does not seem as urgent for PBEs as it was for for-profit entities.</p>
<p>Are the amendments minor?</p> <p>The amendments are not extensive. They clarify, rather than change, the existing requirements in NZ IAS 37. However, we are aware that internationally, there is some diversity in practice in terms of determining the cost to fulfil a contract for the purpose of assessing whether the contract is onerous under IAS 37. Therefore, it is possible that some entities in New Zealand will need to change how they determine whether a contract is onerous as a result of the amendments.</p>
<p>Costs and benefits of getting ahead of the IPSASB</p> <p><u>Costs</u></p> <p>There is a risk that the IPSASB could decide not to issue the amendments, which would result in a permanent difference between IPSAS and PBE Standards.</p> <p>Furthermore, if the IPSASB decides to issue similar amendments but makes changes to these amendments, this could result in a second round of amendments to PBE Standards.</p> <p><u>Who would benefit?</u></p> <p>Tier 1 and Tier 2 PBEs would benefit from greater clarification about what costs to include when assessing whether a contract is onerous under PBE IPSAS 19. (However, as noted above, PBEs are unlikely to require such clarification with respect to construction contracts, as PBE IPSAS 11 is still applicable to PBEs).</p> <p>PBEs that are part of a mixed group would also benefit from having consistent requirements with for-profit entities regarding the assessment of whether a contract is onerous. (However, as noted above, the amendments clarify, rather than change, existing requirements).</p>
<p>RDR</p> <p>There are no new disclosures and therefore no RDR concessions are proposed.</p>

Next steps

6. Based on the analysis in Table 1 above, staff are of the view that it is appropriate to wait for the IPSASB to consider equivalent amendments to IPSAS as part of its next *Improvements to IPSAS* project.

Question for the Board

- Q1. With respect to *Onerous Contracts – Cost of Fulfilling a Contract*, does the Board agree to wait for the IPSASB to consider proposing equivalent amendments to IPSAS?



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Tracey Crookston

Subject: *Annual Improvements to NZ IFRS 2018–2020*

Recommendations¹

1. We recommend that the Board:
 - (a) APPROVES for issue *Annual Improvements to NZ IFRS 2018–2020*, which contains amendments to NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards*, NZ IFRS 9 *Financial Instruments* and NZ IAS 41 *Agriculture*;
 - (b) APPROVES the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board requesting approval to issue the Standard; and
 - (c) AGREES to wait for the IPSASB to propose these amendments as part of its improvements to IPSAS project in 2021 (see agenda item 8.4).

Background

2. All of the amendments were developed in response to requests to the IASB for clarification of requirements in IFRS Standards and to address circumstances in which there was diversity in practice.
3. Please refer to the draft signing memorandum (agenda item 8.3, under the heading Due process) for details about the background to the amendments.

RDR concessions and consistency with Australian Accounting Standards

4. The amending standard does not establish or amend any disclosure requirements. Therefore, there are no RDR concessions.
5. The Australian Accounting Standards Board (AASB) is expected to adopt an equivalent amending standard in the near future. Therefore, the Tier 1 and Tier 2 for-profit reporting requirements will continue to be aligned with those in Australia.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Due process

6. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of IASB ED/2019/2 *Annual Improvements to IFRS Standards 2018–2020* and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB’s December 2019 meeting.²
7. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in our view, meets the requirements of section 22 of the Financial Reporting Act 2013.
8. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the amending standard is likely to require the disclosure of personal information. In our view the amending standard does not include requirements that would result in the disclosure of personal information, and therefore no consultation with the Privacy Commissioner is required.

Draft amending standard and signing memorandum

9. Attached as agenda item 8.2 is a copy of draft *Annual Improvements to NZ IFRS 2018–2020*. A paragraph has been added to limit the application of the Standard to Tier 1 and Tier 2 for-profit entities only.
10. Attached as agenda item 8.3 is a draft signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

PBE Policy Approach

11. Attached as agenda item 8.4 is a memo which considers the application of the [Policy Approach to the Development of PBE Standards](#) (the PBE Policy Approach) to *Annual Improvements to NZ IFRS 2018–2020*.

Questions for the Board

- Q1. Does the Board approve for issue *Annual Improvements to NZ IFRS 2018–2020*?
- Q2. Does the Board approve the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board requesting approval to issue the Standard?
- Q3. Does the Board agree to wait for the IPSASB to propose these amendments as part of its improvements to IPSAS project in 2021?

Attachments

- Agenda item 8.2: Draft: *Annual Improvements to NZ IFRS 2018–2020*
- Agenda item 8.3: Draft: signing memorandum
- Agenda item 8.4: Memo: PBE Policy Approach

² A summary of the IASB’s December 2019 meeting is available at: [IASB Update December 2019](#)



Annual Improvements to NZ IFRS 2018–2020

Issued June 2020

This Standard was issued on 25 June 2020 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 23 July 2020.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date set out in Part D.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Tier 1 and Tier 2 For-profit Accounting Standard is based on *Annual Improvements to IFRS Standards 2018-2020* issued by the International Accounting Standards Board (IASB).

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ANNUAL IMPROVEMENTS TO NZ IFRS 2018–2020

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The following is available within New Zealand on the XRB website as additional material

**APPROVAL BY THE IASB OF ANNUAL IMPROVEMENTS TO IFRS STANDARDS 2018–2020
ISSUED IN MAY 2020**

AMENDMENTS TO THE IASB BASIS FOR CONCLUSIONS ON:

- **IFRS 1 *FIRST-TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS***
- **IFRS 9 *FINANCIAL INSTRUMENTS***
- **IFRS 16 *LEASES***
- **IAS 41 *AGRICULTURE***

AMENDMENT TO ILLUSTRATIVE EXAMPLES ACCOMPANYING IFRS 16 *LEASES*

Part A – Introduction

This document sets out amendments made to NZ IFRS as a consequence of *Annual Improvements to IFRS Standards 2018–2020*.

The following table shows the standards amended and the subject of the amendments.

Standard	Subject of amendment
NZ IFRS 1 <i>First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards</i>	Subsidiary as a First-time Adopter
NZ IFRS 9 <i>Financial Instruments</i>	Fees in the '10 per cent' Test for Derecognition of Financial Liabilities
NZ IAS 41 <i>Agriculture</i>	Taxation in Fair Value Measurements

Part B – Scope

This Standard applies to Tier 1 and Tier 2 for-profit entities.

Part C – Amendments to NZ IFRS

Amendment to NZ IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph 39AG and, in Appendix D, paragraph D13A are added. Paragraph D1(f) is amended. New text is underlined and deleted text is struck through.

Effective date

...

39AG *Annual Improvements to NZ IFRS 2018–2020*, issued in June 2020, amended paragraph D1(f) and added paragraph D13A. An entity shall apply that amendment for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

Appendix D Exemptions from other NZ IFRSs

This appendix is an integral part of the Standard.

D1 An entity may elect to use one or more of the following exemptions:

- ...
- (f) cumulative translation differences (paragraphs D12–~~D13A~~ and ~~D13~~);
- ...

Cumulative translation differences

...

D13A Instead of applying paragraph D12 or paragraph D13, a subsidiary that uses the exemption in paragraph D16(a) may elect, in its financial statements, to measure cumulative translation differences for all foreign operations at the carrying amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. A similar election is available to an associate or joint venture that uses the exemption in paragraph D16(a).

...

Amendment to NZ IFRS 9 *Financial Instruments*

Paragraph 7.1.9, paragraph 7.2.35 and its heading, and paragraph B3.3.6A are added. Paragraph B3.3.6 is amended. New text is underlined. The requirements in paragraph B3.3.6A have not been amended but have been moved from paragraph B3.3.6.

Chapter 7 Effective date and transition

7.1 Effective date

...

7.1.9 *Annual Improvements to NZ IFRS 2018–2020*, issued in June 2020, added paragraphs 7.2.35 and B3.3.6A and amended paragraph B3.3.6. An entity shall apply that amendment for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

7.2 Transition

...

7.2.35 An entity shall apply *Annual Improvements to NZ IFRS 2018–2020* to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

Appendix B Application Guidance

This appendix is an integral part of the Standard.

Recognition and derecognition (Chapter 3)

...

Derecognition of financial liabilities (Section 3.3)

...

B3.3.6 For the purpose of paragraph 3.3.2, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. In determining those fees paid net of fees received, a borrower includes only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf.

B3.3.6A If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

...

Amendment to NZ IAS 41 Agriculture

Paragraph 22 is amended and paragraph 65 is added. New text is underlined and deleted text is struck through.

Recognition and measurement

- ...
- 22 An entity does not include any cash flows for financing the assets, ~~taxation~~, or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).
- ...

Effective date and transition

- ...
- 65 Annual Improvements to NZ IFRS Standards 2018–2020, issued in June 2020, amended paragraph 22. An entity shall apply that amendment to fair value measurements on or after the beginning of the first annual reporting period beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

Part D – Effective Date

This Standard shall be applied for annual periods beginning on or after 1 January 2022. Earlier application is permitted.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: Michele Embling, Chair External Reporting Board

From: Kimberley Crook, Chair NZASB

Subject: *Annual Improvements to NZ IFRS 2018–2020*

Introduction¹

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue *Annual Improvements to NZ IFRS 2018–2020*. These amendments incorporate the amendments in *Annual Improvements to IFRS Standards 2018–2020*.
2. There are three sets of amendments in the amending standard. A brief description of each set of amendments follows.
 - (a) The amendment to NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards* permits a subsidiary that elects to apply paragraph D16(a) of NZ IFRS 1 to measure cumulative translation differences (CTD) for all foreign operations using the amount reported by the parent, based on the parent's date of transition to NZ IFRS (if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary).² The amendment would also apply to associates and joint ventures that elect to apply paragraph D16(a) of NZ IFRS 1.
 - (b) The amendment to NZ IFRS 9 *Financial Instruments* clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability (the 'fees in the 10 per cent test').
 - (c) The amendment to NZ IAS 41 *Agriculture* removes the requirement in paragraph 22 for entities to exclude cash flows for taxation when measuring fair value applying NZ IAS 41. The amendment aligns the requirements in NZ IAS 41 on fair value measurement with those in NZ IFRS 13 *Fair Value Measurement*.

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² Paragraph D16(a) requires a subsidiary that becomes a first-time adopter later than its parent to measure, in its financial statements, assets and liabilities at the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to NZ IFRS, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary.

3. All of the amendments were developed in response to requests to the IASB for clarification of requirements in IFRS Standards and to address circumstances in which there was diversity in practice.

Due process

4. IASB ED/2019/2 *Annual Improvements to IFRS Standards 2018–2020* was issued for comment in New Zealand in May 2019.
5. Comments on IASB ED/2019/2 were due to the NZASB on 22 July 2019 and to the IASB on 20 August 2019. The NZASB received no comment letters from New Zealand constituents. The NZASB did not comment to the IASB. The IASB received 59 comment letters on this ED from its world-wide constituents. Not all respondents commented on all the proposals. The IASB did not receive any comments from New Zealand constituents.

Issues raised by respondents

Amendment to IFRS 1

6. The amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* in IASB ED/2019/2 proposed to require a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences (CTD) using the amounts reported by the parent, based on the parent's date of transition to IFRSs.
7. Forty-six respondents commented on the proposed amendment. Almost all respondents agreed for the reasons outlined in the Basis for Conclusions. Some respondents expressed concerns about particular aspects of the proposed amendment.
8. Some respondents suggested that a subsidiary that applies paragraph D16(a) to measure CTD should be permitted, rather than be required, to measure CTD using the amounts reported by the parent based on the parent's date of transition to IFRSs because the proposed requirement could, for various reasons, be burdensome for some subsidiaries.
9. The IASB noted that entities that apply paragraph D16(a) could in some situations find it burdensome to measure cumulative translation differences using the amount reported by the parent. The IASB therefore decided to permit, rather than to require, a subsidiary to measure cumulative translation differences (CTD) using the amounts reported by the parent, based on the parent's date of transition to IFRSs.

Amendment to IFRS 9

10. The amendment to IFRS 9 *Financial Instruments* clarifies which fees should be included in the 10 percent test (i.e. only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf).
11. Fifty-two respondents commented on the proposed amendment to IFRS 9. Almost all respondents agreed with the proposed amendment for the reasons outlined in the Basis for Conclusions. Some respondents expressed concerns about particular aspects of the proposed

amendment however the IASB, after considering the staff response, decided the proposed amendments were appropriate.³

12. The IASB did not propose to amend IAS 39 *Financial Instruments: Recognition and Measurement* because any such amendment would apply only to a limited number of entities, for a limited period of time (i.e. from the effective date of the amendment to the effective date of IFRS 17 *Insurance Contracts*).

Finalising the amendments

13. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2019/2 and concluded that the applicable due process steps for the amendments being finalised as part of its annual improvements project had been completed. This review of due process occurred at the IASB's meeting in December 2019.⁴
14. The IASB issued *Annual Improvements to IFRS Standards 2018–2020* in May 2020. All of the amendments in the amending standard are effective for annual periods beginning on or after 1 January 2022 with early application permitted.
15. The NZASB has approved Annual Improvements to NZ IFRS 2018–2020. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in the NZASB's view, meets the requirements of section 22 of the Financial Reporting Act 2013.
16. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the amending standard is likely to require the disclosure of personal information. In the NZASB's view the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Consistency with XRB Financial Reporting Strategy

17. The amending standard is a standard in its own right. *Annual Improvements to NZ IFRS 2018–2020* is identical to *Annual Improvements to IFRS Standards 2018–2020* except for the New Zealand specific introduction and a scope paragraph limiting its application to Tier 1 and Tier 2 for-profit entities.
18. The amending standard does not establish or amend disclosure requirements. The Australian Accounting Standards Board (AASB) is expected to adopt an equivalent amending standard in the near future. Therefore, the Tier 1 and Tier 2 for-profit reporting requirements will continue to be aligned with those in Australia.

³ IASB Staff response proposed amendment to IFRS 9: [IASB Staff paper](#)

⁴ A summary of the IASB's December 2019 meeting is available at: [IASB Update December 2019](#)

19. The issue of this amending standard is consistent with all three elements of the Financial Reporting Strategy: it adopts the international standard, retains a harmonised position with Australia and is consistent with the Accounting Standards Framework.

Effective date

20. The amending standard will be applicable for annual reporting periods beginning on or after 1 January 2022, with early application permitted.

Other matters

21. There are no other matters relating to the issue of this amending standard that the NZASB considers to be pertinent or that should be drawn to your attention.

Recommendation

22. The NZASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

Annual Improvements to NZ IFRS 2018–2020

Certificate of Determination

Kimberley Crook
Chair NZASB



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Tracey Crookston

Subject: **PBE Policy Approach: Annual Improvements to IFRS Standards 2018–2020**

Recommendations¹

1. The Board is asked to:
 - (a) CONSIDER the application of the [Policy Approach to the Development of PBE Standards](#) (the PBE Policy Approach) to *Annual Improvements to IFRS Standards 2018–2020*; and
 - (b) AGREE to wait for the IPSASB to propose adopting the amendments into IPSAS via its improvements to IPSAS project in 2021.

Background

2. The IASB issued *Annual Improvements to IFRS Standards 2018–2020* to make minor amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, IFRS 9 *Financial Instruments* and IAS 41 *Agriculture*. Refer to the signing memorandum at agenda item 8.3 for further detail.
3. The next step is to consider whether the amendments should be incorporated in PBE Standards, and if so, when. In this memo we have applied the relevant parts of the PBE Policy Approach to *Annual Improvements to IFRS Standards 2018–2020*.

PBE Policy Approach

4. The relevant triggers for considering whether to amend PBE Standards are set out in paragraph 4.2 of the PBE Policy Approach. In this case the IASB has issued amendments to IFRS Standards which the IPSASB has used as the basis for IPSAS. In addition, the amendments affect an IFRS Standard (IFRS 1) that the NZASB has used as the basis for a PBE Standard, PBE FRS 47 *First-Time Adoption of PBE Standards* (PBE FRS 47)).
5. Paragraphs 28–31 of the PBE Policy Approach set out the matters to be considered. Paragraphs 28–29 highlight the need to consider whether the IPSASB will address the change in an acceptable timeframe and the need to balance this against the costs and benefits of getting ahead of the IPSASB. Paragraph 30 establishes a rebuttable presumption that the

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NZASB will not get ahead of the IPSASB if the amendments are minor. Table 2 sets out our thoughts on these matters.

Table 2 Applying the PBE Policy Approach

<p>Will the IPSASB consider these issues in an acceptable timeframe?</p> <p>The IPSASB will consider these amendments for inclusion in the improvements to IPSAS project. An exposure draft (ED) for the improvements project is currently scheduled for 2021.²</p>
<p>Are the amendments minor?</p> <p>The amendments are minor. The IASB’s annual improvements are limited to changes that either clarify the wording in an IFRS Standard or correct relatively minor unintended consequences, oversights or conflicts between requirements in the standards.</p>
<p>Costs and benefits of getting ahead of the IPSASB</p> <p><u>Costs</u></p> <p>There is a risk that the IPSASB could decide not to issue the amendments which would result in a permanent difference between IPSAS and PBE Standards.</p> <p>Waiting for the IPSASB would not affect the resources required to develop and issue a domestic standard.</p> <p><u>Who would benefit?</u></p> <p>Tier 1 and Tier 2 PBEs would benefit from clarifications made to the PBE Standards.</p>
<p>RDR</p> <p>There are no new disclosures and therefore no RDR concessions are proposed.</p>

Next steps

6. Based on the analysis in Table 2 above, staff are of the view that it is appropriate to wait for the IPSASB to issue the equivalent amendments in an ED as part of the improvements to IPSAS project.
7. The NZASB would then consider these amendments as part of the Omnibus Amendments to PBE Standards project.

² Program and Technical Directors Report, IPSASB Agenda item 3, June 4 2020.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Jamie Cattell

Subject: *Property, Plant and Equipment—Proceeds before Intended Use*

Recommendations¹

1. We recommend that the Board:
 - (a) APPROVES for issue *Property, Plant and Equipment—Proceeds before Intended Use* which amends NZ IAS 16 *Property, Plant and Equipment*; and
 - (b) APPROVES the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board requesting approval to issue the Standard.

Background

2. Please refer to the signing memorandum (agenda item 9.3 under the heading Due process) for details about the background to the amendments.

Due process

3. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2017/4 *Property, Plant and Equipment—Proceeds before Intended Use* and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB meeting in October 2019.²
4. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and in our view, meets the requirements of section 22 of the Financial Reporting Act 2013.
5. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the amending standard is likely to require the disclosure of personal information. In our view the amending standard does not include requirements that would result in the disclosure of personal information, and therefore no consultation with the Privacy Commissioner is required.

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² A summary of the IASB's October 2019 meeting is available at [IASB Update October 2019](#)

RDR concessions and consistency with Australian Accounting Standards

6. The amending standard establishes a new disclosure requirement. We do not propose an RDR concessions in respect of this new disclosure because it was added in response to feedback received by the IASB.
7. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard in the near future. AASB staff are not proposing to add this new disclosure to the Australian simplified disclosure standard.³ Consequently, the Tier 2 for-profit reporting requirements will not be harmonised with those in Australia. However, the Tier 1 for-profit reporting requirements will remain harmonised.

Draft amending standard and signing memorandum

8. Attached as agenda item 9.2 is a copy of *Property, Plant and Equipment—Proceeds before Intended Use*. A paragraph has been added to limit the application of the amending standard to Tier 1 and Tier 2 for-profit entities only.
9. Attached as agenda item 9.3 is a draft certificate signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

Recommendations

Attachments

- Agenda item 9.2: Draft *Property, Plant and Equipment—Proceeds before Intended Use*
- Agenda item 9.3: Draft signing memorandum
- Agenda item 9.4 PBE Policy Approach memorandum

³ AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*



NZ ACCOUNTING
STANDARDS
BOARD

Property, Plant and Equipment—Proceeds before Intended Use

Issued June 2020

This Standard was issued on 25 June 2020 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(2) of the Financial Reporting Act 2013 takes effect on 23 July 2020.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date set out in Part D.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Tier 1 and Tier 2 For-profit Accounting Standard is based on *Property, Plant and Equipment—Proceeds before Intended Use*, issued by the International Accounting Standards Board. This Standard amends NZ IAS 16 to prohibit a reporting entity from deducting from the cost of property, plant and equipment amounts received from selling items produced while the entity is preparing the asset for its intended use. Instead, an entity will recognise such sales proceeds and related costs in profit or loss.

PROPERTY, PLANT AND EQUIPMENT—PROCEEDS BEFORE INTENDED USE

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PROPERTY, PLANT AND EQUIPMENT—PROCEEDS BEFORE INTENDED USE

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<p>The following is available within New Zealand on the XRB website as additional material</p>
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APPROVAL BY THE IASB OF *PROPERTY, PLANT AND EQUIPMENT—PROCEEDS BEFORE INTENDED USE* ISSUED IN MAY 2020

AMENDMENT TO THE IASB BASIS FOR CONCLUSIONS ON IAS 16 *PROPERTY, PLANT AND EQUIPMENT*

Part A – Introduction

This standard sets out an amendment to NZ IAS 16 that prohibits reporting entities from deducting from the cost of property, plant and equipment amounts received from selling items produced while the entity is preparing the asset for its intended use. Instead, an entity will recognise such sales proceeds and related costs in profit or loss.

Part B – Scope

This Standard applies to Tier 1 and Tier 2 for-profit entities.

Part C – Amendments to NZ IAS 16 *Property, Plant and Equipment*

Paragraphs 17 and 74 are amended; paragraphs 20A, 74A, 80D and 81N are added. The requirements formerly in paragraph 74(d) have not been amended but have been moved to paragraph 74A(a). Deleted text is struck through and new text is underlined.

Measurement at recognition

...

Elements of cost

...

17 Examples of directly attributable costs are:

...

- (e) costs of testing whether the asset is functioning properly (ie assessing whether the technical and physical performance of the asset is such that it is capable of being used in the production or supply of goods or services, for rental to others, or for administrative purposes); ~~after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment)~~; and

...

...

20A Items may be produced while bringing an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management (such as samples produced when testing whether the asset is functioning properly). An entity recognises the proceeds from selling any such items, and the cost of those items, in profit or loss in accordance with applicable Standards. The entity measures the cost of those items applying the measurement requirements of NZ IAS 2.

...

PROPERTY, PLANT AND EQUIPMENT—PROCEEDS BEFORE INTENDED USE

Disclosure

- ...
- 74 The financial statements shall also disclose:
- ...
- (b) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction; and
 - (c) the amount of contractual commitments for the acquisition of property, plant and equipment; and
 - (d) ~~if it is not disclosed separately in the statement of comprehensive income, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.~~
- 74A** If not presented separately in the statement of comprehensive income, the financial statements shall also disclose:
- *(a) the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss; and
 - (b) the amounts of proceeds and cost included in profit or loss in accordance with paragraph 20A that relate to items produced that are not an output of the entity's ordinary activities, and which line item(s) in the statement of comprehensive income include(s) such proceeds and cost.

Transitional provisions

- ...
- 80D Property, Plant and Equipment—Proceeds before Intended Use, issued in June 2020, amended paragraphs 17 and 74 and added paragraphs 20A and 74A. An entity shall apply those amendments retrospectively, but only to items of property, plant and equipment that are brought to the location and condition necessary for them to be capable of operating in the manner intended by management on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendments. The entity shall recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of that earliest period presented.

Effective date

- ...
- 81N Property, Plant and Equipment—Proceeds before Intended Use, issued in June 2020, amended paragraphs 17 and 74, and added paragraphs 20A, 74A and 80D. An entity shall apply those amendments for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Part D – Effective Date

This Standard shall be applied for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 17 June 2020

To: Michele Embling, Chair External Reporting Board

From: Kimberley Crook, Chair NZASB

Subject: *Property, Plant and Equipment—Proceeds before Intended Use*

Introduction¹

1. In accordance with the protocols established by the XRB Board, NZASB seeks your approval to issue *Property, Plant and Equipment: Proceeds before Intended Use* which amends NZ IAS 16 *Property, Plant and Equipment*
2. The amendments prohibit an entity from deducting from the cost of property, plant and equipment amounts received from selling items produced while the entity is preparing the asset for its intended use. Instead, an entity will recognise such sales proceeds and related costs in profit or loss.
3. The amendments also clarify that the meaning of ‘testing’ in the context of the standard involves assessing the technical and physical performance of an asset and not its financial performance.

Due process

4. The IASB issued Exposure Draft ED/2017/4 *Property, Plant and Equipment—Proceeds before Intended Use* (ED/2017/4) in June 2017.
5. The NZASB issued the ED for comment in New Zealand around the same time. Comments were due to the NZASB on 25 August 2017 and to the IASB on 19 October 2017. The NZASB did not comment on ED/2017/4, and it also did not receive any comments from New Zealand constituents.
6. The IASB received 72 comment letters from its world-wide constituents. None were received from New Zealand constituents.
7. Some respondents supported the proposed amendments, submitting that reporting the sale proceeds as revenue in profit or loss would improve financial reporting by removing diversity in reporting practice.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

8. However, some respondents questioned whether the proposed amendments would provide relevant information. Among the concerns expressed were that:
 - (a) the amendments may result in the recognition of income and costs that are not part of an entity's ordinary activities;
 - (b) the recognition of this revenue and expenditure may not be reflective of the asset's performance after it is available for use; and
 - (c) the amendments could introduce additional volatility in profit or loss.
9. These respondents suggested the IASB could alternatively consider additional disclosure requirements.
10. Many respondents either disagreed with, or expressed concerns about the Basis for Conclusions on the proposed amendments. The main concerns raised were:
 - (a) that it is practically difficult to identify costs that relate to items produced and sold before an item of PPE is available for use; and
 - (b) the process of identifying these costs could be highly judgmental and inconsistent in the absence of any guidance on cost allocation.
11. Conversely, some respondents agreed with the IASB's preliminary observation that the proposed amendments would not result in a significant level of judgement beyond that already required in applying IFRS standards.
12. Responding to constituent feedback, the IASB finalised the proposals in the ED, with the following changes.
 - (a) An entity is required to identify and measure production costs for items produced by an asset before it is available for use by applying the measurement requirements in paragraphs 9–33 of IAS 2 *Inventories*.
 - (b) For sales of items that are not part of an entity's ordinary activities, where IFRS 15 *Revenue from Contracts with Customers* and IAS 2 are not applied, require an entity to:
 - (i) disclose separately those sale proceeds and related production costs: and
 - (ii) specify the line items in the statement of profit or loss and other comprehensive income in which they are included.
13. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2017/4 and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB meeting in October 2019.²
14. The IASB issued *Property, Plant and Equipment—Proceeds before Intended Use* in May 2020.
15. The NZASB has approved *Property, Plant and Equipment—Proceeds before Intended Use*. The due process followed by the NZASB complied with the due process requirements established

² A summary of the IASB's October 2019 meeting is available at [IASB Update October 2019](#)

by the XRB Board and, in the NZASB's view, meets the requirements of section 22 of the Financial Reporting Act 2013.

16. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the amending standard is likely to require the disclosure of personal information. In the NZASB's view the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Consistency with XRB Financial Reporting Strategy

17. The amending standard is a standard in its own right. *Property, Plant and Equipment—Proceeds before Intended Use* is identical to *Property, Plant and Equipment—Proceeds before Intended Use* issued by the IASB, except for the New Zealand specific introduction and a scope paragraph limiting the application of the standard to Tier 1 and Tier 2 for-profit entities.
18. The amending standard establishes a new disclosure requirement. This disclosure was added in response to feedback received by the IASB on ED/2017/4 that it would provide useful information for users of the financial statements. We do not propose an RDR concession in respect of this disclosure at this time. IASB staff are developing proposals for disclosures by subsidiaries that are SMEs and these proposals may be appropriate for Tier 2 for-profit entities applying NZ IFRS. A discussion paper or exposure draft is planned for early 2021 so we propose to wait and see what, if anything, IASB staff propose in respect of this new disclosure.
19. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard in the near future. AASB staff are not proposing to add this new disclosure to the Australian simplified disclosure standard.³ Consequently, the Tier 2 for-profit reporting requirements will not be harmonised with those in Australia. However, the Tier 1 for-profit reporting requirements will remain harmonised.
20. The issue of this amending standard is consistent with all three elements of the Financial Reporting Strategy: it adopts the international standard, retains a harmonised position with Australia as appropriate and is consistent with the Accounting Standards Framework.

Effective date

21. The amending standard will be applicable for annual reporting periods beginning on or after 1 January 2022 with early application permitted.

Other matters

22. There are no other matters relating to the issue of this amending standard that the NZASB considers to be pertinent or that should be drawn to your attention.

³ AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*

Recommendation

23. The NZASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

Property, Plant and Equipment—Proceeds before Intended Use

Certificate of determination

Kimberley Crook
Chair NZASB



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 5 June 2020

To: NZASB Members

From: Jamie Cattell

Subject: **PBE Policy Approach: *Property, Plant and Equipment—Proceeds before Intended Use***

Recommendations¹

1. The Board is asked to:
 - (a) CONSIDER the application of the [Policy Approach to the Development of PBE Standards](#) (the PBE Policy Approach) to *Property, Plant and Equipment—Proceeds before Intended Use*; and
 - (b) AGREE to wait for the IPSASB to propose adopting the amendments into IPSAS via its improvements to IPSAS project in 2021.

Background

2. The IASB issued *Property, Plant and Equipment—Proceeds before Intended Use* to make minor amendments to IAS 16 *Property, Plant and Equipment*. Refer to the signing memorandum at agenda item 9.3 for further detail.
3. The next step is to consider whether the amendments should be incorporated in PBE Standards, and if so, when. In this memo we have applied the relevant parts of the PBE Policy Approach to *Property, Plant and Equipment—Proceeds before Intended Use*.

PBE Policy Approach

4. The relevant triggers for considering whether to amend PBE Standards are set out in paragraph 4.2 of the PBE Policy Approach. In this case the IASB has issued amendments to IAS 16 *Property, Plant and Equipment* which the IPSASB has used as the basis for IPSAS 17 *Property, Plant and Equipment*.
5. Paragraphs 28–31 of the PBE Policy Approach set out the matters to be considered. Paragraphs 28–29 highlight the need to consider whether the IPSASB will address the change in an acceptable timeframe and the need to balance this against the costs and benefits of getting ahead of the IPSASB. Paragraph 30 establishes a rebuttable presumption that the

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NZASB will not get ahead of the IPSASB if the amendments are minor. Table 2 sets out our thoughts on these matters.

Table 2 Applying the PBE Policy Approach

<p>Will the IPSASB consider these issues in an acceptable timeframe?</p> <p>The IPSASB will consider these amendments for inclusion in the improvements to IPSAS project in 2021. An exposure draft (ED) for the improvements project is expected in 2021.²</p>
<p>Are the amendments minor?</p> <p>The amendments are minor. They change the accounting requirements that apply to sale of goods produced by an item of PPE while it is being prepared for its intended use. While it was noted by the IASB that this would have a potentially larger impact in the extractive industry, we do not consider this reasoning applies to the PBE sector in New Zealand.</p>
<p>Costs and benefits of getting ahead of the IPSASB</p> <p><u>Costs</u></p> <p>There is a risk that the IPSASB could decide not to issue the amendments which would result in a permanent difference between IPSAS and PBE Standards if the Board subsequently decided to incorporate the amendments in PBE Standards.</p> <p>Waiting for the IPSASB would not affect the resources required to develop and issue a domestic standard.</p> <p><u>Who would benefit?</u></p> <p>Tier 1 and Tier 2 PBEs would benefit both from the improved consistency in practice and the additional clarification made to the meaning of ‘testing’ provided by the amendments. However, it is noted that the extent of these benefits would likely be significantly more limited due to the difference in activities between the PBE and for-profit sectors.</p>

Next steps

6. Based on the analysis in Table 2 above, staff are of the view that it is appropriate to wait for the IPSASB to issue the equivalent amendments in an ED as part of the improvements to IPSAS project in 2021.
7. The Board would then consider these amendments as part of the Omnibus Amendments to PBE Standards project.

² Program and Technical Directors Report, IPSASB agenda item 3, 4 June 2020