

Board Meeting Agenda

In-person Meeting — Wednesday, 23 June 2021

External Reporting Board, Level 7, 50 Manners Street, Wellington

Est Time	Item	Topic	Objective		Page
NON-PUBLIC SESSION					
PUBLIC SESSION					
10.30 am	4	Post-implementation Review of Tier 3 and Tier 4 Standards	(JC/NH)		
	4.1	Cover memo	Consider	Paper	
	4.2	Issues paper	Consider	Paper	
11.30 am	5	IASB Agenda Consultation	(TC/JP)		
	5.1	Cover memo	Consider	Paper	
	5.2	Draft comment letter	Consider	Paper	
	5.3	<i>RFI Third Agenda Consultation</i>	Note	Link to XRB website	
	5.4	Going concern issues	Consider	Paper	
	5.5	<i>Going concern – a focus on disclosure</i>	Consider	Paper	
12.00 pm	6	Business Combinations under Common Control	(GS)		
	6.1	Cover memo	Consider	Paper	
	6.2	Draft comment letter	Consider	Paper	
	6.3	IASB DP/2020/2 <i>Business Combinations under Common Control</i>	Consider	Link to XRB website	
6.4	Snapshot IASB DP/2020/2	Consider	Link to XRB website		
12.30 pm	Lunch break				
NON-PUBLIC SESSION					
PUBLIC SESSION					
1.20 pm	8	Public Sector Insurance	(AT/VSF)		
	8.1	Cover memo	Consider	Paper	
	8.2	Issues paper – Discounting and inflating	Consider	Paper	

Est Time	Item	Topic	Objective		Page
	8.3	Issues paper – Premium allocation approach	Consider	Paper	
2.35 pm	Mini break				
2.45 pm	9	IPSASB Measurement Projects	(JS/GS/TC)		
	9.1	Cover memo	Consider	Paper	
	9.2	Draft comment letter	Consider	Paper	
	9.3	IPSASB EDs 76–79	Consider	Link to XRB website	
3.45 pm	Afternoon tea break				
4.00 pm	10	<i>Deferred Tax related to Assets and Liabilities arising from a Single Transaction</i>	(NH)		
	10.1	Cover memo	Consider	Paper	
	10.2	Draft <i>Deferred Tax related to Assets and Liabilities arising from a Single Transaction</i>	Approve	Paper	
	10.3	Draft signing memo	Approve	Paper	
	10.4	Application of the PBE Policy Approach	Consider	Paper	
	10.5	PBE Policy Approach	Note	Link to XRB website	
NON-PUBLIC SESSION					
4.50 pm	<i>Finish</i>				

Next NZASB meeting: Thursday 12 August 2021 (virtual)



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 11 June 2021

To: NZASB Members

From: Jamie Cattell and Nicola Hankinson

Subject: **Post-implementation Review of Tier 3 and Tier 4 Standards Cover Memo**

Purpose and introduction

1. The purpose of this memo is to:
 - (a) Provide detailed analysis on each of the topics we received feedback on as part of the Post Implementation Review; and
 - (b) Request Board feedback on the proposed actions to address each topic.

Recommendations

2. The Board is asked to:
 - (a) NOTE the detailed analysis of feedback received (see agenda item 4.2); and
 - (b) PROVIDE FEEDBACK on the proposed actions to address each topic (also included in agenda item 4.2).

Background

3. The NZASB issued the Request for Information *Simple Format Reporting Standards Post Implementation Review* (RFI) for public consultation in September 2020 to seek feedback from constituents on the Simple Format Reporting Standards (Tier 3 and Tier 4).
4. Staff presented high-level analysis to the Board in May 2021 with the following themes being identified:
 - (a) The Simple Format Reporting Standards are working well overall;
 - (b) There is general support for reducing the length and complexity of the Tier 4 standard, guidance, and optional reporting templates;
 - (c) Some constituents consider the XRB should take on a more educative role in relation to promoting the use and consistent application of the Simple Format Reporting Standards; and
 - (d) There is some concern about how well the Simple Format Reporting Standards are currently working for Māori entities.

5. In addition, the following topics were identified for further investigation:
 - (a) Service performance reporting
 - (b) Asset valuation in the Tier 3 standard
 - (c) The minimum categories for presenting income and expenditure
 - (d) Revenue recognition in the Tier 3 Standard
 - (e) Accumulated funds and reserve reporting in the Tier 3 standard
 - (f) Understandability of the requirements for the statement of cash flows in the Tier 3 standard
 - (g) Additional guidance on the requirements related opting up to the PBE standards for specific transactions or balances

Detailed analysis of submissions

6. Attached as agenda item 4.2 is the detailed analysis of written feedback received.

Next steps

7. Staff will begin developing the feedback statement subject to the Board's views on the proposed messages in agenda item 4.2. We expect a draft of this statement will be presented at the Board's August meeting.
8. Staff will begin developing possible responses to the matters identified in agenda item 4.2 as requiring further consideration by the NZASB. We expect these options will be presented for the Board's consideration at the August and October meeting.

Attachments

Agenda item 4.2: Detailed analysis of submissions



**NZ ACCOUNTING
STANDARDS
BOARD**

Memorandum

Date: 11 June 2021

To: NZASB Members

From: Jamie Cattell and Nicola Hankinson

Subject: **Post-implementation Review Tier 3 and 4 Standards: Detailed analysis of feedback and proposed next steps**

Purpose and introduction¹

1. This paper provides a detailed analysis of the feedback provided as part of the Post-implementation Review and staff views regarding recommended next steps, including development of the feedback statement.
2. The purpose of this paper is to:
 - (a) Give the Board an opportunity to NOTE the detailed analysis of the feedback received on the *Tier 3 and 4 Review of Simple Format Reporting Standards Post Implementation Review (PIR)*²;
 - (b) Seek the Board's AGREEMENT with staff recommendations for next steps for each key matter identified;
 - (c) Seek the Board's AGREEMENT on the proposed approach to developing a feedback statement and high-level content for this statement.

Structure of this memo

This memo is structured as follows:

- (a) Overview of respondents
- (b) Analysis of feedback received and staff recommendations for next steps
- (c) Proposed approach to developing the feedback statement and key messages .
- (d) Appendix A: Detailed analysis key issues identified and staff recommendations on next steps

Additional background information

- (e) Appendix B: Detailed analysis of feedback received – main themes
- (f) Appendix C: Detailed analysis of specific feedback – other issues

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 Following on from the analysis of feedback provided at the May Board meeting

Overview of respondents

3. As noted in the May Board meeting update, we received 36 individual submissions (10 written, 20 face-to-face interviews and 6 via our online feedback form) and a further 65 submissions via our online survey.

Analysis of feedback received and staff recommendations for next steps

4. In the May meeting update feedback received was divided into:
 - (a) feedback representing general views on the Tier 3 and Tier 4 standards; and
 - (b) feedback on specific topics within the Tier 3 and Tier 4 standards.
5. A detailed analysis of general views on the Tier 3 and Tier 4 standards was presented from which the following key messages emerged:
 - (a) the Simple Format Reporting Standards are working well overall;
 - (b) there is general support for reducing the length and complexity of the Tier 4 standard;
 - (c) some constituents consider the XRB should take on a more educative role in relation to promoting the use and consistent application of the Simple Format Reporting Standards; and
 - (d) there is some concern about how well the Simple Format Reporting Standards are currently working for Māori entities.
6. A high-level overview of the feedback received on specific topics was presented under the following themes:
 - (a) Service performance reporting
 - (b) Asset valuation in the Tier 3 standard
 - (c) The minimum categories for presenting income and expenditure
 - (d) Revenue recognition in the Tier 3 Standard
 - (e) Accumulated funds and reserve reporting in the Tier 3 standard
 - (f) Understandability of the requirements for the statement of cash flows in the Tier 3 standard
 - (g) Additional guidance on the requirements related opting up to the PBE standards for specific transactions or balances

7. For each key message and specific topic above we sought to identify the underlying issue (i.e. the root cause) and developed a staff view on whether the XRB response requires:

No further action recommended
Conducting additional educational and awareness raising activities in conjunction with Charities Services as required (including development of FAQ like guidance material)
Refining accompanying guidance material (i.e. to consider possible amendments to the Tier 3 or 4 guidance, templates or related documents – no standard-setting activity) ³
Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards) ⁴

8. As part of our analysis some of the matters above have been expanded to capture other issues raised in the detailed feedback which are closely related to the themes previously discussed. All other matters not as frequently mentioned have been grouped together under an “other issues” category.

Summary of recommended responses to feedback received

9. Table 1 below summarises the recommended responses to the feedback received.

Table 1	
Proposed Response	Issues and next steps
Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)	<p>Several issues raised as part of the PIR require the consideration of options to amend the Tier 3 and 4 standards. These include:</p> <ul style="list-style-type: none"> • simplifying the language and requirements within the standards, • considering how to incorporate te ao Māori world view, including the use of Te Reo headings into the key statements, • considering the requirements in relation to reserves, • modifying the minimum categories, • aligning the definition of Cash with the definition of Cash and Cash Equivalents in the Tier 1 and 2 PBE standards, and

³ These actions will not require public consultation on proposed amendments, but any changes will be developed in consultation with the Board.

⁴ These are matters that relate to possible issues at an accounting standards level. Further action would include research and analysis of possible options before forming a view as to whether the matter should be addressed through amendments the existing standards.

	<ul style="list-style-type: none"> • aligning the statement of service performance requirements to FRS 48 • exploring whether changes should be made in relation to revenue recognition; • requirements in relation to asset revaluation; • clarifying other Tier 2 opt-up requirements for Tier 3. <p>Staff request preliminary Board feedback on each of these issues (as discussed further in Table 2 in Appendix A).</p> <p>We propose developing an Exposure Draft to seek stakeholder input on proposed amendments to address each of these issues.</p>
<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p>	<p>Staff propose developing a range of FAQs and illustrative examples to address issues arising as a lack of understanding and application issues arising in practice, rather than unclear requirements in the Standards.</p> <p>These issues include:</p> <ul style="list-style-type: none"> • reminding preparers of what is meant by the term ‘significant’; • explaining the flexibility permitted within the Tier 3 standard relating to cash flow statement classifications; and • and providing additional guidance and illustrative examples in relation to performance measures and preparation of the statement of service performance. <p>In addition, staff propose approaching CA ANZ and Charities Services to include a specific category for kaupapa Māori NFP entities within the annual CA ANZ Charity Reporting Awards to promote and encourage best practice reporting for kaupapa Māori NFP entities.</p>
<p>Refining accompanying guidance material (i.e. to consider possible amendments to the Tier 3 or 4 guidance, templates or related</p>	<p>In general, we will review all the existing guidance material and reporting templates to consider refinements and the need for additional material based on feedback received.</p>

documents – no standard-setting activity)	<p>One action that has already taken to address issues raised in relation to the complexity and understandability of the Tier 4 standard is to issue a simpler two-page template for Tier 4 NFP entities.</p> <p>The existing guidance material and reporting templates will also need to be updated for any changes to the standards.</p>
No further action recommended	<p>Staff propose not taking any specific action in relation to calls for:</p> <ul style="list-style-type: none"> • additional guidance or requirements in relation to biological and intangible assets in the Tier 3 standard; • allowing depreciation to be split on the face of the statement of financial performance and/or notes; • adding additional items to the statement of financial performance outside of net surplus/deficit; • allowing alternative layouts for the statement of financial position; • changing the definition of current and non-current in the Tier 3 standard; and • removing the requirement to sign performance reports. <p>We consider that these are not widespread issues and that including additional guidance would result in unnecessarily increasing the length and complexity of the Tier 3 standard.</p>

Proposed approach to developing the feedback statement and high-level content

10. Given the broad range of stakeholders who provided feedback as part of the PIR, we consider it is important that the feedback statement is clear and approachable, prioritising the use of plain English. The feedback statement will include a summary of the key issues identified and the proposed next steps (primarily based on Table 1 above).
11. We also propose supplementing the formal feedback statement with messaging through other channels and in other formats emphasising the key messages (for example brief videos which may be shared on social media).
12. Our view is that utilising other channels will make it easier to communicate the outcomes of the PIR through our key stakeholders including Charities Services and Chartered Accountants ANZ. It may also be appropriate to ask Charities Services and/or CA ANZ if we would be able to

Speak or to play this video message at the next annual Charity Reporting Awards and other similar events.

13. The key messages we intend to include in this feedback statement are:
- (a) Thank you for your feedback – we really appreciate it;
 - (b) We have taken your feedback on board and have made changes to make it easier for you to prepare Performance Reports using the standards;
 - (c) We really value the contribution of kaupapa Māori entities and welcome innovation in the use of Te Reo Māori in Performance Reports and Statements of Service Performance;
 - (d) We have started preparing more FAQs to help unpick some of the more technical parts of the standards – you can find these on our website
 - (e) We are committed to making it easier and are preparing an Exposure Draft (as part of our due process) before we can finalise changes to the standards themselves.

Questions for the Board

- (a) Does the Board agree with the staff recommendations for the proposed response for each key issue identified in [Table 1](#)?
- (b) For issues identified for further consideration by the NZASB, does the Board agree with the staff recommendations for next steps in [Table 2](#) (Appendix B)?
- (c) Does the Board have any other feedback on the proposed approach to developing the feedback statement?

Appendix A: Detailed analysis key issues identified and staff recommendations on next steps

Table 2 below summarises our analysis of the key issues identified and staff recommendations on next steps.

Table 2: Analysis of key issues identified and staff recommendations on next steps

General themes	Staff recommendation on next steps
<p>General support for reducing the length and complexity of the Tier 4 standard, guidance, and template (in relation to language used)</p> <p>Respondents noted the increasing rate of non-compliance among Tier 4 not-for-profit entities and considered that the standard was difficult to apply. Their reasons for holding this view included:</p> <ul style="list-style-type: none"> (a) The Tier 4 standard and associated guidance is too long and complex for most Tier 4 not-for-profit entities. (b) The language used in the Tier 4 standard is too technical to be understood by non-accountants. (c) It is still common for not-for-profit entities to view preparing their performance reports as simply a compliance exercise, rather than as an important part of managing their organisation and discharging accountability. One respondent suggested that this could be improved by making it easier for entities to follow through the entire thought process starting with XRB A1. (d) Small not-for-profit entities find it difficult to attract and retain volunteers or staff who understand the reporting requirements (and 	<p>Further consideration by the NZASB in relation to the language and requirements of the standards.</p> <p>We agree there is scope for reducing the length and complexity of the Tier 4 standard and propose developing an Exposure Draft which includes the proposals outlined in Table 3 below.</p> <p>Refining accompanying guidance material (i.e. to consider possible amendments to the Tier 3 or 4 guidance, templates or related documents – no standard-setting activity)</p> <p>As a short-short term action to partially address issues with the template staff have released a two-page simplified reporting template for Tier 4 entities.⁵</p>

⁵ The template was published on the XRB website on 24 May 2021.

<p>are often under-resourced). There is a general lack of financial capability in the not-for-profit sector.</p> <p>These respondents generally considered that our key focus should be to reduce the length and complexity of the Tier 4 standard and to simplify the language used. They considered this could be achieved without compromising transparency and accountability provided that the standards are focused on the key information required.</p> <p>However, a few respondents considered that the current Tier 4 standard is appropriate given the accountabilities these entities owe to the public. These respondents also commented they could not see much scope for simplifying the requirements of the standard beyond what they are currently.</p>	
<p>The XRB should take on a more educative role</p> <p>Respondents considered that part of the non-compliance was due to an ongoing lack of awareness of the standards in the sector. To address this concern and the previous concerns raised, some respondents considered that the XRB should take on a more educative role in relation to the Simple Format Reporting Standards.</p> <p>These respondents specifically identified the work done in conjunction with Charities Services when the Simple Format Reporting Standards were first introduced. They indicated that while they would not necessarily expect any ongoing activity to be as significant, they consider similar activities would have a significant positive effect on awareness and understanding.</p>	<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>In general, we agree that it is appropriate for us to take more of an educative role in relation to promotion and understanding of the NFP standards.</p>
<p>Applicability of the standards for Māori entities</p> <p>Respondents advised that the standards do not include any Te Reo or encourage its use in preparing performance reports. One respondent noted that many entities he deals with would like to include more Te Reo in their</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p>

<p>performance reports but are unsure whether they are allowed to under the standards.</p> <p>Respondents also commented that the standards and associated guidance do not provide examples relevant to Māori entities and the terminology and associated concepts in the standards are often not appropriate for entities with a kaupapa Māori focus.</p> <p>Specific examples cited included Taonga and Koha which may conflict with the concepts of significance and donations in the standards. Difficulties with applying the concept of related parties in a marae context and determining the appropriate accounting treatment of Māori land were also raised.</p> <p>Charities Services, CA ANZ, and CPA Australia recommended that we develop specific guidance and examples to address these issues and provide a template which includes Te Reo.</p>	<p>Including Te Reo headings for each section (i.e. Entity information, financial statements, SSP and Notes) in the Tier 3 and 4 standards and possibly also the templates. We propose using the headings from the XRB Annual Report as a starting point and consult with the CA ANZ Māori Advisory Group regarding the appropriate terminology for each of these.</p> <p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>We also propose working with Charities Services and the CA ANZ Māori Advisory Group to develop a dedicated Information Sheet targeted to entities with a Kaupapa Māori focus. This could include examples on how to account for Taonga and Koha. We are aware that Charities Services has already drafted a guidance document on accounting for Koha and we propose encouraging them to publish this.</p> <p>We also propose actively promoting the te ao Māori financial reporting page and associated guidance on the Charities Services website. This page includes an illustrative Tier 4 template for a marae and two examples of performance reports that have been prepared for Kaupapa Māori entities.</p> <p>Another suggestion is to sponsor a dedicated category in the CA ANZ Reporting Awards to recognise entities that are leading the way in terms of incorporating te ao Māori concepts and language in their financial statements or performance reports. Doing so would raise positive awareness that these standards can be applied to Kaupapa Māori entities and help share best practice regarding how this can be done.</p>
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Summary of specific themes raised	Staff recommendation on next steps
Service Performance Reporting	
<p>Difficulty understanding the objectives and requirements related to the statement of service performance.</p> <p>Many NFP entities commented that they find the objectives and requirements of the Statement of Service Performance (the SSP) difficult to understand, in particular the requirement to select and measure their ‘outcomes’ and ‘outputs’. There is a sense that the requirements of the Tier 3 and 4 Standards in relation to the SSP are too prescriptive.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>It is likely that a standard-setting response is required in relation to service performance reporting, with proposals for simplifying the requirements and terminology used (in particular ‘outputs’ and ‘outcomes’) and aligning more with the principles-based requirements of FRS 48 <i>Service Performance Reporting</i> for Tier 1 and 2 NFP entities.</p>
<p>Additional guidance on selecting appropriate performance measures.</p> <p>Respondents also advised that NFP entities have difficulty selecting appropriate performance measures and guidance would be useful in determining which performance measures are most meaningful, including example performance measures for different types of entities, illustrative example SSPs and outlining the information that may need to be collected to report against these performance measures.</p> <p>Staff have already prepared a guidance paper on service performance reporting, EG A10, which includes some of the information requested by respondents.</p>	<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>A draft FAQ has been prepared to promote the service performance reporting guidance paper, and to showcase some of the recipients of the CA ANZ Charity Reporting Awards, which can be used as illustrative example SSPs.</p> <p>Staff intend to review EG A10 to ensure that it is fit for purpose for Tier 3 and 4 NFPs and determine whether a standalone (simplified) guidance document is required</p>

Summary of specific themes raised	Staff recommendation on next steps
Assets	
<p>Asset valuation</p> <p>Many respondents requested an increased ability to revalue their assets when applying the Tier 3 Standard. The underlying issue appears to be difficulty in applying the Tier 2 ‘opt-up’ option for certain transactions.</p> <p>Refer opt up below for further discussion on this.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>We see two potential options for addressing this concern, with both requiring a standard-setting approach.</p> <ul style="list-style-type: none"> (a) Provide additional guidance on how to apply the opt-up option (i.e. clarify the measurement, disclosure and presentation requirements when applying Tier 2 reporting requirements); or (b) Introduce a new market value option (and associated simplified reporting requirements) for measuring certain types of assets into the Tier 3 Standard <p>Staff suggest developing proposed amendments to Tier 3 based on option (b), but will bring back further analysis to the Board at a future meeting.</p>
<p>The definition of Cash in the Tier 3 standard is inconsistent with the definition of Cash and Cash Equivalents in the PBE standards.</p> <p>The Tier 3 standard does not include short-term deposits, which are included in the Cash and Cash Equivalents definition in PBE IPSAS 2.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>We consider it would be sensible to align the definition of Cash in the Tier 3 standard with the definition of Cash and Cash Equivalents in the Tier 1 and 2 standards. This would need to be done as part of the standard-setting response (i.e. including this proposal within the Exposure Draft).</p>

Summary of specific themes raised	Staff recommendation on next steps
	<p>However, we are conscious that we need to keep the Tier 3 standard simple and the concept of “cash and cash equivalents” may not be useful for non-accountants.</p>
<p>Biological assets</p> <p>One respondent noted that no guidance is provided in the Tier 3 standard on biological assets.</p>	<p>No further action recommended</p> <p>This issue may be partly addressed by the inclusion of opting up requirements within the Tier 3 standard.</p> <p>This concern is not widespread based on feedback received. We consider that including additional guidance on accounting for biological assets within the Tier 3 standard would result in additional complexity. For the relatively small number of NFPs with biological assets, they can refer to Tier 2 requirements for guidance. We could highlight this through the Tier 3 accompanying guidance material.</p>
<p>Intangible assets</p> <p>One respondent noted that no explicit guidance is provided in the Tier 3 standard on intangible assets.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>Although this was not a widespread issue raised through feedback, we can see how it would be useful for intangible assets acquired by a NFP to be recognised separately on the balance sheet. This will need to be done in a way that does not add additional complexity.</p> <p>The Tier 3 standard does refer to intangible assets but does provide specific guidance or disclosure requirements</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>Presentation of depreciation</p> <p>One respondent considered that there should be an option to show the split of depreciation by class in either the face of the statement of financial performance or in the notes.</p>	<p>No further action recommended</p> <p>The Tier 3 notes to property, plant and equipment already require this split.</p>
The minimum categories for presenting income and expenditure	
<p>Appropriateness and clarity of the minimum categories</p> <p>Many respondents considered that the specific categories required were inappropriate and do not do a good job of describing the activities of most entities. These respondents also considered that aggregation of some items has obscured important information. For example, some respondents considered that bequests, public donations, and government grants should be separated.</p> <p>Some raised issues with determining the appropriate category for particular items and considered that the guidance in the standard is too generic. They noted that this is leading to diversity in practice with entities categorising what are essentially the same transactions differently or simply putting anything they are unsure about into the “other” category. These respondents considered that this reduces the comparability and usefulness of the financial information provided by these entities.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>We consider that the current minimum categories may need to be refined to better reflect common terms used within the NFP sector to describe their key financial statement items and to reduce complexity.</p> <p>We will bring proposed changes to the minimum categories used in the Statement of Financial Performance and Statement of Financial Position to a future NZASB meeting.</p> <p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>Many respondents advised that the minimum categories had led to issues with their auditors. It appears that some auditors are reluctant to allow entities to remove or relabel the minimum categories despite this being permitted in the standards.</p>	<p>In terms of responding specifically to concerns around flexibility, we could work with CA ANZ to help us share messages targeted to Qualified Auditors. We could develop a FAQ and illustrative examples to demonstrate how flexibility can be applied, while still achieving the overall objective⁶ of improving the quality and consistency of the information disclosed in Performance Reports, and facilitating comparability between entities, and between years for each entity.</p>
<p>Disaggregation of the minimum categories</p> <p>Many considered that the standards are unclear about the degree to which disaggregation and relabelling of the minimum categories is permissible. They noted this is leading to diversity in practice with many entities essentially still presenting full lists of all expense lines based on their trial balance. They would like any intended limitations to be more clearly stated within the standards.</p>	
<p>Revenue</p>	
<p>Revenue recognition and disclosure requirements in the Tier 3 standard</p> <p>Many respondents would like revenue deferral to be more widely permitted</p> <p>Concern about the unintended consequences of the current ‘use or return’ requirement and the impact on funding arrangements.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>Standard-setting response likely required. Staff will consider the options and bring these back for Board consideration at a future meeting</p>

⁶ Paraphrased from para 1 of the Tier 3 standard

Summary of specific themes raised	Staff recommendation on next steps
<p>Illustrative examples for revenue in the Tier 3 standard</p> <p>Two respondents raised concerns with the illustrative examples given in the Tier 3 Standard.</p> <p>One respondent considered the examples in the Public Sector version of the standard were unclear.</p> <p>One respondent considered that an example of for sponsorship revenue was needed in the not-for-profit version of the Tier 3 Standard.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>This response will depend on the Board’s decision in relation to revenue recognition above. Any change to the revenue recognition requirements will require amendments to the accompanying illustrative examples.</p>
Cash Flow Statement	
<p>Understandability of the requirements for the statement of cash flows in the Tier 3 Standard</p> <p>Three respondents commented that the cash flow statement was difficult to prepare. The main issue expressed was the difficulty distinguishing between operating cash flows and investing and financing cash flows (which are permitted to be combined in the Tier 3 cash flow statement).</p> <p>The Tier 3 standard (paras A161 and A169) already includes guidance which permits judgement to be applied in determining the most appropriate classification:</p> <p><i>“If there is difficulty in determining the category that should be used for a particular transaction, the entity shall make its best estimate of the appropriate classification. This classification shall then be used consistently in future periods so that the information reported is comparable over time.”</i></p>	<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>We propose developing an FAQ which explains the difference between operating activities and investing and financing activities and includes a couple of examples that can be applied to service-orientated NFP entities. The FAQ would also highlight the existing flexibility regarding classification provided within the Tier 3 standard and the guidance on what should be included in these categories.</p> <p>We consider that this issue could be addressed through the provision of an FAQ to alert auditors, as well as preparers, of the flexibility afforded in terms of classification.</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>In addition, the Tier 3 guidance, EG A5, outlines what these three classifications are and what should be included in investing, financing and operating activities⁷.</p> <p>As such, we consider that the issue may be more related to users lack of familiarity with preparation of cash flow statements and lack of awareness of the existing flexibility within the standard and the classification guidance included in the guidance document (i.e. EG A5).</p> <p>One respondent also questioned the usefulness of the cash flow statement, in particular whether the statement was used by Charities Services. Charities Services have confirmed that they find the cash flow statement useful in assessing complaints made against registered charities and that they considered the statement was working well.</p> <p>Two respondents commented that the complexity of classification and preparation of the cash flow statement led to complications with the audit process.</p> <p>One respondent commented that the cash flow statement is a ‘dinosaur report that has no place in the 21st century’ and another commented that parishes don’t like cash flow statements.</p> <p>However, we consider these comments do not represent most Tier 3 entities and can be resolved through greater education.</p>	<p>To address concerns regarding the usefulness of the cash flow statement, we propose undertaking an educational campaign targeted at Tier 3 charities, in conjunction with Charities Services. Messaging in this campaign could include the importance of cash flow management and emphasising the ‘cash is king’ mantra – that unless entities have a good handle on where they are getting their cash from and where they are spending it, they may have difficulties in both an operational sense and in being able to discharge their accountability to funders and other stakeholders.</p> <p>We do not consider that it is appropriate at this time to remove the requirement for a cash flow statement from the Tier 3 Standard.</p>

⁷ Section 7 of EG A5 states: Investing activities are the acquisition and disposal of long-term assets and investments not included in the cash balance. For example, purchase of property, plant and equipment; or investments. Financing activities comprises receipts and payments relating to borrowing by the entity (the principal amount only); and any capital contributions to/from owners or members (if any). Operating activities are the activities of the entity that are not investing or financing activities. They include the normal operations of the entity, for example, providing goods or services.

Summary of specific themes raised	Staff recommendation on next steps
<p>Layout of the statement of cash flows.</p> <p>One respondent suggested that the Tier 3 cash flow statement requirements should be aligned to the Tier 4 Statement of Receipts and Payments. We consider this is a sensible suggestion that may assist with understandability of this statement.</p> <p>Another respondent suggested that a reconciliation between the cash flow statement and the Cash balance movements in the Statement of Financial Position should be provided. We consider that this may add additional complexity to the Tier 3 standard which would not provide useful information to the majority of users, but we could consider including this as optional information.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>We will develop proposal for Board consideration at a future meeting.</p>
Accumulated Funds	
<p>Narrative description about the nature and purpose of reserves.</p> <p>Respondents advised that additional guidance is needed on reserves, particularly in relation to restricted reserves.</p> <p>Other respondents suggested a reserves policy should be included as a disclosure requirement in the Tier 3 Standard, to provide greater transparency over entities' reasons for accumulating resources, the purposes for which this is done and any restrictions on those reserves.</p> <p>DIA are currently undertaking targeted consultation as part of the Charities Act Review and are asking respondents whether they consider additional requirements should be included in the accounting standards in relation to</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>We consider that requiring entities to disclose some form of information about the purpose for holding accumulating reserves would be useful.</p> <p>The development of additional disclosures will be informed by the feedback received by DIA in relation to this matter.</p>

Summary of specific themes raised	Staff recommendation on next steps
reserves (i.e. the amount of accumulated funds they hold and the reasons for those funds). Responses to this targeted consultation were required by 31 May 2021.	
<p>Simplification of terminology related to accumulated funds.</p> <p>One respondent considered there was not enough clarity about the difference between reserves for accounting purposes and “operating reserves”.</p> <p>One respondent commented that capital contributions is meaningless and creates confusion for NFPs. They recommended removing the requirement to distinguish capital contributions and suggested that any references to owners is removed from the standard.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>Staff propose developing proposed wording amendments to the Tier 3 Standards in response to these comments</p>
Opting Up	
<p>Additional guidance on the requirements related to opting up to the PBE standards for specific transactions or balances</p> <p>The Tier 3 Standard currently allows an entity to opt-up to a higher tier of reporting requirements for certain balances and transactions⁸ – e.g. valuing property or investment assets at current market value amounts.</p> <p>The opt-up option has been highlighted by respondents as causing issues in practice, as opting up to revalue assets often results in revaluation gains/losses which are required to be recognised in Other Comprehensive Income. The Tier 3 standard does not currently include Other Comprehensive</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>The staff view is that including a revaluation option should be included within the Tier 3 standard itself. If this is done, the Tier 3 template would then need to be updated to include disclosures relating to revaluation.</p> <p>In our view, inclusion of an option to revalue within the Tier 3 Standard would significantly reduce the need to opt up to Tier 2 standards for the majority of NFP entities.</p>

⁸ Paras 7-9 of the Tier 3 standard

Summary of specific themes raised	Staff recommendation on next steps
<p>Income within the Statement of Financial Performance and there is no guidance on how this should be done.</p> <p>At the time the Tier 3 and 4 standards were developed, the option to revalue assets was excluded on the basis that this may make the standards too complex⁹. Instead, the option to opt up to the Tier 2 standard was introduced. We acknowledge that many charities have held their assets for a long period of time and continuing to recognise these assets at cost may no longer fairly reflect the charity's resource base.</p>	<p>Additional analysis is required to reach a staff view on whether the opt up requirements could/should be removed entirely from the Tier 3 Standard and instead replaced by simple requirements within the Standard.</p> <p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>Staff propose preparing an FAQ and illustrative guidance to advise preparers and their auditors (if applicable) of how revaluation movements should be presented in Tier 3 Simple Format Reports.</p>
Other Issues	
<p>Accounting Policies</p> <p>Some respondents consider that more guidance on accounting policies is needed, including plain English examples of common accounting policies.</p>	<p>Refining accompanying guidance material (i.e. to consider possible amendments to the Tier 3 or 4 guidance, templates or related documents – no standard-setting activity)</p> <p>We will consider including examples in the Tier 3 accompanying guidance material and/or reporting templates. However, we are conscious that this should avoid encouraging template reporting.</p>

⁹ BC6 of the Tier 3 standard

Summary of specific themes raised	Staff recommendation on next steps
<p>Requirement to report on resources and commitments in the Tier 4 standard.</p> <p>Some respondents consider that more information should be required by the in relation to resources and commitments. They consider that the current amount of information does not meet the needs of users.</p> <p>Some respondents think that depreciation should be incorporated into the disclosures on resources.</p> <p>One respondent does not think that requiring these disclosures is appropriate on the basis that they inappropriately force accrual concepts onto preparers in a standard that is intended to be cash-based.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>Based on other feedback received through outreach activities, we feel a discussion is needed on whether the Statement of Resources and Commitments should be retained in a Tier 4 cash-based standard.</p> <p>Additional analysis on this matter will be brought to a future NZASB meeting to assist the Board in reaching a view on the standards-level response.</p>
<p>Meaning of “significant”</p> <p>The principle of considering “significant” items is used throughout the Tier 3 and Tier 4 Standard.</p> <p>The term significant is defined in para A26 of the Tier 3 standard as:</p> <p><i>“Items are significant if their omission or misstatement could, individually or collectively, influence the decisions or assessment of users relying on the performance report. Significance is considered in relation to both the nature and size of the item, or a combination of both. For the purposes of this Standard, significance has the same meaning as materiality”.</i></p> <p>Some respondents advised that they were unclear what was meant by this term. We consider that the definition itself is fairly clear and that the issue could be more that preparers are not aware of the definition.</p>	<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>We propose developing an FAQ on the meaning “significant” and factors to be consider when forming this judgement.</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>Related party transactions</p> <p>Some respondents noted that the requirements in the Tier 3 and Tier 4 Standards for reporting related party transactions are not well understood.</p> <p>These respondents considered that more guidance is required about:</p> <ul style="list-style-type: none"> • who is captured by the definition of related parties; and • which transactions are required to be disclosed. <p>Two respondents considered that some entities may be concerned that disclosing related party transactions will result in the disclosure of private information.</p>	<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>We propose developing an FAQ around related party transactions and referring to these in the feedback statement. Noting that useful guidance has already been developed by Charities Services.</p>
<p>Determining whether an entity has exceeded the size threshold for Tier 3 or Tier 4</p> <p>One respondent considered that more clarity is needed about when and how entities are required to transition between tiers. They recommend including guidance on determining whether an entity has exceeded the size threshold for Tier 3 or Tier 4 within the standards themselves (rather than XRB A1).</p> <p>One respondent considered the definition of what is a capital payment in the Tier 4 standard needs to be reviewed.</p>	<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>We will consider whether any actions are required to improve awareness of existing guidance on this matter.</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>Expenses in the Tier 3 Standard</p> <p>One respondent considered that it is not appropriate to treat distributions from trusts with named beneficiaries as grant expenditure. Their view is that it is more appropriate to treat this as an equity transaction.</p> <p>One respondent noted that current expense recognition requirements for multi-year grants could inappropriately result in entities being pushed into a higher reporting tier.</p> <p>One respondent recommended that the reference to “entitlement” in recording wages, salaries, and leave upon entitlement be removed and that examples related to long service and retiring should be included in the standard.</p>	<p>No further action recommended</p> <p>These comments were not widespread, and we consider the cost of introducing these changes would outweigh any benefits.</p>
<p>Inclusion of additional items in the statement of financial performance</p> <p>Two respondents considered that the statement of financial performance should allow for reporting of items outside of net surplus and deficit.</p> <p>One respondent considered it should allow for the reporting of “below the line” items similar to other comprehensive income in the Tier 1 and Tier 2 PBE standards.</p> <p>One respondent considered that it should be permitted to present the statement of financial performance in a manner which aligns with the accounting treatment prescribed by trust law.</p>	<p>No further action recommended</p> <p>This was not a widespread issue and on balance we consider that including additional items (or prescribed sub totals) in the statement of financial performance would result in unnecessary complexity.</p> <p>We note that the concept of introducing an OCI concept for revaluation movements will be explored further by staff under an earlier issue.</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>Going concern and events after balance date in the Tier 3 Standard.</p> <p>Two respondents considered that refinements were needed to the disclosure requirements related to going concern and events after balance date to make them more appropriate for NFPs.</p> <p>One respondent expressed concerns that NFPs may not be appropriately considering the impact of COVID-19 on their going concern assessments.</p>	<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>Staff will consider developing FAQ guidance on these matters to promote an improved understanding of what good disclosure look like.</p>
<p>Requirement to prepare a statement of entity information in the Tier 3 and Tier 4 standards.</p> <p>Two respondents considered that preparation of this statement was unnecessary and needed to be removed or simplified.</p> <p>One respondent noted that the information was already available elsewhere.</p> <p>One respondent noted that the requirements for the statement of entity information are more onerous than those which apply to Tier 2 entities.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>Staff can see there could be opportunities to refine (and possibly reduce) the current level of disclosures required in the Statement of Entity Information in the Tier 3 and Tier 4 Standards.</p> <p>Refining non-authoritative guidance material (i.e. to consider possible amendments to the Tier 3 or 4 guidance, templates or related documents – no standard-setting activity)</p> <p>In addition, the templates and guidance material can be updated to encourage entities to use cross referencing for this type of information about the entity where it is publicly available on their website or another source.</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>Choice to report on a GST inclusive or exclusive basis in the Tier 4 Standard.</p> <p>Two respondents raised concerns with allowing this choice.</p> <p>One respondent noted that reporting on a GST exclusive basis can create reconciliation issues within the statement of receipts and payments.</p> <p>One respondent considered it would be unlikely that an entity which is registered for GST would elect to report on a GST inclusive basis.</p>	<p>No further action recommended</p> <p>On balance, staff support retaining the reporting option.</p>
<p>Use of the term “performance” in the Tier 3 standard.</p> <p>One respondent considered that this term is value-laden and should be changed to a more neutral term.</p> <p>One respondent considered that the frequent use of this term in different context is confusing for small NFPs.</p>	<p>No further action recommended</p> <p>The “Performance Report” is now the common terminology used by Charities Services and funding organisations.</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>Consolidation requirements</p> <p>Two respondents raised concerns with the requirement to consolidate where there is a control relationship for financial reporting purposes.</p> <p>One respondent considered that the requirements are unclear and two judgemental. They recommended including consolidation requirements in the Tier 3 Standard which explicitly state when an entity is required to consolidate and how.</p> <p>One respondent noted that there is still widespread misunderstanding about control for financial reporting purposes and how it differs from the layman’s conception of control.</p>	<p>Conducting additional educational and awareness raising activities in conjunction with Charities Services (including development of FAQ like guidance material)</p> <p>We consider that there is still more that can be done to spread the message regarding the need to consolidate where there is ‘control’ for financial reporting purposes. We propose developing an FAQ in relation to control and entities can assess whether they have control for financial reporting purposes. We also propose incorporating this message within the feedback statement to communicate to those involved with NFP entities ‘why’ consolidated financial statements should be prepared if control exists.</p>
<p>Format of the Statement of Financial Position in the Tier 3 Standard</p> <p>One respondent considers that greater flexibility in the layout of the Statement of Financial Position would be useful.</p>	<p>No further action required</p> <p>This will be considered as part of reviewing the minimum categories in both the Statement of Financial Performance and Statement of Financial Position (discussed earlier).</p>
<p>Use of the term “receipts” in the Tier 4 Standard</p> <p>One respondent noted that use of this terminology was confused with physical receipts and may lead to inappropriate inclusion of receipts from members in the revenue section of the Statement of Receipts and Payments.</p> <p>One respondent considered that some items may inappropriately be treated as receipts in the Tier 4 Standard in cases where funds are being held on behalf of others.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>We agree that there may be value in clarifying use of this term within the Tier 4 Standard. This will be considered as part of an overall review to simplify the terminology and language used in the Tier 4 Standard.</p>

Summary of specific themes raised	Staff recommendation on next steps
<p>Definition of current and non-current in the Tier 3 Standard.</p> <p>One respondent considered that the current definitions do not appropriately reflect the information that funders are looking for when assessing working capital.</p>	<p>No further action recommended</p> <p>We do not consider this comment indicates an widespread issue with the Tier 3 Standard and we consider it important that definitions remain aligned with the Tier 1 and Tier 2 Standards to the extent appropriate.</p>
<p>Requirement to sign performance reports</p> <p>One respondent commented that the requirement to sign the Performance Report was superfluous given the Charities Register recorded the date of when the Annual Return (which includes the Performance Report) is submitted and who it was submitted by. They also considered that including signatures on a public register created undue risk for NFPs.</p>	<p>No further action recommended</p> <p>We consider that the benefit of signing and dating the Performance Report outweighs the cost or any risks .</p> <p>This requirement was added in response to feedback received when the Tier 3 and 4 Standards were first introduced, that it was important that the Performance Reports be signed and dated to discharge accountability in relation to financial reporting responsibilities by those charged with governance.</p>
<p>Title of the Tier 4 standard</p> <p>One respondent considered that use of the word “cash” in the title of the Tier 4 Standard was confusing and that many charities do not think it applies to them because they do not operate using physical cash.</p>	<p>Further consideration by the NZASB in a standard-setting capacity (i.e. to consider possible standard-setting options to amend the Tier 3 and Tier 4 Standards)</p> <p>We will consider the title of the standards as part of the overall review to simplify the terminology and language used in the Tier 4 Standard.</p>

Appendix B: Detailed analysis of feedback received – main themes

Appendix B includes the detailed feedback on the main themes identified from the analysis of responses to Q1 and Q2 of the RFI (detailed analysis on Q1 of the RFI was provided at the May 2021 meeting of the Board).

RFI Questions

Q2. *What parts of standards, guidance or templates have been working well? Are there any that have been particularly useful?*

Q3. *Are there any specific issues that you have encountered in applying the standards, guidance, or templates?*

All the themes identified the recommended actions have been discussed in the main part of this agenda paper.

Table 4 – Summary of written responses to questions 2 and 3 on main themes

Respondents to question 2			17
Respondents to question 3			36
Themes	Comments on individual themes		
	Respondents to question 2	Respondents to question 3	Total
Service performance	9	19	21
Assets	0	15	15
Minimum categories	3	12	15
Revenue recognition	0	13	13
Cash flow statement	1	6	7
Accumulated funds and reserves	0	7	7
Opting up for specific transactions	1	5	6

In table 5 below the responses to question 3 have been summarised in detail and grouped together into specific topics. A detailed analysis of the responses to question 2 has not been included in this table as these responses do not require further action by their nature.

Table 5 – Detailed responses to question 3 on main themes

Service Performance Reporting	
Topic	Summary of feedback received
<p>Difficulty understanding the objectives and requirements related to the statement of service performance.</p>	<p>Accounting Firm 2, Presbyterian Church, Community Foundations NZ, Community Capacity Accounting, NZ Ukulele Trust, Louise Edwards, Accountant roundtable, Charities Services – Commented that in general, they did not consider the requirements applicable to preparing the statement of service performance are well understood. These respondents raised concerns that the lack of understanding among NFPs was reducing the overall quality of information provided in performance reports.</p> <p>Charities Services noted that entities will frequently report what they spent money on during the period in the statement of service performance rather than reporting their outputs.</p> <p>These respondents noted that a frequent cause of the misunderstanding is the terminology used in the Tier 3 and Tier 4 standards to describe these requirements. In particular these respondents noted that NFPs do not understand what is meant by the terms “outputs” and “outcomes”.</p> <p>Some respondents made suggestions about how to improve the requirements including:</p> <ul style="list-style-type: none"> • making the requirements more open-ended and encouraging more narrative description; • replacement of the “outputs” and “outcomes” terminology with plain-language terms such as “goods and services delivered”; and • making it clear in the standard and guidance that the statement of service performance is asking about what “activities” a charity has undertaken during the period. <p>Academics roundtable participants noted that with regard to the reporting of outcomes, there will always be an attribution</p>

	<p>issue among NFPs. That is, it is difficult to know what effect an entities outputs have had on achieving the desired outcome. She suggested that it may be more useful to frame the statement of service performance as reporting of a not-for-profits “achievements” and that this may improve understanding of the requirements. Cherrie also noted that the output and outcome focus of the statement of service performance for Tier 3 and Tier 4 entities is now inconsistent with the model established for Tier 1 and Tier 2 entities in PBE FRS 48 <i>Service Performance Reporting</i> and suggested the Tier 3 and Tier 4 standards should now be aligned with the approach taken in that standard.</p> <p>Community Capacity Accounting considered that the XRB was not the appropriate entity to issue service performance reporting requirements for NFPs due to its lack of proximity to the NFP sector and primary role as a financial reporting standard-setter. They considered that responsibility for setting service performance reporting requirements should instead lie with Charities Services.</p>
<p>Additional guidance on selecting appropriate performance measures.</p>	<p>Respondents Accountants’ Roundtable, AGNIU Accounting , CA ANZ and CPA Australia, Charity Integrity Audit, Community Capacity Accounting, Hui E, Louise Edwards, Rata Foundation, and Ruth Sio-Lokam made comments about difficulties NFP entities are having in selecting appropriate, meaningful performance measures. These respondents generally noted that while they considered it appropriate to keep the requirements for the statement of service performance broad, this makes it difficult for some NFPs to understand how to apply them in their specific context. They noted that in practice, this is leading to a “template” approach to preparing statements of service performance and a lack of variety among the measures being used by entities. Some of these respondents also raised concerns that this was leading to entities not considering whether their chosen performance are appropriate on an ongoing basis.</p> <p>Academics roundtable participants and Rata Foundation noted that they frequently come across statements of service performance that use performance measures which bear no resemblance to the NFP entity’s stated purposes. Rata Foundation also raised a concern that in some cases entities were selecting performance measures in a way which did not provide a balanced view of the entities performance and instead focused on the measures that provided only a positive view of the entity.</p> <p>CA ANZ and CPA Australia, and AGNIU Accounting noted that many of these entities do not have appropriate systems in place to collect information and that this lack of underlying support makes it difficult for them to know what measures can feasibly be reported on.</p>

	<p>These respondents generally considered that the XRB should provide more guidance on preparing statements of service performance including:</p> <ul style="list-style-type: none"> • guidance on determining which performance measures are meaningful; • a wider range of example performance measures which may be relevant for different types of entities; • illustrative examples of statements of service performance; and • the information that may need to be collected to report on different performance measures.
Assets	
Topic	Summary of feedback received
Asset Valuation	<p>Respondents Accounting firm 2, Audit Professionals, Perpetual Guardian, CA ANZ, BDO, KPMG, Bellyful, D.V Bryant Trust, Accountants' Roundtable Participants, and The Presbyterian Church commented on the requirements in the Tier 3 standard related to valuation of assets. These respondents noted that many entities wish to carry their assets based on some form of market value and generally considered that the Tier 3 standard should allow for entities to do so without being required to opt up to the relevant PBE standard.</p> <p>Audit Professionals noted that the under the PBE standards an entity which elects to revalue their assets is required to show a separate reserve within equity for the unrealised revaluation uplift in the statement of financial position. They considered that calculation of this reserve at each balance date can be time consuming and does not provide any real benefit for entities (as the reserve is simply a component of equity). They considered that if entities continue to be required to opt up to the PBE standards to revalue their assets, a dispensation from having to apply these requirements should be provided.</p> <p>Community Capacity Accounting considered that both investments and land and buildings should be required to be carried at market value under the Tier 3 standard as opposed to the current requirement to carry these items at cost.</p> <p>BDO and Accountants roundtable noted that the requirements which apply to revaluation of property, plant, and equipment are inconsistent with those applicable to revaluation of investment properties. If entities wish to revalue their property, plant and equipment they are required to opt up to the PBE standards but are allowed to use rateable value in</p>

	<p>lieu of market value. This concession is not allowed with respect to revaluation of investment properties. They considered that entities should also be permitted to use rateable value for investment properties.</p> <p>D.V. Bryant noted that the requirement to undertake revaluations of investment properties was a very costly and difficult exercise. They considered that this could be alleviated by allowing rateable value to be used.</p> <p>Presbyterian church noted that for many religious entities, the properties they hold have often been in their possession for many year and that this makes it very difficult to obtain historical records related to those properties. Because of this, churches are often forced into revaluing their properties and at a group level this results in significant costs.</p> <p>Upper Hutt City Council (UHCC) noted that church buildings are often highly specialised which makes it difficult to obtain market data applicable to those assets.</p> <p>KPMG considered that the Tier 3 standard should be clarified with respect to revaluation of investment portfolios. When revaluing these assets entities are required to apply the PBE standards but with respect to financial instruments there are several applicable PBE standards. They did not consider the standard is clear about which of these standards needs to be applied or if entities are required to apply all of the related standards.</p> <p>Charity Integrity Audit noted that many entities are not currently depreciating buildings on the basis that they have a long term maintenance plan. They considered that there should be a requirement in the standards for entities which are relying on this to demonstrate their plan will be funded.</p> <p>Methodist Church do not consider it is appropriate to allow additional accounting options within the Tier 3 standard. They consider that it would be difficult to develop appropriate options that are simple to understand and apply. They also consider that doing so creates a risk of the Tier 3 standard becoming more complex over time which is contrary to the original intention of the standard.</p>
<p>The definition of cash in the Tier 3 standard is inconsistent with the definition of cash and</p>	<p>Accountants roundtable noted that the definition of cash in Tier 3 standard does not include cash equivalents as in the PBE standards. It was noted that this inconsistency is leading to audit adjustments for entities who are applying the definition in the PBE standards when preparing performance reports for Tier 3 entities.</p>

cash equivalents in the PBE standards.	<p>The definition of Cash in paragraph A39 of the Tier 3 standard is:</p> <p><i>“Bank Accounts and cash comprise petty cash, cheque or savings accounts, and deposits held at call with banks.”</i></p> <p>The definition of Cash Equivalents in paragraph 8 of PBE IPSAS 2 is:</p> <p><i>“Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value”.</i></p>
Biological assets	BDO noted that there is currently no guidance in the Tier 3 standard which applies to accounting for biological assets. They consider that introducing guidance on this topic would be helpful as many registered charities also operate farming businesses.
Intangible assets.	Community Capacity Accounting noted that the Tier 3 standard does not include any requirements related to intangible assets. However, they are aware of many organisations which capitalise website and software development costs. They considered that recognition of intangible assets should be explicitly prohibited in the Tier 3 standard.
Presentation of depreciation.	Audit Professionals considered that the Tier 3 standard should allow entities to show the split of depreciation either on the face of the financial statements or in the expenses note.
Minimum Categories	
Topic	Summary of feedback received
Appropriateness and clarity of the minimum categories	<p>Respondents Community Capacity Accounting, Charities Services, Rata Foundation, Foundation North, UHCC, JB Were, and NZ Ukulele Trust generally considered that the standards and associated guidance are unclear about what belongs in each category.</p> <p>NZ Ukulele Trust noted that the minimum categories as they are currently defined are inconsistent both with the way most charities think about themselves and with the way users generally think about registered charities. They consider that the categories should be restructured to more appropriately reflect the way preparers and users think about registered</p>

	<p>charities.</p> <p>Foundation North, UHCC, Charities Services, JB Were NZ noted that the minimum categories when applied strictly result in some useful information which was previously disclosed now being obscured.</p> <ul style="list-style-type: none"> • Foundation North, UHCC, Charities Services noted that government grants, other grants, and donations are now aggregated together into a single category. They consider that government grants should be disclosed separately from other grants and donations. • JB Were NZ considered that salary and wages should be disclosed separately from other volunteer and employee costs. <p>Charities Services and UHCC considered that separation of Revenue/Receipts into that received from members and non-members introduces unnecessary complexity into the standard and does not provide useful information. They also noted that this distinction creates particular problems when considered within a te ao Māori or religious context.</p> <p>CA ANZ Practice Review, AGNIU Accounting, Louise Edwards, Methodist Church, consider that in principle having requirements to aggregate items into minimum categories is appropriate. They consider that if set up appropriately, the minimum categories will make performance reports more understandable and comparable.</p> <p>CA ANZ Practice Review also noted that they consider the prohibition on offsetting of amounts related to the minimum categories is appropriate.</p>
<p>Disaggregation of the minimum categories</p>	<p>Audit Professionals, CA ANZ Practice Review, KPMG, Audit NZ and UHCC considered that the Tier 3 and Tier 4 standards are unclear about the level of disaggregation permitted. They considered that the standard should be more explicit about whether the categories are highly flexible or whether disaggregation is only permitted in specific circumstances.</p> <p>Audit NZ, UHCC however also noted that they consider the standard is too prescriptive about what the categories are and that it would be more appropriate to approach aggregation of revenue/receipts and expenses/payments on a principles basis.</p> <p>Accountant roundtable noted that the minimum categories in the Tier 3 and Tier 4 standard are still not well used with</p>

	many entities still presenting a full list of all expense lines based on their Trial balance. They considered that this could be addressed by providing more guidance on the minimum categories and how they are used.
Revenue	
Topic	Summary of feedback received
Revenue recognition and disclosure requirements in the Tier 3 standard.	<p>Many respondents commented on the requirements related to revenue recognition. In general respondents considered that the requirement to recognise revenue when amounts are received unless there is a related “use or return” condition need to be reviewed. Some of the specific issues raised about this are described below.</p> <p>Accounting firm 2 considers that the disclosure requirements in the Tier 3 standard should be aligned with those in the PBE standards.</p> <p>NFP 1, CA ANZ Practice Review, Ruth Sio Lokam, Rata Foundation noted that entities are having difficulties in applying the requirements and that while they are getting better at applying them, revenue is still not being recognised by many entities as required by the Tier 3 standard. They noted that there often, entities do not understand the rationale for the requirements.</p> <p>Perpetual Guardian noted that the strict requirement for a use or return condition results in many multi-year funding arrangements not being eligible for deferral despite the fact that they may have other relevant conditions attached to them. For example, the grant may be:</p> <ul style="list-style-type: none"> • Re-evaluated and confirmed on an annual basis; • Subject to changes in strategic direction with subsequent years being withdrawn; or • Payable only on the condition that the grantor has sufficient available funds. <p>They considered that these circumstances should also be eligible for deferral and that additional guidance should be provided in the Tier 3 standard which covers these circumstances.</p> <p>Northern Masonic noted that the requirements in the Tier 3 standard can lead to a mismatch in deferral between grantor and the grantee where a multi-year grant has a use or return condition. Paragraph A80 of the Tier 3 standard requires a</p>

	<p>grant to be recognised as an expense when approved and the recipient has been advised. As there is no exception to this where the grant has a use or return condition, the grantor will be required to expense the full grant in the period it is approved while the grantee will be eligible to defer the grant until it is used. They noted that this issue has led to some funders no longer entering multi-year funding arrangements which has imposed additional administrative burden on NFPs who instead have to apply for funding on an annual basis.</p> <p>Audit NZ noted that some of the illustrative examples given for revenue in the public sector version of the Tier 3 standard appear to be inconsistent with accrual principles. Instead, these examples state that revenue is recognised on receipt of when funding or cash is received.</p> <p>Accountant roundtable raised concerns with grants received for capital purposes being aggregated with grants received to fund operations. They considered that grants for capital purposes are not a true reflection of the operations of an entity and that aggregating these with grants for operating purposes distorts the picture of the entity's financial performance. They recommended that instead, the Tier 3 standard should allow entities to present an adjusted Statement of Financial Performance which separates these with grants for capital purposes being presented below operating surplus/deficit.</p> <p>CA ANZ Māori Resource Development Working Group raised similar concerns in relation to grants for capital purposes. They raised an additional example of koha given for capital purposes. They considered this to essentially represent a donation with a restriction on its use and noted that the Tier 3 standard does not currently provide any guidance on these transactions. They recommended that guidance on donations with restrictions be added to the Tier 3 standard.</p>
<p>Illustrative examples and additional examples for revenue in the Tier 3 standard.</p>	<p>Audit NZ raised concerns with the illustrative examples provided in section 10 of the public sector version of the Tier 3 standard. They did not consider that the difference between scenarios 2 and 3 are sufficiently clear. They noted that in both scenarios the Fish and Game Council/Registration Board are providing a right to the applicant but the entities are not required to provide any additional services to the applicant beyond the issuance of the license/registration. Based on the scenario information provided and guidance in the standard, they would expect the revenue for the Fish and Game Council to be recognised up front and not spread over the license period. Additionally, Scenario 3 says revenue is accounted for when the fees are received, which implies when the cash is received. This is not consistent with para A64 where other fees and charges are recorded as revenue when the fee is due to be received.</p>

	Community Networks Aotearoa considered that additional guidance should be included in the Tier 3 standard which covers sponsorship. They noted that many entities are currently treating sponsorship as a donation/grant (non-exchange) but they consider it to be closer to an exchange transaction such as purchase of advertising.
Cash Flow	
Topic	Summary of feedback received
Understandability of the requirements for the statement of cash flows in the Tier 3 standard.	<p>Accounting firm 2, Ruth Sio-Lokam considered that while the theoretical aims of including the statement of cash flows in the Tier 3 standard are sound, they are poorly done in practice.</p> <p>Charities Services noted that both the statement of cash flows and the statement of receipts and payments have been useful to them in fulfilling their regulatory functions under the Charities Act 2005. In particular they have been helpful in assessing complaints made about registered charities and whether there is prima facie evidence of serious wrongdoing.</p> <p>Presbyterian Church noted that feedback they have received from their member organisations indicates that many of them do not like preparing the statement of cash flows. These organisations have frequently indicated that they do not consider the statement of cash flows is useful for them or for their users. In their experience this is the statement that these entities will fail to prepare most often. They also noted that there is often no significant difference between the statement of financial performance and the statement of cash flows for these entities.</p> <p>Charities Services, Charity Integrity Audit noted that many entities find the terminology related to preparing the statement of cash flows. They considered that this terminology should be changed to use plain English terms.</p> <ul style="list-style-type: none"> • Charities Services suggested that the heading “Cash Flows from Investing and Financing Activities” could be changed to “Cash Received from or Spent on Non-Current/Balance Sheet Items”. • Charity Integrity Audit also considered that the Tier 3 standard should require a reconciliation between operating cash flows and the surplus/deficit reported in the statement of financial performance.
Layout of the statement of cash flows.	Community Capacity Accounting noted that the layout of the statement of cash flows required by the Tier 3 standard is inconsistent with that of the statement of receipts and payments required by the Tier 4 standard. They consider that this is

	<p>inappropriate on the basis that these two statements are essentially the same thing. They recommend that we align the required format of the statement of cash flows with that of the statement of receipts and payments.</p> <p>Audit Professionals noted that many NFPs receive significant grants for major building projects. They consider that cash inflows and outflows related to these arrangements are clearly cash flows from investing and financing activities as contemplated by the Tier 3 standard. However, they noted that while paragraph A165 discussed loans borrowed from other parties, it does not discuss significant grants from other parties. Further, paragraph A155 of the Tier 3 standard which mentions financing activities describes these only as being long term borrowings and capital contributions. In their view, grants which are received specifically for the purchase or development of property are best shown in the investing and financing activities section which is what they primarily relate to. They recommend that both A155 and A165 are amended to state that grants for capital projects are treated as cash flows from investing and financing activities.</p>
Accumulated Funds	
Topic	Summary of feedback received
Narrative description about the nature and purpose of reserves.	<p>CA ANZ and CPA, Accountant roundtable, Foundation North, Community Networks Aotearoa, and New Zealand Ukulele Trust considered that there is room to improve disclosures on reserves by Tier 3 entities. In particular these respondents considered that more narrative description about the nature and purposes of reserves is needed.</p> <ul style="list-style-type: none"> • CA ANZ and CPA considered that a NFPs should provide more narrative description on their accumulation strategy, the purpose of any accumulations, and any restrictions in place on their reserves. • Accountants roundtable also considered that more guidance is needed on using reserves in accordance with the Tier 3 standard. In particular they considered that more guidance is needed on the circumstances in which it is appropriate to create a restricted reserve and how any such created reserves should be disclosed. • Foundation North noted that creation of reserves for restricted purpose donations or grants is not a practice they have frequently encountered. However, they have observed cases where they have been created. They considered that in the cases where they have seen the being used, the disclosures do not describe the purpose of the reserve or the relevant restrictions on it very well. • Community Networks Aotearoa considered that reserve reporting requirements should capture both the accounting

	<p>treatment as part of accumulated funds and the disclosure of an organisation’s reserve policies. They noted that small NFPs are struggling to attract funding and they consider a key driver of this is misinterpretation of performance reports by funders. Their understanding is that funders frequently assume that because an entity has cash in the bank, it doesn’t need any more funding. They consider that more robust requirements and greater clarity on the nature and purpose of accumulated funds would help address this.</p> <ul style="list-style-type: none"> • New Zealand Ukulele Trust consider that the current requirements which apply to accumulated funds provide and unnecessary amount of detail on the nominal value while not providing enough focus on the narrative description.
Simplification of terminology related to accumulated funds.	<p>Charities Services and Community Capacity Accounting raised concerns related to the terminology used in the Tier 3 standard in relation to accumulated funds.</p> <ul style="list-style-type: none"> • Charities Services noted that there is a widespread misunderstanding among registered charities about the meaning of the term “reserves” for accounting purposes. Commonly this is thought of as “operating reserves” set aside to fund future operations. They consider that more guidance is needed to clarify that these are two separate concepts. • Community Capacity Accounting raised concerns regarding the use “capital contributions” and more widely of “owners” throughout the Tier 3 standard. They consider that for NFPs both of these terms are often meaningless and create confusion. They recommend these be removed from the Tier 3 standard or changed to more appropriate terminology.
Opting Up	
Topic	Summary of feedback received
Additional guidance on the requirements related to opting up to the PBE standards for specific transactions or balances.	<p>CA ANZ and CPA consider that in general, the ability to opt up to the PBE standards for specific transactions or balances is helpful and should be retained in the Tier 3 standard.</p> <p>Perpetual Guardian, CA ANZ Practice Review, Bellyful, Accountant roundtable noted that many entities do not understand the requirements for opting up to the PBE standards for a class of transactions or balances. They generally considered there is a need to add more guidance on what this means in practice. They considered that guidance is particularly needed on what is required in practice for common situations in which entities opt up to the PBE standards. They noted that many entities which opt up, will apply the recognition and measurement requirements but will not apply the related presentation</p>

	<p>and disclosure requirements.</p>
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- Accountants roundtable also noted that the only other alternative is to include all the possible treatments in the Tier 3 standard which they did not consider appropriate.

Appendix C: Detailed analysis of specific feedback – other issues

Appendix C includes the detailed feedback on other issues identified from the analysis of responses to Q1 and Q2 of the RFI.

All the other issues identified the recommended actions have been discussed in the main part of this agenda paper.

Table 6 – Summary of written responses to questions 2 and 3 on other issues

Respondents to question 2	17	
Respondents to question 3	36	
Themes	Comments on individual themes	
	Respondents to question 2	Respondents to question 3
Accounting Policies	0	4
Requirement to report on resources and commitments in the Tier 4 standard	0	4
Meaning of “significant”	0	4
Related party transactions	0	4
Determining whether an entity has exceeded the size threshold for Tier 3 or Tier 4	0	3
Expenses in the Tier 3 standard	0	3
Going concern and events after balance date in the Tier 3 standard	0	3
Inclusion of additional items in the statement of financial performance	0	2
Requirement to prepare a statement of entity information in the Tier 3 and Tier 4 standards	0	2
Choice to report on a GST inclusive or exclusive basis in the Tier 4 standard	0	2
Use of the term “performance” in the Tier 3 standard	0	2
Consolidation requirements.	0	2
Format of the statement of financial position in the Tier 3 standard	0	1
Receipts in the Tier 4 standard	0	1
Definition of current and non-current in the Tier 3 standard	0	1
Requirement to sign performance reports	0	1
Title of the Tier 4 standard	0	1

Table 7 – Detailed responses to question 3 on other issues

Other issues	
Topic	Summary of feedback received
Accounting Policies	<p>Audit Professionals noted that the requirements which apply to accounting policies in the Tier 3 standard are inconsistent with those in the Tier 4 standard. Section 8 of the Tier 3 standard requires a separate statement of accounting policies to be prepared while the Tier 4 standard instead requires accounting policies to be disclosed as note 1 to the performance report. They consider that the Tier 3 should be amended to be consistent with the Tier 4 standard.</p> <p>CA ANZ Practice Review, Bellyful, and NZ Ukulele Trust raised concerns with the requirements that apply to presentation of accounting policies and considered that more guidance needs to be provided.</p> <ul style="list-style-type: none"> • CA ANZ Practice Review noted that they come across many entities which are not including all relevant accounting policies. For example, not including revenue or property, plant and equipment policies despite these items being significant to the entity. • Bellyful noted that many preparers find it difficult to know how to describe accounting policies in a way that both they and the users of their performance report can understand. They suggested that illustrative examples for common accounting policies (such as property, plant and equipment, grant income with restrictions, and interest income) would be helpful for these entities. • New Zealand Ukulele Trust considered that the requirements related to accounting policies in the Tier 3 and Tier 4 standards result in disclosures that are primarily composed of technical jargon and not easily understood by most users of performance reports. They suggested that providing a plain English example of basis of preparation paragraphs which meet the requirements of the standards would be helpful for preparers. <p>Community Capacity Accounting considered that the accounting policies requirements in the Tier 3 standard related to property, plant and equipment should be strengthened and explicitly require disclosure of a policy where applicable. They considered that the disclosure requirements should include the depreciation rates for each class of assets and the basis on which that depreciation rate was determined. They also considered entities should be required to disclose any policies it has</p>

	to expense assets under a particular value.
Requirement to report on resources and commitments in the Tier 4 standard.	<p>Accounting firm 1, Community Capacity Accounting, Foundation North, and Rata Foundation commented on the statement of resources and commitments in the Tier 4 standard. They generally considered that the requirement to prepare this statement should be retained and that these requirements needed to be expanded in some places.</p> <p>Community Capacity Accounting considered that the Tier 4 standard should require more detail to be provided in the statement of resources and commitments. Specifically, they recommend we make it clearer that significant items relating to the next financial year should be disclosed in the statement as accounts payable and receivable, if practicable to obtain. They also consider that the current name is confusing for small NFPs and that the statement should therefore be renamed to the "statement of assets and liabilities".</p> <p>Foundation North consider that the statement of resources and commitments usually doesn't provide the best overview of what entities have. They noted that often they have to go back to entities which prepare Tier 4 performance reports for more for more information on their resources and commitments before any funding applications are approved.</p> <p>Rata Foundation consider that further guidance is needed in the Tier 4 standard relating to unexpended grants and that specific guidance should be added on annual leave accruals and accrued interest. They also consider that unexpended grants should be disclosed in the schedule of commitments rather than in the schedule of other information.</p> <p>Accounting firm 1 noted that despite the Tier 4 standard being cash-based many entities prepare their performance reports including a depreciated value for their property, plant and equipment. They consider that the Tier 4 standard should provide guidance on how to report on this or that the standard should explicitly state that depreciation is not to be reflected.</p> <p>Community Capacity Accounting consider that a depreciated value should be allowable as a method for reporting on the value of property, plant and equipment held by Tier 4 entities.</p> <p>Audit New Zealand raised concerns regarding the requirement to disclose significant resources and commitments in the public sector version of the Tier 4. They consider that the requirements at paragraph A80 and A81 suggest working capital items require disclosure. They consider working capital items should be outside the scope of these disclosures as the standard is cash-based. They consider that requiring the information in these paragraphs inappropriately forces accrual</p>

	<p>concepts onto preparers and auditors.</p>
<p>Meaning of “significant”.</p>	<p>Audit NZ, CA ANZ Practice Review, Foundation North and Rata Foundation consider that the Tier 3 and Tier 4 standard are not clear enough about the meaning of the term “significant” and that entities often misunderstand what this means in practice. They consider that both the Tier 3 and Tier 4 standard could be clarified in this respect or that additional guidance and illustrative examples could be provided.</p> <p>CA ANZ Practice Review noted that a common finding from their reviews is that large balances and transactions are not adequately explained. They consider that the lack of clarity about when these items are considered to be significant is a contributing factor to this.</p>
<p>Determining whether an entity has exceeded the size threshold for Tier 3 or Tier 4.</p>	<p>Blind Low Vision NZ raised concerns about the lack of guidance in the Tier 4 standard about what is considered to be a capital payment as opposed to an operating payment and how this may affect whether or not an entity is required to transition from Tier 4 to Tier 3 when an entity undertakes a major capital project. Their understanding is that in this case any payments for goods or services related to the project which are not purchases of the asset are considered to be operating payments rather than capital payments. Should the project continue over several years this could result in the Tier 4 entity being required to transition into Tier 3 temporarily before returning to Tier 4. They do not consider this should be the intended outcome and recommend that additional guidance is added to the Tier 4 standard which addresses these situations and clarifies what is considered to be a capital payment.</p> <p>BDO noted that transitioning from Tier 4 to Tier 3 involves moving from a cash-based to an accrual-based standard. Given that this change is significant they consider that guidance on when and how an entity is required to transition should be included in the Tier 4 standard. Currently the only guidance on transitioning between Tier 4 and Tier 3 is included in XRB A1 which they did not consider provides sufficient detail about making this transition.</p> <p>BDO also noted that similar difficulties can be encountered with respect to transitioning between Tier 3 and Tier 2. If whether an entity has breached the operating expenditure threshold for Tier 2 is determined by assessing their expenditure in accordance with the requirements in the PBE standards, an entity may not be able to make this assessment without already making the transition in substance. They consider that additional guidance about how operating expenditure is to be assessed for each Tier is needed, either in XRB A1 or in the standards themselves.</p>

<p>Related party transactions</p>	<p>Accountants roundtable, Community Capacity Accounting, CA ANZ Practice Review, and NZ Ukulele Trust noted that while they agree with the requirement to disclose related party transactions, these requirements are still not well understood. They generally considered that more guidance should be provided on who is captured by the definition of related parties what should be disclosed.</p> <ul style="list-style-type: none"> • Community Capacity Accounting also noted that many NFPs and funders confuse the term “related party transaction” with a “conflict of interest”, or “pecuniary benefit” and therefore consider them all to be bad. They consider that additional guidance should be provided to clarify that this is not the case. They also do not consider that NFPs should be required to report related party transactions which are not significant. • CA ANZ Practice Review notes that many entities are currently not disclosing these at all. They have observed that these entities frequently use the templates provided by Xero to prepare their performance reports and that these templates include a default note which states there are no related party transactions. They are concerned that preparers are not considering what should be disclosed under this note and simply reporting that there are no related party transactions. • NZ Ukulele Trust consider that any guidance provided needs to be clear, concise and express in general terms what it means for in the context of registered charities. <p>Both Community Capacity Accounting and CA ANZ practice review noted that these entities may have concerns that disclosure of related party transactions also results in the disclosure of private information. This is a common problem where the related party transaction relates to the payment of salary and wages.</p>
<p>Expenses in the Tier 3 standard.</p>	<p>Perpetual Guardian noted that distributions from trusts may be different to the treatment of distributions from other types of charities. For example, they consider that charitable trusts with fixed (named) beneficiaries and a direction to allocate a specific portion of the charity's income to each beneficiary should be viewed as distributions to owners reported through Accumulated Funds rather than as grant expenditure.</p> <p>Northern Masonic Association Trust Board noted that in cases where multi-year grants are significant, this may result in the NFP being required to change reporting tier despite grants of this size not being an ordinary part of the entities operations.</p> <p>Audit NZ recommended that the reference to “entitlement” in recording wages, salaries and leave upon entitlement be</p>

	<p>removed as it suggests only vested annual leave (i.e entitled annual leave up to the last anniversary date) is recorded and not accrued annual leave (i.e. annual leave accrued since the last anniversary date). They also considered it would be helpful to include long-service leave and retiring leave as an example of recording a staff expense upon entitlement to the leave entitlement i.e. when the entitlement vests for the employee.</p>
<p>Going concern and events after balance date in the Tier 3 standard.</p>	<p>Community Capacity Accounting and Perpetual Guardian raised concerns about the appropriateness of the existing requirements for going concern and events after balance date in the Tier 3 standard. They considered that this guidance needs to be reconsidered and made more appropriate for NFPs.</p> <ul style="list-style-type: none"> • Community Capacity Accounting noted that ‘Going concern’ and ‘Events after balance date’ disclosures originated in the need of investors to be warned of events impacting on profit or profitability on a business, but are not relevant to most not for profits. • Perpetual Guardian noted that models used to establish the ongoing viability of some types of charities may not be appropriate. For example NFPs can generate income through donations or on the event of a donor's death which makes future income difficult to estimate based on past income for these entities. Similarly NFPs don't necessarily incur expenditure in the same way as businesses due to use of volunteers or donated goods and services. Some NFPs may commit to providing funding for multiple years in advance of having the funds available. <p>Bellyful noted that we have recently issued additional guidance on going concern for Tier 1 and 2 NFPs which has not been introduced into the Tier 3 standard. They expressed concerns that Tier 3 NFPs which have been impacted by COVID-19 may not be incorporating this guidance into their going concern assessments.</p>
<p>Inclusion of additional items in the statement of financial performance</p>	<p>Community Capacity Accounting consider that the requirements for the statement of financial performance should be amended to allow for “below the line” items such as:</p> <ul style="list-style-type: none"> • Grants for capital expenditure • Comprehensive income from revaluations; and • Investment income. <p>Perpetual Guardian do not consider the standards appropriately accommodate the reporting of income and capital from a trustee’s perspective. They noted that trustees are required to follow trust law and the trust’s governing document in the</p>

	<p>management and administration of the trust property. This involves the classification of payments made and received as either income or capital. In some situations, expenses are paid from the trust's capital balance. If the standard is followed then these payments would be shown in the statement of financial performance which would result in the net surplus being less than what it would be had the trustee's treatment being followed. There would also be a difference with the trustee's record of the capital and income balance which could require the trustee to prepare a second set of financial statements in accordance with trust law which imposes additional administrative burden on trusts. They consider this issue would be resolved by allowing the use of trustee's accounts with appropriate additional disclosures.</p>
<p>Requirement to prepare a statement of entity information in the Tier 3 and Tier 4 standards.</p>	<p>New Zealand Ukulele Trust considered that the statement of entity information was unnecessary on the basis that most of this information is already provided by NFPs as part of their other annual reporting obligations to either Charities Services or the Ministry of Business Innovation and Employment. They considered that the statement of entity information should include only identifying information such as name and registration number as the rest of the information can be found on the public register. They also considered that if the full requirements are retained, more guidance is needed on what is required for each part of the statement of entity information. For example, in their view Main sources of cash and resources and main methods to raise funds, are very confusing and seem to cross over quite heavily.</p> <p>Audit NZ suggest that more plain English terminology be used. They consider the requirement in PBE IPSAS 1 paragraph 150(b) may be easier for tier 3 and 4 entities to understand and apply: "a description of the nature of the entity's operations and principal activities". However, they also note that the PBE IPSAS 1.150(b) has a disclosure concession for tier 2 entities. They suggest we consider removing the requirements as they are currently more onerous than the disclosure requirements applying to tier 2 entities or alternatively to change the language of the requirement to make it easier for small entities to understand by aligning with PBE IPSAS.150(b).</p>
<p>Choice to report on a GST inclusive or exclusive basis in the Tier 4 standard.</p>	<p>Paul Dunmore noted that there is an inconsistency in reporting when an entity applying the Tier 4 standard elects to report on a GST exclusive basis. In these cases, the GST payments have not formed part of the reported cash flows but may still be in the bank account which causes it not to reconcile.</p> <p>Bellyful queried the appropriateness of allowing a choice between reporting on a GST inclusive or exclusive basis in the standard as opposed to basis this on the entity's registration for GST. They considered it would be unlikely that a preparer who was registered for GST would elect to report on a GST inclusive basis.</p>

<p>Use of the term “performance” in the Tier 3 standard.</p>	<p>Community Capacity Accounting and Charities Services both raised concerns with the use of the word “performance” throughout the Tier 3 standard.</p> <ul style="list-style-type: none"> • Community Capacity Accounting considered that "performance" is a value laden word which implies objectives to accumulate resources or minimum acceptable activity requirements. They suggesting changing references to performance, including in the statement of service performance to an alternative. • Charities Services noted that “performance” is used throughout the standard to refer to many different things. For example, "Performance Report", "Statement of Service Performance", "Statement of Financial Performance". The consider this to be confusing for small NFPs and suggest changing these references.
<p>Consolidation requirements.</p>	<p>Community Capacity Accounting raised concerns with the consolidation requirements in the Tier 3 standard. In their view, many NFPs do not prepare consolidated financial statements where they should either out of ignorance or intentionally to avoid showing wealth. In relation to this issue they:</p> <ul style="list-style-type: none"> • consider that referencing the PBE standards on consolidation is unclear and recommend that the Tier 3 standard be amended to explicitly state the cases in which an entity is required to prepare consolidated financial statements; • consider that many users are interested in the activities of the parent entity as opposed to the consolidated group and recommend reintroducing the parent column to provide this information; • consider that where an entity is the sole or majority shareholder the interests of users are better served by the controlling entity treating the controlled entity as an investment; and • consider that where an entity is holding assets to support another entity it should be mandatory to disclose the net surplus/deficit as well as the net assets of the holding entity within the accounts of the benefitting entity regardless of the existence or lack of a control relationship. <p>Presbyterian Church noted that control for financial reporting purposes has been a contentious issue which has been practically very difficult. They noted that many of their parishes are wary of the head entity and therefore resistant to providing them with the financial information needed to undertake a consolidation. They considered that a contributing factor to this problem was the misconception of “control” and how it’s meaning in layman’s terms differs from control for financial reporting purposes.</p>

<p>Format of the statement of financial position in the Tier 3 standard.</p>	<p>Audit Professionals consider that the format of the Statement of Financial Position set out in the Tier 3 standard at paragraphs A88 and A89 is quite prescriptive. However, they have noted that some chartered accountants prefer to show accumulated funds before assets and liabilities, instead of after. They consider that additional guidance is needed to clarify the extent of flexibility allowed in preparing the Statement of Financial Position. They also consider that it should be permitted to change the layout of the statement as long as all of the required information is clearly shown.</p>
<p>Receipts in the Tier 4 standard.</p>	<p>Charities Services consider that use of the term “receipts” is confusing. They noted that many charities think this refers to the receipt document you are provided after you have made a transaction. They consider this confusion is increased by also adding the term “operating receipts”.</p> <p>David Walker considered that the Tier 4 standard currently treats some receipts as part of Gross Income when they are not. For example, funds received from members to pay for specific trip accommodation may need to be included in the statement of receipts and payments in order for it to reconcile despite the amounts not being related to the entity.</p>
<p>Definition of current and non-current in the Tier 3 standard.</p>	<p>Community Capacity Accounting noted that some funders use ‘working capital’ in assessing funding applications, but they do so as a proxy indicator for an organisation’s financial stability and sustainability, rather than liquidity. Their view is that they are actually interested in the total amount of all assets that the organisation can liquefy without affecting service provision, less any significant liabilities, including commitments to funders. They recommend that the definition of current and non-current assets in the Tier 3 standard is reviewed to address this issue.</p>
<p>Requirement to sign performance reports</p>	<p>NZ Ukulele Trust consider that the requirement to sign the performance report is excessive. They note that the process followed to submit an annual return requires a certification process. They are also note that uploading a signature to a public register creates undue risk for entities.</p>
<p>Title of the Tier 4 standard</p>	<p>Charities Services consider that use of the term “Cash” in the title of the Tier 4 standard is confusing and recommend that the title of the standard should be amended to address this. They note that many charities think this refers to physical cash and therefor think the standard doesn't apply because they don't transact using physical cash.</p>



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 11 June 2021

To: NZASB Members

From: Tracey Crookston and Judith Pinny

Subject: IASB Agenda Consultation

Recommendation¹

1. The Board is asked to PROVIDE FEEDBACK on the draft comment letter on the Request for Information – *Third Agenda Consultation* (the Agenda consultation).

Background

The Agenda consultation

2. The IASB issued the Agenda consultation on 30 March 2021.
3. Feedback on the Agenda consultation will help prioritise activities within the scope of the IASB's work² and will be used to develop the IASB's work plan for 2022 to 2026.
4. The IASB is seeking views on the following three areas:
 - (a) the strategic direction and balance of the Board's activities;
 - (b) the criteria for assessing the priority of financial reporting issues that could be added to the work plan; and
 - (c) new financial reporting issues that could be given priority in the Board's work plan.
5. The IASB has indicated that if the current level of focus on activities related to new IFRS standards and major amendments to IFRS standards (40-45%) remains unchanged, the Board expects to be able to start two to three large projects, or four to five medium-sized projects, or seven to eight small projects. This is after setting aside capacity to:
 - (a) continue existing projects on the work plan (as described in Appendix A of the Agenda consultation);
 - (b) the post-implementation reviews (PIRs) of IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*; and

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 scope of the IASB's work is general purpose financial statements and supporting management commentary for profit-oriented companies.

- (c) undertake some time-sensitive projects that may arise after the Agenda consultation (for example, possible follow-on projects from the required PiR's, if those projects are determined to be priorities).
6. Appendix B of the Agenda consultation sets out 22 potential projects³ including a description of what the IASB could do within each project. Appendix C lists the financial reporting issues suggested by a small number of stakeholders in the outreach carried out before publishing the Agenda consultation.
 7. The NZASB provided some initial feedback on the anticipated content of the Agenda consultation at the February Joint Boards' meeting. The Agenda consultation was also discussed at the April meeting and the Board rated the projects in Appendix B and Appendix C as high, medium or low.

IFRS Trustees – Strategic Review

8. At the same time as the IASB is seeking information on the Agenda consultation, the IFRS Foundation Trustees (the Trustees) have been considering whether to establish a new board to set sustainability reporting standards. A consultation paper was issued in September 2020.⁴
9. Between January and April 2021, the Trustees reviewed the feedback on the consultation paper and issued an exposure draft (ED).⁵ The ED proposes a strategy to create an International Sustainability Standards Board (ISSB), that will set IFRS Sustainability Standards, under the Foundation's governance structure.
10. In the ED, the Trustees explain that due to the urgent need for better information about climate-related matters, the new ISSB would initially focus on climate-related reporting while also moving quickly to work towards meeting the information needs of investors on other environmental, social and governance (ESG) matters.
11. The Trustees intend to produce a definitive proposal before the November 2021 United Nations Climate Change conference (COP26).
12. Therefore, the Agenda consultation does not seek feedback on issues related to sustainability reporting but does include a potential project on climate-related risks as it relates to information disclosed in the financial statements. However, decisions made by the Trustees could affect the scope of the IASB's future work, in particular supporting and coordinating with the work of the ISSB.

Feedback from AASB Staff

13. AASB staff have shared their preliminary recommendations on the three areas of the Agenda Consultation. We have set out these preliminary views in **Appendix A**.

³ A summary of the 22 potential projects is currently on the XRB's website: [Table of 22 Potential Projects](#)

⁴ IFRS Foundation CP issued September 2020: [Consultation Paper on Sustainability Reporting](#)

⁵ IFRS Foundation ED issued April 2021: [Proposed Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards](#)

Structure of this memo

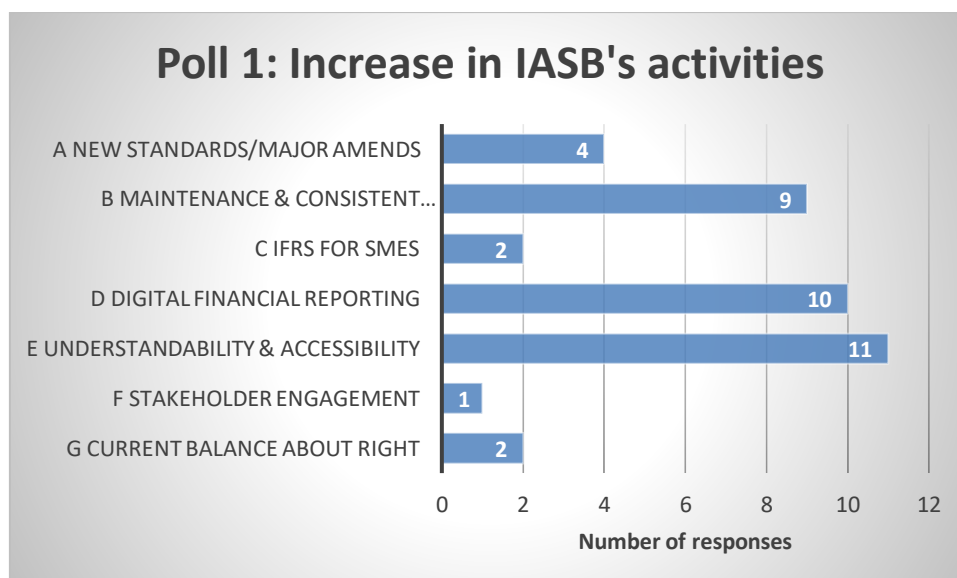
- 14. The remaining sections in this memo are as follows:
 - (a) outreach – conducted to date and ongoing;
 - (b) draft comment letter; and
 - (c) next steps.

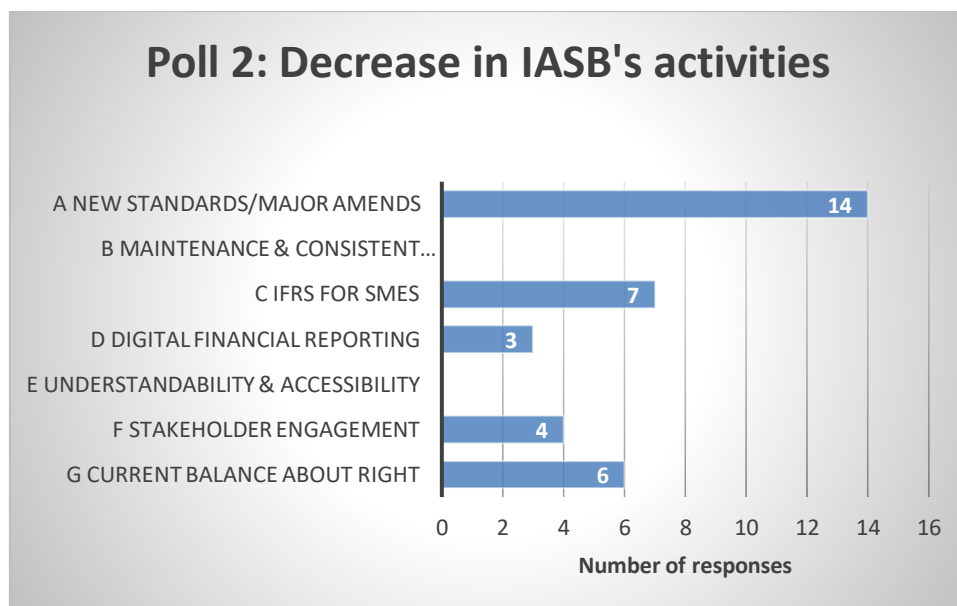
Outreach

- 15. We have conducted a variety of outreach activities and received feedback from:
 - (a) the NZAuASB at the February Joint Boards’ meeting;
 - (b) the March meeting of the Technical Reference Group (TRG);
 - (c) the May XRB Virtual Event – “Shape future agenda priorities”; and
 - (d) the NZASB’s [online survey](#) launched in May.
- 16. More details about the XRB Virtual event and the online survey are set out below. The survey will continue to be promoted via our normal communication channels. We intend to update the Board on the survey feedback received to date at the Board meeting.

Virtual Event

- 17. Staff hosted an XRB Virtual event on the Agenda Consultation entitled “Shape future agenda priorities” on 26 May 2021. This was presented by Sue Lloyd, Vice-Chair IASB, and Rafal Markowski, Project lead on the IASB Agenda Consultation project.
- 18. 66 people registered for the event, and 40 people attended the live event online. Two polls about the balance of the IASB activities were held during the event.





19. The poll results indicated a strong preference for a decrease in IASB activity in developing new standards and major amendments to standards. This could be indicative of a level of preparer fatigue after implementing recent major new IFRS Standards e.g. IFRS 9, IFRS 15, IFRS 16, and IFRS 17.
20. There was strong support for an increase in the IASB's activities in relation to understandability and accessibility and digital financial reporting. We think respondents supported an increase in digital financial reporting as it relates to the digitisation of IFRS Standards and future developments in digital reporting. The project scope for digital financial reporting in the RFI is conveyed exclusively in terms of development of the IFRS Taxonomy which we have not adopted in New Zealand.
21. There was also a significant amount of support for an increase in maintenance and consistent application activities. Interestingly, the polls did not indicate strong support for increased stakeholder engagement. This could reflect preparer consultation fatigue.
22. The overall preference for a decrease in activities relating to the *IFRS for SMEs* Standard is probably because we have not adopted this standard in New Zealand.

Online Survey

23. In addition to the XRB Virtual event, an Agenda Consultation Survey (the Survey) was launched on the XRB website, which registrants to the Virtual event were encouraged to complete. We have also sent the Survey details to the XRB Board, NZAuASB, Accounting TRG and XRAP members.
24. Externally we have contacted the Heads of the Schools of Accountancy at all New Zealand Universities to pass on the survey details to their Financial Accounting Lecturers and other interested staff. We have also contacted ten CFOs from issuers, and fifteen investors and sharebrokers. To date we have had thirteen responses.

25. The Survey was developed on SurveyMonkey and takes about 15 minutes to complete. It substantially follows the format of the IASB survey with some amendments to assist with developing the NZASB response to the IASB.
26. We plan to keep the survey open over the June/July period and promote through various communication channels. The Survey results will be collated for the NZASB's 12 August meeting, where we intend to submit a near final comment letter.
27. The Survey can be accessed at: <https://www.surveymonkey.com/r/IASB3AC>

Draft comment letter

28. The draft comment letter at agenda item 5.2, reflects feedback from the:
 - (a) Joint Boards' meeting held in February;
 - (b) TRG meeting in March;
 - (c) NZASB meeting held in April;
 - (d) XRB Virtual event in May; and
 - (e) NZASB survey responses received to date.
29. At the meeting, we will ask the Board for feedback on the questions in the draft comment letter.

Next steps

30. Our planned next steps are to:
 - (a) continue to promote and collate responses to the Survey; and
 - (b) present a near final comment letter to the August NZASB meeting for approval.

Attachments

- Agenda item 5.2: Draft comment letter
- Agenda item 5.3: Request for Information: *Third Agenda Consultation* (supplementary paper)
- Agenda item 5.4: Memo on Going concern issues
- Agenda item 5.5: *Going Concern – a focus on disclosure*
- Agenda item 5.6: *IFRS Standards and climate-related disclosures*

Appendix A – AASB staff preliminary views on the Agenda consultation

The table below sets out the AASB staff preliminary view on each of the three parts of the Agenda consultation:

- (a) strategic balance and direction of the IASB’s activities;
- (b) criteria for adding projects to the IASB’s work plan; and
- (c) financial reporting issues that could be added to the IASB’s work plan.

AASB staff have advised that these recommendations are based on initial feedback from two outreach sessions and may change based on any additional outreach or submissions received in the coming months.

A.	Strategic balance and direction of the IASB’s activities
	<ul style="list-style-type: none"> • Recommend the IASB increase its current level of focus on digital reporting and the maintenance and consistent application of IFRS Standards. The latter of these was the most selected area by stakeholders during outreach to date – users were particularly keen for the IASB to focus on the recently implemented standards such as IFRS 16 to ensure their consistent application. • To compensate for the recommended increases in focus, the recommendation is for the IASB to decrease its current level of focus on the development of new IFRS Standards and major amendments to IFRS Standards. Although AASB staff have received some mixed views on this, many stakeholders (mainly users) believed the current focus on this activity (40-45%) was quite high and there was not a large demand for new standards as these stakeholders were of the view that the market is still adjusting to the implementation of standards such as IFRS 15 and IFRS 16. • Recommend the IASB maintain its current level of focus on all other activities (AASB staff did not hear strong views on any of these).
B.	Criteria for adding projects to the IASB’s work plan
	<ul style="list-style-type: none"> • Recommend the IASB maintain the existing criteria used. AASB staff did not hear any strong views in favour of changing the existing criteria or adding new criteria.

C.	Financial reporting issues that could be added to the IASB’s work plan
	<ul style="list-style-type: none"> • Recommend the IASB add the following projects to its upcoming work plan as a <u>High priority</u>: <ul style="list-style-type: none"> ○ Intangible Assets – Develop improved disclosures about intangibles not recognised as assets (medium-sized project). This was the most selected project by stakeholders throughout the outreach to date with primary concerns raised around the inconsistency in reporting and valuation of internally generated versus acquired intangibles and amortisation of goodwill. ○ Going concern – Develop specific examples and explicit step-by-step guidance for preparers on how to assess going concern and undertake a research project to better understand the extent of underlying issues regarding the preparation of financial statements on a non-going concern basis (large project) – though not selected by as many stakeholders during agenda consultation outreach to date. However, AASB staff have consistently heard from stakeholders throughout the past year that this is a high priority area. • Recommend the IASB add the following projects to its work plan as a <u>Medium priority</u>: <ul style="list-style-type: none"> ○ Climate-related risks – Provision of further information of the effect of climate-related risks on the carrying amounts of assets and liabilities in the financial statements (medium-sized project). This was selected by a number of stakeholders across both outreach sessions to date who provided support for more information in the financial statements but were also conscious of the upcoming Trustees’ review and consideration of a sustainability reporting standards board. ○ Statement of cash flows and related matters – Develop more effective disclosures about ongoing maintenance expenses and growth expenditure (small project). During outreach this was selected as a priority due to concerns surrounding the effectiveness of disclosures about ongoing maintenance and growth expenditure as a result of the existing lack of separation of what is considered maintenance versus growth.

[date]

Mr Andreas Barckow
Chairman of the International Accounting Standards Board
IFRS Foundation
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Submitted to: www.ifrs.org

Dear Andreas

Request for Information – *Third Agenda Consultation*

Thank you for the opportunity to comment on the Request for Information – *Third Agenda Consultation* (RFI). The RFI has been exposed for comment in New Zealand and some New Zealand constituents may comment directly to you.

[The main points will be noted in the cover letter]

Our recommendations and responses to the specific questions for respondents are provided in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Tracey Crookston (tracey.crookston@xrb.govt.nz) or me.

Yours sincerely

Carolyn Cordery
Chair – New Zealand Accounting Standards Board

Appendix

RFI Question 1—Strategic direction and balance of the Board’s activities	
(a)	Should the Board increase, leave unchanged or decrease its current level of focus for each main activity? Why or why not? If you think the Board should increase or decrease its current level of focus on each of its activities, could you please specify the types of work within each activity that the Board should increase or decrease.
(b)	Should the Board undertake any other activities within the current scope of its work?

Response to question 1(a)

Preliminary staff view

1. We have set out in Table 1 below our preferences for the level of focus for each main activity.

Table 1: The IASB’s Main Activities

Activity	Objective	Percentage in RFI	Increase/ Decrease/ Unchanged?
Developing new IFRS Standards and major amendments to IFRS Standards ¹	Research issues and, if appropriate, develop major new financial reporting requirements	40-45%	Unchanged
Maintenance and consistent application of IFRS Standards	Help stakeholders obtain a common understanding of financial reporting requirements	15-20%	Increase
The <i>IFRS for SMEs</i> Standard	Provide financial reporting requirements tailored for companies that do not have public accountability (SMEs)	5%	- ²
Digital financial reporting	Facilitate the digital consumption of financial information	5%	- ³
Understandability and accessibility of the Standards	Improve the understandability and accessibility of our financial reporting requirements	5%	Increase
Stakeholder engagement	Obtain views to support the development of high-quality financial reporting requirements and promote acceptance of the Standards	20-25%	Increase

¹ Includes the PiR of IFRSs 10–12 and the PiR for IFRS 9, 15 and 16.

² We have not provided comments on the activity level relating to the *IFRS for SMEs* standard because this is not used in New Zealand. We appreciate internationally there is a need to keep the standard up to date.

³ We have not provided comments on the activity level relating to Digital financial reporting because we do not use the IFRS Taxonomy in New Zealand. We are supportive of the IASB using technology to improve the accessibility, understandability and useability of IFRS Standards.

Developing new IFRS Standards and major amendments to IFRS Standards (40–45%)Paragraph 21 of the RFI:

“... If the current level of focus on activities related to new IFRS Standards and major amendments to IFRS Standards remains unchanged... the Board expects to be able to start two or three large projects, or four to five medium-sized projects, or seven to eight small projects after setting aside work to: ... (a) continue projects on its work plan as described in Appendix A ... (b) conduct the required post-implementation reviews of IFRS 9, IFRS 15 and IFRS 16, (c) undertake some time-sensitive projects that may arise after this agenda consultation – for example possible follow on projects from the required post-implementation reviews...”

2. Our preference is that the percentage of the Board’s activities for developing new IFRS Standards and major amendments to IFRS Standards remains unchanged, particularly when we consider that this activity includes the post-implementation reviews as well as development of new IFRS Standards.
3. Feedback from some constituents has indicated support for the IASB decreasing its allocation of resources to new IFRS Standards and major amendments to IFRS Standards. Many preparers are still navigating the disruption and ongoing uncertainty caused by COVID-19 and there is some preparer fatigue from the implementation of recent major new standards – IFRS 9, IFRS 15, IFRS 16, and IFRS 17.
4. We appreciate this call to not introduce any new major standards over the next 2–3 years, but we do not think this should distract from the IASB continuing its focus on developing new standards or major amendments in the longer term. We are therefore supportive of the IASB allowing appropriate time for the development of new standards, including for public consultation and implementation periods.

Question for the Board

- Q1. Does the Board have any comments on the draft response to the ‘Developing new IFRS Standards and major amendments to IFRS Standards’ activity?

Maintenance and consistent application of IFRS Standards (15–20%)Page 13 of the RFI

“... The Board, together with the Interpretations Committee, maintains and supports the consistent application of IFRS Standards by:

- (a) monitoring the consistent application of IFRS Standards;*
- (b) developing narrow-scope amendments to, and interpretations of, IFRS Standards;*
- (c) publishing agenda decisions that improve consistency in the application of IFRS Standards;*
- (d) using transition resource groups to support the implementation of new IFRS Standards*
- (e) providing educational materials such as webinars, webcasts and articles; and*
- (f) supporting regulators and national standard-setters in their role to support consistent application of the IFRS Standards*

5. Our preference is for the IASB’s maintenance and implementation activities to increase. We have received feedback from constituents that the IASB needs to increase its activities in relation to the understandability of IFRS Standards (see our response in paragraphs 12–17 below). Therefore, we consider the “providing educational materials” and “simplification of the standards” aspects of this activity should be increased. We also suggest some efficiencies that could be made through the processing of narrow-scope amendments to help address preparer and standard-setter fatigue.
6. Feedback from our constituents has indicated support for the IASB to increase its focus on providing educational materials to support preparer application and understandability of IFRS Standards. IFRS Standards have become increasingly complex, and constituents have suggested that the IASB simplify IFRS Standards or invest additional resources in making them more understandable.
7. While we agree that maintenance and implementation projects are an important part of standard-setting, we encourage the IASB not to devote too much of its time and attention to minor technical matters at the expense of more significant projects. We consider it would be helpful for the IASB to reduce the number of maintenance due process documents that it issues by combining minor amendments into annual omnibus improvements where possible.
8. The work involved in making minor changes to a standard takes time and effort for the IASB, national standard-setters and users. Due process is necessary, even for small changes, and standard-setting fatigue for all participants can result from the need to adopt and implement on-going minor changes.
9. We encourage the IASB to continue to batch minor amendments to standards where possible. This could be achieved by broadening the criteria for annual improvements to allow a broader range of amendments to be incorporated into this project. Alternatively, it may be possible to group narrow-scope amendments together in a single exposure draft. Reducing the number of consultation documents issued to address narrow-scope amendments would be appreciated by national standard setters and preparers.

Question for the Board

- Q2. Does the Board have any comments on the draft response to the 'Maintenance and consistent application of IFRS Standards' activity?

The IFRS for SMEs Standard (5%)

10. We have not provided comments on the level of activity related to the *IFRS for SMEs* standard because this is not used in New Zealand. We appreciate internationally there is a need to keep the standard up to date.

Digital financial reporting (5%)

11. The RFI describes the IFRS Taxonomy as the focus of the Digital financial reporting activity. We have not provided comments on the level of activity related to Digital financial reporting because we have not adopted the IFRS Taxonomy in New Zealand.
12. We do, however, strongly support the IASB's focus on improving accessibility of the IFRS Standards in the digital environment as this will inevitably improve the usability of IFRS Standards. We have encouraged the IASB to dedicate additional resources to this as part of the 'understandability and accessibility' activity.

Question for the Board

- Q3. Does the Board have any comments on the draft response to the 'IFRS for SMEs standard' or 'Digital financial reporting' activities?

Understandability and accessibility of the Standards (5%)Page 16 of the RFIUnderstandability

... Examples of what more the Board could do:

A 2017 survey report on the reputation of the IFRS Foundation identified stakeholders' need for simple, practical and workable Standards. To respond comprehensively to such needs, the Board could:

- *create an inventory of possible areas of unnecessary complexity in applying financial reporting requirements and assess whether improvements can be made to those areas.*
- *improve the understandability of the Standards in those areas by undertaking projects that:*
 - *amend existing requirements to reduce unnecessary complexity.*
 - *make changes to the way in which Standards are drafted so that Standards are more clearly articulated and consistent terminology and structure are used. This approach could be applied to amend existing Standards or to develop new Standards.*

Accessibility

The Board could further improve accessibility by using technology and other tools to help stakeholders find materials that are most relevant to them and understand how those materials relate to each other.

13. We strongly support an increase in the IASB's work on improving the understandability and

accessibility of IFRS Standards.

14. Over time, IFRS Standards have become increasingly complex and our constituents have said that they would like greater clarity in the standards. We are supportive of the IASB undertaking projects to clarify existing requirements to reduce unnecessary complexity and to ensure that the standards are more clearly articulated with a consistent terminology and structure.
15. We consider this approach to improving understandability should be applied across the development of any new IFRS Standards and amendments and suggest that such an approach could be used to eventually update the existing suite of standards (including IASs).
16. We also encourage the IASB to explore how advances in technology are changing the way information is consumed and to assess the extent to which technological improvements are needed in the way in which the Board writes the standards.
17. We support the Board improving accessibility by using technology and other tools to help stakeholders find materials that are most relevant to them and to understand how those materials relate to each other (as identified in the RFI as potential future work for the IASB).
18. While it is important to improve accessibility, clarity and understandability of IFRS Standards, it is also important that such improvements lead to improved accessibility and understandability of the financial statements.

Question for the Board

- Q4. Does the Board have any comments on the draft response to the 'Understandability and accessibility of Standards' activity?

Stakeholder Engagement (20-25%)

Page 17 of the RFI

... Examples of what more the Board could do:

- *increase engagement with a broader range of stakeholders through standing consultative groups, informal dialogue and events.*
- *increase engagement on formal consultations by further exploring, and using, digital-friendly approaches, such as surveys to supplement the comment letter process.*
- *arrange more investor-focused educational materials and initiatives to increase investor engagement across the Board's activities.*

19. We support an increase in IASB activities in relation to stakeholder engagement.
20. Stakeholder engagement is vital in ensuring that the IFRS Standards are fit for purpose and meet the needs of the primary users of the financial statements.
21. We agree that stakeholder engagement on formal consultations could be enhanced by the IASB exploring and using digital friendly approaches (e.g. the survey for the Agenda consultation) to supplement the comment letter process.
22. We encourage the IASB to continue to hold virtual events, which have been very successful in New Zealand, to communicate with stakeholders on forthcoming discussion papers, exposure

drafts, etc. to solicit engagement and input at the early stages of IASB projects.

23. We also encourage the IASB to increase engagement with a broader range of stakeholders (e.g. valuers) through consultative groups, informal dialogue and other events. A broader level of input will provide a different perspective and assist decision-making in relation to complex accounting issues. Consideration of a broader range of views as part of the standard-setting process may also help to identify and address practical application issues at an earlier stage.

<p>Question for the Board</p> <p>Q5. Does the Board have any comments on the draft response to the ‘Stakeholder Engagement’ activity?</p>
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<p>RFI Question 2—Criteria for assessing which projects to add to the work plan</p> <p><i>(refer to the seven factors in diagram below)</i></p> <p>(a) Do you think the Board identified the right criteria to use? Why or why not?</p> <p>(b) Should the Board consider any other criteria? If so, what additional criteria should be considered and why?</p>

Factor	What is considered
1. The importance to investors	<ul style="list-style-type: none"> Whether addressing the issue improves financial reporting for the primary users of general purpose financial reports (as defined by the Conceptual Framework). The extent to which existing practice adequately addresses the issue for investors. If the issue is one of diversity in practice, how problematic is that for investors.
2. Deficiency in Reporting	<ul style="list-style-type: none"> Whether the issue is due to standard-setting or compliance. If there is a compliance problem, whether a standard-setting solution is feasible (criterion 6).
3. Companies affected, prevalence? (which jurisdictions?)	<ul style="list-style-type: none"> Data on prevalence of the issue. Types of companies affected and in what jurisdictions, regional or global?
4. How pervasive or acute is the matter?	<ul style="list-style-type: none"> Same as for (3) above.
5. Interaction with other projects	<ul style="list-style-type: none"> Updated information as current work plan projects progress.
6. Complexity and feasibility	<ul style="list-style-type: none"> Information about previous project(s) on the issue that was not finalised. If the issue concerns the need for judgement in the application of the Standards, whether a standard-setting solution is feasible.
7. Board capacity	<ul style="list-style-type: none"> Updated information as current work plan projects progress.

24. We agree that the IASB has identified appropriate criteria when determining the priority of potential projects that could be added to the workplan. We acknowledge that balancing these criteria will always require an element of judgement.
25. However, an additional criterion could be added to reflect the need for the IASB to respond to changes in the broader economic or regulatory environment. We commend the IASB's timely response to the economic impact arising from the COVID-19 pandemic, in adding the *Covid-19-Related Rent Concessions* project to its workplan and undertaking the due process required to finalise this amendment. We also acknowledge the responsiveness of the IASB to changes in the regulatory environment in its standard-setting response to interest rate benchmark reform.
26. We support the inclusion of "Economic and regulatory environment impacts" as an additional criterion in assessing which projects to add to the work plan. This will assist the IASB in continuing to ensure that the Standards remain relevant and enable it to allocate resources in line with broader environmental changes.

Question for the Board

- Q6. Does the Board have any comments on the draft response to the 'factors considered by the IASB when deciding whether to include a project on the IASB's work plan' section of the draft comment letter?

RFI Question 3—Priority of financial reporting issues

- (a) What priority would give each of the potential projects described in the RFI—high, medium or low. In particular, we would like to know if your prioritisation refers to all or only some aspects included in the project description—for example, a project on intangible assets may mean recognition and measurement of currently unrecognised intangible assets or improved disclosure requirements about unrecognised intangible assets.
- (b) Should the Board add any financial reporting issues not described in the RFI? Please explain:
- (i) the nature of the issue; and
 - (ii) why you think the issue is important.

Note for the Board:

We have suggested 3 high priority projects based on the assumption that the Board agrees that the 40–45% allocation for the development of new IFRS Standards and major amendments to IFRS Standards remains unchanged.

27. We recommend the IASB add three large high priority projects on Intangible Assets, Going concern and Climate-related risks to its 2022-2026 work plan. We set out below our reasons for the potential projects' priority and size.
28. In **Appendix A**, we have rated as high, medium and low, the 22 Appendix B potential projects and the Appendix C list of financial reporting issues.

Intangible assets

The three options outlined in the RFI are set out below.

Intangible assets project options	Indicative Size
The Board could:	
(a) require improved disclosures about intangibles not recognised as assets	Medium
(b) require disclosures about the fair value of some intangible assets, especially those held for investment	Medium
(c) undertake a comprehensive review of the Standard, including the definition of intangible assets	Large

29. We support the IASB conducting a comprehensive review of IAS 38 *Intangible Assets* (option (c) above) for the reasons set out below.
30. As noted in our submission on the IASB Discussion Paper *Goodwill and Impairment*, intangible assets represent an important source of value for many entities. However, many internally generated intangible assets currently cannot be recognised on entities' balance sheets. In our view, both investors and preparers would benefit from the IASB considering how to provide a more complete view of an entity's intangible resources in the financial statements.
31. We consider that IAS 38 may be too restrictive about when internally generated intangible assets can be recognised and when subsequent measurement of intangible assets at fair value is permitted (i.e. reliance is currently placed on the presence of an active market).
32. As stated in the RFI, IAS 38 covers a variety of transactions and assets, many of which were not envisaged when the Standard was developed in 1998. As such, IAS 38 does not fully address some new types of transactions and assets, including intangible assets that are held for investment purposes or traded – for example, cryptocurrencies or emission allowances.
33. Cryptocurrencies are becoming more prevalent and accordingly 'cryptocurrencies and related transactions' is identified as a separate project within the RFI. We have heard from constituents that it is important that this topic is addressed by the IASB in its 2022–2026 work plan and consider that this could be included as part of a comprehensive review of IAS 38.
34. We are aware that the IFRS Interpretations Committee (the Interpretations Committee) has recently issued an agenda decision in relation to configuration or customisation of costs in a cloud computing arrangement (software as a service). This was based on a submission around the ability to recognise an intangible asset to reflect the upfront costs incurred as part of the arrangement. While the Interpretations Committee agreed not to add the matter to their standard-setting agenda, the decision does highlight potential issues that could be included in the review of IAS 38 as well as indicating the complexity and potential size of the project.
35. We are also aware that the AASB is currently undertaking a domestic research project into the recognition of intangibles focussing on internally generated intangible assets that are currently not permitted to be recognised, and recognising intangible assets that cannot be

revalued unless there is an active market. We note that the findings of this project may be a useful input into the IASB project on intangible assets.

Question for the Board

Q7. Does the Board have any comments on the draft response on a possible large high priority intangible assets project?

Going Concern

36. The four project options outlined in the RFI are set out below.

Going Concern project options	Indicative Size
The Board could:	
(a) develop enhanced requirements on how management should assess whether the going-concern basis of preparation is appropriate	Medium
(b) develop enhanced specific disclosure requirements about the going concern assumption	Medium
(c) develop requirements to specify the basis of accounting that applies when an entity is no longer a going concern	Large
(d) address the issues collectively as a single project	Large

37. Staff currently support recommending that the IASB conduct a ‘large’ high-priority project on going concern that will address all the issues identified in the RFI and other issues noted though the development of specific going concern disclosures in New Zealand. The AASB have also reached the preliminary view that going concern be classified as a large high-priority project by the IASB.

38. However, we are seeking further Board direction on this project before drafting this section of the comment letter – please refer to **agenda item 5.4**.

39. We will update the draft comment letter with the Board’s comments for the August Board meeting.

Climate-related risks

40. The four project options outlined in the RFI are set out below.

Climate-related risks project options	Indicative Size
The Board could:	
(a) lower the threshold for disclosing information about sources of estimation uncertainty in paragraph 125 ⁴ of IAS 1 <i>Presentation of Financial Statements</i> . A lower threshold for disclosing information about estimation uncertainty – such as elimination of the reference to ‘the next financial year’ – could result in the disclosure of more information about climate-related risks than companies currently disclose and improve the information available to investors. Such a change would have a pervasive effect on the requirements in IFRS Standards beyond just climate-related risks.	Medium
(b) broaden the requirements in IAS 36 <i>Impairment of Assets</i> for cash flow projections to be used in measuring value in use when testing assets for impairment. Paragraph 33(b) of IAS 36 requires cash flow projections to cover a maximum period of five years, unless a longer period can be justified. This requirement may be misinterpreted as restricting the consideration of material, long-term, climate-related effects on the value in use measurement.	Small
(c) consider combining the projects described in (a) and (b) to create a single project.	Large
(d) develop accounting requirements for various types of pollutant pricing mechanisms.	Large

41. We support option (c) because we consider that the projects described in (a) and (b) will provide the primary users of the financial statements with some of the information needed to understand the impact of climate-related risks on the entity.
42. We consider that more information should be disclosed about climate-related risks in general purpose financial statements. We recognise that there is a need for improvements in the quality and consistency of disclosures about climate-related risks by entities and the need for entities to comprehensively consider these types of risks across their business (e.g. as part of impairment modelling).
43. We note the article by Nick Anderson⁵ (IASB Board member) provides an analysis of how IFRS Standards and the concept of materiality can be applied to climate-related risks and other emerging risks and recognise that the IASB’s proposals in the RFI are aligned with this.
44. The IASB guidance to date has focused on materiality and how the principles within IFRS Standards require consideration of climate-related risks and disclosures about these

⁴ Paragraph 125 of IAS 1 requires a company to disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year.

⁵ [In Brief: Climate-related and other emerging risks disclosures: Assessing financial statement materiality November 2019](#)

types of risks. However, we consider the need to consider and disclose climate-related risks could be made more explicit within IFRS Standards. If this is not able to be achieved within the scope of the potential project identified in the RFI, we would encourage the IASB to develop educational materials or illustrative examples.

45. This would assist preparers to understand the requirements when accounting for the impacts of, and making disclosures about, climate-related risks especially as this is an emerging area.
46. We acknowledge that there are aspects around climate-related reporting and disclosures that are yet to be settled in the international standard-setting environment. We understand that the International Sustainability Standards Board (ISSB) may also have a role in relation to climate-related reporting and disclosures but that the nature and extent of this role will be clarified later this year.
47. However, whatever the final determination is in relation to the establishment of an ISSB, it is important that appropriate climate-related risk disclosures are provided in general purpose financial statements – i.e. this is an area within the scope of the IASB’s mandate.
48. We have also heard from constituents about the need for standard setting activities in relation to pollutant pricing mechanisms (option (d) above). Whether this is an area that will require attention from standard-setters in future years is to some extent dependant on the extent to which individual jurisdictions adopt these schemes. This could be an area of interest for the International Sustainability Standards Board.

Question for the Board

- Q8. Does the Board have any comments on the draft response on a possible large high priority climate-related risks project?

Other Matters

Other matters below are set out for the Board to note and consider as part of this agenda item.

Audit engagement-related disclosures

- *We understand that the AASB may include audit engagement-related disclosures in its submission on the Agenda Consultation – we need to consider whether to also include this in our comment letter. AASB staff have indicated that whether this is included in the submission is dependent on AASB discussion on a separate agenda item dedicated to audit engagement-related disclosures at the 21–22 June AASB meeting.*
- *We have set out in Appendix B comments made by the NZASB in recent comment letters to the IASB about potential future standard setting activities of the IASB and provided some comments in relation to this. As part of this analysis we have also noted the priority projects currently being progressed by the AASB staff at this stage of their IASB Agenda consultation project.*

Appendix A – Potential IASB projects and proposed NZASB priority rating

The Request for Information (RFI) – Third Agenda Consultation at question 3(a) on page 22, asks respondents to give a priority rating of High, Medium or Low to each of the potential projects described in Appendix B (highlighted in the table below in blue). We have set out below our rating of the 22 potential projects in Appendix B and Appendix C of the RFI.

Described projects	Proposed NZASB priority rating
Potential IASB projects⁶	
Borrowing costs	Low
Climate-related risks	High
Commodity transactions	Low
Cryptocurrencies and related transactions	Medium
Discount rates	Medium
Employee benefits	Low
Expenses — inventory and cost of sales	Low
Foreign currencies	Low
Going concern	High
Government grants	Medium
Income taxes	Medium
Intangible assets	High
Interim financial reporting	Low
Negative interest rates	Medium
Operating segments	Medium
Other comprehensive income	Medium
Separate financial statements	Low
Statement of cash flows and related matters	Medium
Research Pipeline Projects⁷	
Discontinued operations and disposal groups	Low

⁶ These potential projects were suggested to the IASB during outreach conducted to help prepare the RFI.

⁷ These are the remaining research pipeline projects that arose from the 2015 Agenda Consultation. These projects were not started because of the need to devote resources to other projects (see Table 3 on page 21 of the RFI).

Described projects	Proposed NZASB priority rating
Inflation	Low
Pollutant pricing mechanisms	Medium
Variable and contingent consideration	Low
<i>Other financial reporting issues suggested to the Board⁸</i>	
Align the definition of cost in IFRS Standards	Low
Clarify the accounting for transactions with owners (including government owners) acting in their capacity as owners	Low
Converge IFRS 13 <i>Fair Value Measurement</i> with International Valuation Standards	Medium
Develop accounting requirements for assets acquired at no cost (from related and third parties)	Medium
Develop enhanced disclosures about the process used in determining materiality, including quantitative thresholds applied	Medium
Develop standardised disclosure of financial ratios with numerators and denominators based on line items presented in the primary financial statements	Low
Review the accounting for shares bought back to replace shares granted in share-based payment transactions	Low
Review the requirements of IAS 33 <i>Earnings per Share</i> in the light of changes to the business environment and the Conceptual Framework for Financial Reporting	Low
Review the requirements of IAS 36 <i>Impairment of Assets</i>	Medium
Review the requirements of IAS 41 <i>Agriculture</i> , focusing on immature biological assets that cannot be sold in their current condition	Low

⁸ The 'other financial reporting issues' projects were suggested to the IASB by a small number of stakeholders in the outreach carried out before publishing the RFI (see Appendix C on page 54 of the RFI).

Appendix B – Comments made by the NZASB in previous comment letters to the IASB

IASB Publication	NZASB comment	Points to note
<p>DP on <i>Goodwill and Impairment</i></p>	<p><i>Extract from the NZASB cover letter (Dec 2020) – DP Goodwill and Impairment</i> Our comments should be read in the following context:</p> <p>Section 6 of the DP refers to the 2019 research report by the Australian Accounting Standards Board (AASB), entitled AASB Research Report 9 Perspectives on IAS 36: A Case for Standard Setting Activity (AASB Research Report). The AASB Research Report notes that the ongoing application issues relating to IAS 36 <i>Impairment of Assets</i> demonstrate a consistent divergence in preparers’, users’, auditors’ and regulators’ understanding of the impairment requirements. Consequently, the AASB Research Report recommends a holistic review of IAS 36. Section 6 of the DP notes that such a holistic review is beyond the scope of this project. However, stakeholders who consider that such a holistic review is required are encouraged to provide this feedback by responding to the IASB’s forthcoming 2020 agenda consultation.</p> <p>While we have focused our responses on the specific matters discussed in the DP, we would strongly support a holistic review of IAS 36 and intend to make a recommendation to that effect when we comment on the IASB’s forthcoming agenda consultation.</p>	<ul style="list-style-type: none"> • We have not included the need for a holistic review of IAS 36 in the draft comment letter. If we suggested this it would be considered another “high” priority project. It is currently rated as a “Medium” in the Appendix C list on page 13. • The AASB comment letter to the IASB on the DP <i>Goodwill and Impairment</i> did not mention the need for a holistic review of IAS 36 <i>Impairment</i>. • The AASB is not currently progressing a comprehensive review of IAS 36 as part of its response to the Agenda consultation. • AASB staff have indicated that the priority projects being progressed at this stage are: <ul style="list-style-type: none"> ○ Intangible Assets (medium-sized project) ○ Going concern (large project) ○ Climate-related risks (medium-sized project) ○ Statement of cash flows and related matters (small project)
<p>DP on <i>Goodwill and Impairment</i></p>	<p><i>Extract from the NZASB cover letter (Dec 2020) – DP Goodwill and Impairment</i> Our comments should be read in the following context:</p> <p>We also intend to recommend a holistic review of the accounting for goodwill and other intangible assets, including internally generated intangible items that are not recognised under current requirements in IFRS® Standards. In today’s</p>	<ul style="list-style-type: none"> • In our draft comment letter we suggest the IASB give high priority to a large project on Intangible Assets.

IASB Publication	NZASB comment	Points to note
	<p>economy, intangible assets represent an important source of value for many entities. However, many internally generated intangible assets currently cannot be recognised on entities’ balance sheets. We think that both investors and preparers would benefit from the IASB considering how to provide a more complete view of an entity’s intangible resources in the financial statements. We would strongly support a holistic review of the accounting for intangible assets in general – and we think that changes in the accounting for goodwill should be considered in the wider context of such a review.</p>	
<p>IASB ED/2019/7 <i>General Presentation and Disclosures</i></p>	<p>We believe to improve the communication of information about income and expenses included in OCI the IASB needs to clearly describe the distinction between profit or loss and OCI and the role of recycling.</p> <p>Extract from NZASB comment letter on ED/2019/7 General Presentation and Disclosures [Sept 2020]:</p> <p>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.</p>	<ul style="list-style-type: none"> • We have not included this point in the draft comment letter at this stage. • The TRG feedback in March was that OCI is generally understood and accepted even if there is no overriding principle – so they would not elevate this potential project to a “high” priority. • OCI is listed as one of the 22 potential projects on page 31 of the RFI. • The RFI (page 49) notes the following in relation to the indicative size of a potential project on OCI: “Applying the principles for the classification of income and expenses in other comprehensive income (and recycling) in the <i>Conceptual Framework</i> to IFRS Standards and considering whether to amend the requirements of those IFRS Standards is likely to be a <i>large</i> project”.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 11 June 2021

To: NZASB Members

From: Judith Pinny

Subject: **IASB – *Third Agenda Consultation*: Going concern issues**

Purpose and introduction¹

1. The purpose of this paper is to provide background information to assist the Board in reaching a view on whether the topic of *going concern* should be recommended as a high-priority project for the IASB Work Plan 2022 to 2026.
2. The Board has previously indicated support for positioning the topic of going concern as a high-priority project in its submission on the IASB's *Third Agenda Consultation*. This view was based on the importance of the going concern assumption in the preparation of general purpose financial statements, which resulted in domestic standard-setting activity in 2020 to introduce improved going concern disclosures,
3. In reaching a view on the priority of a future IASB going concern project, a key consideration is whether the IASB educational material on this topic issued in January 2021 adequately addresses the issues previously identified by the Board or whether further international standard-setting activity is required.
4. This memo includes an overview of going concern issues previously discussed by the Board and those identified by the Australian Accounting Standards Board (AASB). While the focus of this Board has been on improving going concern disclosures², the work of the AASB has been focused on encouraging the IASB to develop requirements to specify the basis of accounting that applies when an entity is no longer a going concern.

Recommendations

5. The staff view is that the Board should:
 - (a) support adding a going concern project to the IASB work plan;
 - (b) prioritise this project as a high priority; and

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 When an entity has concluded it is a going concern, but this management judgement has involved significant judgement and/or the consideration of material uncertainties.

- (c) recommend that the scope of the potential IASB project should include:
 - (i) developing enhanced specific disclosure requirements about the going concern assumption;
 - (ii) developing requirements to specify the basis of accounting that applies when an entity is no longer a going concern; and
 - (iii) addressing the issues collectively in a single project, which will allow for other going concern issues to be considered.

Structure of Paper

- 6. The paper is structured as follows:
 - (a) Going concern disclosures
 - (i) Current IFRS requirements
 - (ii) XRB response
 - (iii) Australian response
 - (iv) International Forum of Accounting Standard Setters (IFASS) feedback
 - (b) Discussion of additional issues
 - (c) IASB response – educational materials
 - (d) Trans-Tasman considerations
 - (e) IASB Agenda Consultation
 - (f) Staff view
 - (g) Question for the Board

Going concern disclosures

Current IFRS requirements

- 7. Paragraph 25 of IAS 1 *Presentation of Financial Statements* requires any material uncertainties about events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern to be disclosed in the financial statements.

Going concern	
25	When preparing financial statements, management shall make an assessment of an entity’s ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.
26	In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may

reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

8. In addition to the above requirements, the general disclosure requirements in paragraph 122 of IAS 1 would also be relevant when an entity has been required to apply significant judgements to reach the view that:
- (a) there are no events or conditions at the reporting date that may cast significant doubt upon an entity's ability to continue as a going concern; or
 - (b) there are material uncertainties related to future events or conditions that may cast significant doubt upon an entity's ability to continue as a going concern that require disclosure in accordance with paragraph 25 of IAS 1.

122 An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), 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.

9. Paragraph 125 of IAS 1 may also be relevant if the assumptions and uncertainties considered as part of the going concern assessment also represented estimation uncertainties that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Therefore, the application of paragraph 125 may result in entities providing useful information where an entity has applied significant judgement or there are material uncertainties related to the going concern assessment.

Sources of estimation uncertainty

125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

- (a) **their nature, and**
- (b) **their carrying amount as at the end of the reporting period.**

10. In addition, agenda decisions issued by the IFRS Interpretations Committee in response to queries about the disclosure requirements in IAS 1 may be helpful in considering the application of IAS 1 in relation to going concern disclosures.³ These agenda decisions are shown below.

³ IFRS Interpretations Committee Agenda Decisions on Going concern disclosure (IAS 1):

July 2010 <https://cdn.ifrs.org/-/media/feature/supporting-implementation/agenda-decisions/ias-1-going-concern-disclosure-july-2010.pdf>

July 2014 <https://cdn.ifrs.org/-/media/feature/supporting-implementation/agenda-decisions/ias-1-disclosure-requirements-relating-to-assessment-of-going-concern-jul-14.pdf>

IAS 1 Presentation of Financial Statements (July 2010)**IAS 1 Financial Statement Presentation – Going concern disclosure**

The Committee received a request for guidance on the disclosure requirements in IAS 1 on uncertainties related to an entity's ability to continue as a going concern. How an entity applies the disclosure requirements in paragraph 25 of IAS 1 requires the exercise of professional judgement. The Committee noted that paragraph 25 requires that an entity shall disclose 'material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern'. The Committee also noted that for this disclosure to be useful it must identify that the disclosed uncertainties may cast significant doubt upon the entity's ability to continue as a going concern.

The Committee noted that IAS 1 provides sufficient guidance on the disclosure requirements on uncertainties related to an entity's ability to continue as a going concern and that it does not expect diversity in practice. Therefore, the Committee decided not to add the issue to its agenda.

Disclosure requirements relating to assessment of going concern (IAS 1 Presentation of Financial Statements)—July 2014

The Interpretations Committee received a submission requesting clarification about the disclosures required in relation to material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

The Interpretations Committee proposed to the IASB that it should make a narrow-scope amendment to change the disclosure requirements in IAS 1 in response to this issue. At its meeting in November 2013 the IASB discussed the issue and considered amendments proposed by the staff, but decided not to proceed with these amendments and removed this topic from its agenda. Consequently, the Interpretations Committee removed the topic from its agenda.

The staff reported the results of the IASB's discussion to the Interpretations Committee. When considering this feedback about the IASB's decision, the Interpretations Committee discussed a situation in which management of an entity has considered events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. Having considered all relevant information, including the feasibility and effectiveness of any planned mitigation, management concluded that there are no material uncertainties that require disclosure in accordance with paragraph 25 of IAS 1. However, reaching the conclusion that there was no material uncertainty involved significant judgement.

The Interpretations Committee observed that paragraph 122 of IAS 1 requires disclosure of the judgements made in applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. The Interpretations Committee also observed that in the circumstance discussed, the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgements made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

XRB response

11. The Board reached the view at its May 2020 meeting that the economic effects of COVID-19 are expected to have a significant impact on the going concern assessments of a large number of entities in New Zealand, both now, and for some time in the future. Many entities will need to apply significant judgement and/or consider the impact of material uncertainties in assessing the entity's ability to continue as a going concern.

12. Consequently, the *Going Concern Disclosures* standards⁴ issued in August 2020 sought to address the increased need of investors and other users of financial statements for relevant and transparent information about:
 - (a) significant judgements and estimates made in management’s assessment of the entity’s ability to continue as a going concern, along with any material uncertainties; and
 - (b) management’s plans to mitigate the effect of any material uncertainties around the entity’s ability to continue as a going concern.
13. It was agreed that establishing specific going concern disclosure requirements will help preparers of financial statements when considering how to provide relevant and transparent information to investors and other users of their financial statements in these circumstances.
14. In addition, the proposals helped align the requirements in accounting standards with the disclosure expectations in the auditing standards. Historically, the going concern disclosure requirements in accounting standards were not as specific as the disclosure expectations in auditing standards. ISA 570 *Going Concern* requires the auditor to consider the adequacy of an entity’s going concern disclosures when significant judgement and/or material uncertainties are involved in the going concern assessment.
15. While the key driver for the *Going Concern Disclosures* standards was to respond to the increased uncertainty arising from the economic effects of COVID-19, the benefits of providing greater specificity in going concern disclosure requirements, as outlined above, are expected to endure over the long term. This provides increased rationale for standard-setting at an international level to be undertaken by the IASB.
16. As part of the XRB’s response to COVID-19 the XRB has taken other steps to inform entities about the importance of going concern disclosures during periods of increased future uncertainty. For example, *XRB Alert—Spotlight on Going Concern Disclosures*⁵ explained the key messages for directors and those charged with governance in relation to going concern disclosures and assurance requirements for for-profit entities⁶.

Australian Response

17. The AASB and Australian Auditing and Assurance Standards Board (AUASB) issued guidance on going concern disclosures in May 2020 in response to the COVID-19 pandemic.⁷ The AASB considered developing Australian-specific disclosure requirements at this time but elected not to. One reason for this was that such a project would not assist Australian entities with 30 June balance dates (the main balance date in Australia) given the timeframe required to undertake standard-setting response. The AASB also considered that the guidance material it had published was sufficient to promote improved going concern disclosures, and that additional standard-setting activity was need not needed ahead of the IASB.

⁴ *Going Concern Disclosures* (Amendments to FRS-44) and *Going Concern Disclosures* (Amendments to PBE IPSAS 1).

⁵ <https://www.xrb.govt.nz/information-hub/information-in-response-to-covid-19/implications-for-financial-reporting/>.

⁶ We have also issued an equivalent *XRB Alert* on going concern disclosure considerations for not-for-profit entities.

⁷ *The Impact of COVID-19 on Going Concern and Related Assessments: A joint publication by the AASB and AUASB*; May 2020. https://www.aasb.gov.au/admin/file/content102/c3/AASB-AUASB_TheImpactOfCOVID19_05-19.pdf

IFASS Feedback

18. The Director of Accounting Standards presented at virtual meetings of IFASS in September 2020 and March 2021.
19. The report from the September 2020 IFASS meeting noted the following from the Going Concern Disclosures presentation:

Mr. Heffernan introduced the NZASB's recent standard setting activities to address the concerns heightened by the COVID-19 pandemic which included the diversity in practice over the information provided when the financial statements were prepared on a going concern basis, but management was aware of the events or conditions that may cast significant doubt on this judgement, and perceived a disconnect between the disclosure requirements in accounting and auditing standards. To respond to the issues, the NZASB released the following new specific going concern disclosure requirements, which were an addition to the current disclosure requirements under *IAS 1 Presentation of Financial Statements*.

1. Specific disclosures about significant judgements management has applied in forming its conclusions on the entity's ability to continue as a going concern to the extent not already disclosed in accordance with paragraphs 122 and 125 of (NZ) IAS 1.
2. Disclosures about material uncertainties management is aware of in forming its conclusions on the entity's ability to continue as a going concern which require an entity to disclose
 - (a) that there are one or more material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern,
 - (b) information about the principal events or conditions giving rise to those material uncertainties,
 - (c) information about management's plans to mitigate the effect of those events or conditions, and
 - (d) that, as a result of those material uncertainties, it may be unable to realise its assets and discharge its liabilities in the normal course of business.

Mr. Heffernan asked:

1. whether IFASS participants encountered similar concerns over going concern disclosures in their respective jurisdictions;
2. whether IFASS participants agreed that more specific going concern disclosures in accounting standards should be required; and
3. whether IFASS participants agreed that the IASB should undertake a project to consider going concern disclosures.

IFASS participants who commented supported the suggestion that the IASB should undertake a project. One participant introduced the initiatives performed in the participant's jurisdiction in response to the COVID-19 pandemic which were not standard-setting but the publication of guidance on the standard-setter's website which gathered the relevant resources available. Another participant noted that the

guidance was not additional requirements but rather a specification of the current general requirements.

20. The report from the March 2021 IFASS meeting noted:

Mr. Heffernan noted that feedback from constituents has continued to be positive subsequent to the issuance of the amended standard and the next steps are to highlight going concern as a topic of importance through the IASB Agenda Consultation process. Mr. Heffernan also introduced other going concern issues raised through recent outreach.

IFASS participants shared their initiatives and accounting standard requirements in their jurisdictions while showing their support for the project. The discussion included when the going concern assumption is considered to be no longer appropriate. Participants from the IASB explained the status of the Agenda Consultation and noted that it is important for them to understand the jurisdictional information including the requirements around liquidation and the current accounting practice when the entity determined that the going concern assumption is no longer appropriate.

21. The issues raised through outreach undertaken in New Zealand (as discussed at the IFASS March 2021 meeting) included the following:

- (a) user lack of general understanding of what is meant by “going concern”;
- (b) no definition, and limited guidance on the meaning of, “material uncertainty”;
- (c) little guidance on how the going concern assessment should be undertaken and the level of analysis required;
- (d) introducing mandatory disclosure of an entity’s basis for applying the going concern assumption; and
- (e) whether the disclosure requirements in IAS 34 *Interim Financial Reporting* meeting user needs in relation to going concern.

22. Two constituents also raised the issue of the time-period for the going concern assessment during the consultation for Going Concern Disclosures. This is also discussed below.

Discussion on additional issues

Going concern and material uncertainty

- 23. In our view, defining the going concern concept within IAS 1 would enhance users’ understanding of the going concern concept. It would also be beneficial for educational materials to be developed to support the general understanding of this concept.
- 24. Similarly, a definition of material uncertainty to support paragraph 25 in IAS 1 would help clarify what is meant by this term. Additional guidance to assist preparers in understanding this term would also be welcomed.

Guidance on undertaking a going concern assessment

- 25. There is currently limited guidance on the process required to undertake a going concern assessment or the depth of analysis that is required when undertaking this assessment. It is

also unclear when a full going concern assessment is required. In our view, an improved understanding that an assessment is required in advance of the audit would be likely to result in a better outcome than doing so as part of the audit process, as is often the case. This results in preparers having difficult conversations with their auditors regarding what is required in terms of an assessment, and a corresponding financial statement disclosure, with the time pressure of an imminent audit deadline.

Mandatory disclosure of going concern status

26. An entity is not currently required to disclose in the financial statements whether it is a going concern or not. Entities are only required to provide disclosures in relation to their going concern position if this management decision has required significant judgement or consideration of material uncertainties. As noted above, clarification of what is meant by material uncertainty would enhance consistency in reporting and assist management (and preparers) in making decisions in relation to going concern disclosures.
27. There has been some discussion regarding whether IFRS Standards should make a positive statement around the appropriateness of the going concern basis, and disclosure of information used by management to support that assessment, as a mandatory requirement – regardless of there being any doubts over the going concern position. In all assignments auditors are required to assert that an entity is a going concern, and therefore the argument is raised that all entities should disclose their going concern position.
28. Reluctance to do this has in part been due to the “self-fulfilling prophecy” argument, where investors may read the statement, consider that the company is heading towards closure and lose confidence in the company, withdrawing their investment as a result. The idea is that any discussion on the going concern position of an entity is seen as a sign of weakness. The perceived fear by directors is that this may lead to a company ceasing to be a going concern.

Interim financial reporting

29. We note that the requirements in NZ IAS 34 *Interim Financial Reporting* were considered during the *Going Concern Disclosures* project. NZ IAS 34 already requires information about changes in economic circumstances in paragraphs 15 and 16. This was considered to include disclosures around events such as the COVID-19 pandemic, so the NZASB agreed that amendments to NZ IAS 34 were not required. However, if the resulting disclosures in the interim financial statements were considered inadequate, guidance should be developed to assist preparers in determining what should be disclosed.
30. The speed of the pandemic’s spread and the corresponding economic impact is unprecedented. The impact on the entity should have been reported in interim and final financial reports (depending on balance date) where they had a material effect on the entity. While financial personnel were busy responding to the economic effects of the pandemic, the detail required in the interim reports particularly, may well have been underestimated.

Timing

31. In addition, as part of the NZASB's consultation on *Going Concern Disclosures* in 2020, two respondents raised an issue with the period for the going concern assessment. The issue is as follows:
- (a) the auditing standards require that, when assessing an entity's ability to continue as a going concern, an entity must consider at least 12 months following the approval of the financial statements, which aligns with the date of the auditor's report;
 - (b) NZ IAS 1 refers to the period 12 months following the end of the reporting period; and
 - (c) NZ IAS 10 *Events after the Reporting Period* refers to the requirement to continually assess the going concern assumption up to the date of authorisation of the financial statements. This standard doesn't make it clear that this requires consideration of at least 12 months from the date of authorisation of the financial statements).

ISA (NZ) 570 (Revised) – relevant paragraphs:

NZ13.1 In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall consider the relevant period, which may be the same as or may differ from that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period. If management's assessment of the entity's ability to continue as a going concern covers less than the relevant period, the auditor shall request management to extend its assessment period to correspond to the relevant period used by the auditor. (Ref: Para. A11–A13)

NZ13.2 **Relevant period means the period of at least 12 months from the date of the auditor's current report.** (Emphasis added)

Application and Other Explanatory Material:

The Period of Management's Assessment (Ref: Para. 13)

A11. Most financial reporting frameworks requiring an explicit management assessment specify the period for which management is required to take into account all available information*.

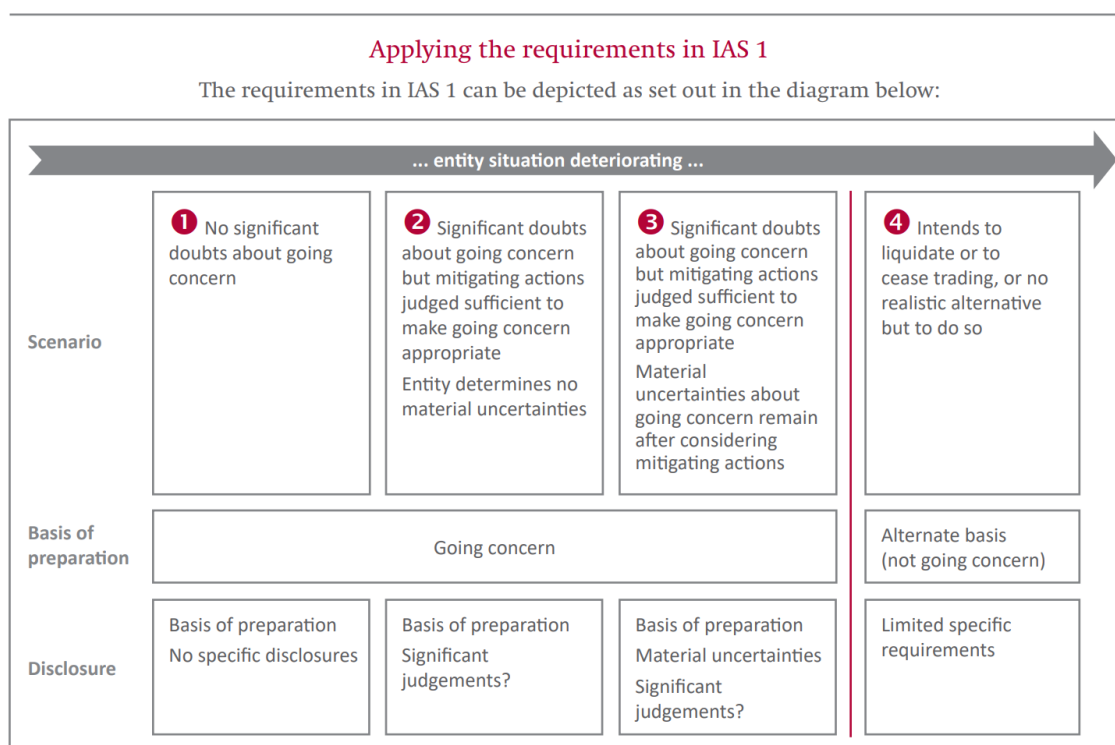
* For example, NZ IAS 1 defines this as a period that should be at least, but is not limited to, twelve months from the end of the reporting period.

32. The IASB's going concern educational material issued in January 2021 addressed the timing issue, suggesting that time periods longer than "12 months is not inconsistent with the requirement in IAS 1, which establishes a minimum period not a cap". However, given that IAS 1 and IAS 10 are arguably inconsistent, and IAS 10 aligns with the auditing standard requirements, a pragmatic solution may be to align IAS 1 with IAS 10 and the auditing and assurance standards.

33. A suggested solution is for the IASB to amend IAS 1 to require an entity to consider the going concern assessment at least 12 months from the date the financial statements are authorised for issue.

IASB Response – educational materials

34. In response to the COVID-19 pandemic the IFRS Foundation noted that, in the stressed economic environment, deciding whether the financial statements should be prepared on a going concern basis may involve a greater degree of judgement than usual. Their response was to publish educational material in January 2021⁸, as mentioned above.
35. The educational material discusses the considerations required when assessing an entity’s ability to continue as a going concern. Circumstances affecting management’s assessment of the entity’s ability to continue as a going concern might change rapidly in the current environment. The educational material discusses the disclosure requirements across a range of going concern assessment outcomes, as depicted by in the diagram below.



36. The educational material published by the IFRS Foundation to support consistent application of IFRS Standards does not change, or add to, existing requirements.
37. The educational material notes the following.
- (a) Management’s assessment of going concern is required to cover at least 12 months from the reporting date but this is a minimum period, not a cap.

⁸ [Going concern—a focus on disclosure](#), also agenda item 5.5.

- (b) The assessment must be updated to reflect the effect of events occurring after the end of the reporting period up to the date that the financial statements are authorised for issue.
- (c) Going concern assessments will often be subject to significant assumptions and judgements which would need to be disclosed under the general requirements of IAS 1 in addition to the specific going concern disclosures required in paragraph 25 of IAS 1.

Trans-Tasman considerations

- 38. The AASB has agreed to undertake a longer-term project focussed on influencing the IASB to undertake a fundamental review of the requirements related to the going concern assessment, disclosures and the basis of preparation where the going concern assumption is no longer appropriate.
- 39. At its November 2020 meeting, the AASB decided to develop a thought leadership paper addressing:
 - (a) the issues and available evidence regarding the adequacy of going concern disclosures currently required by accounting standards and the basis of preparation where the going concern assumption is no longer appropriate; and
 - (b) recommendations on how the IASB could address the issues identified.
- 40. The AASB will include the findings from the thought leadership paper in their submission to the IASB on the IASB's Agenda Consultation.
- 41. At its April 2021 meeting, AASB staff recommended that the following points be raised in the thought leadership paper (and the AASB submission on the IASB's Agenda Consultation).

Issue 1: Adequacy of current going concern disclosures

- Including specific examples and more explicit guidance for preparers on how to assess going concern in the Application Guidance in IAS 1.
- If the IASB decides not to adopt this option, staff recommend (at a minimum) that the IASB expands the educational material issued in January 2021 by providing more explicit guidance to preparers on how to assess going concern.

Issue 2: Lack of guidance on non-going concern preparation

- The IASB initiates a research project to assess:
 - (a) the situations in which financial statements are prepared on a non-going concern basis and how common they are;
 - (b) the extent to which local legislation and regulations regarding liquidation and solvency affect the basis of preparation of these financial reports and their content;
 - (c) who the primary users of these financial statements are and their information needs; and

- (d) the extent of current diversity in practice and therefore the need for standard-setting in this area.

42. The AASB agreed that the above recommendations should be included in the proposed thought leadership paper and the AASB’s submission to the IASB on its *Third Agenda Consultation*.

IASB agenda consultation

43. The potential going concern projects are discussed in the IASB’s Agenda Consultation *Request for Information*, and their indicative sizes:

Going Concern Project	Indicative Size
The Board could:	
(a) develop enhanced requirements on how management should assess whether the going-concern basis of preparation is appropriate	Medium
(b) develop enhanced specific disclosure requirements about the going concern assumption	Medium
(c) develop requirements to specify the basis of accounting that applies when an entity is no longer a going concern	Large
(d) address the issues collectively as a single project	Large

44. Part (a) addresses the factors that require consideration when assessing an entity’s going concern position – increased guidance has been requested by preparers in both New Zealand and Australia. Part (b) addresses specific disclosures introduced through New Zealand domestic amendments. Part (c) would address the issues being explored as part of the Australian project for when an entity is no longer a going concern. Part (d), addresses the issues collectively as a single project and could also consider other going concern assessment issues.

Staff View

45. We consider that there is sufficient user need and demand (by preparers, investors, auditors, regulators) to support the Board recommending that the IASB undertaking a larger going concern project. This project would encompass the specific issues identified in New Zealand and Australia, including the consideration of other issues identified (discussed in paragraphs 23–33 of this memo).

46. We appreciate the usefulness of the IASB education material on going concern issued in January 2021. However, given the fundamental nature of the going concern assumption for the preparation of financial statements, we think that the issues identified should be addressed through the development of authoritative and mandatory requirements. In addition, we note that improved information about the going concern assessment is critical for existing and potential investors in making decisions about investing resources.

47. Additional requirements often result in additional preparation and audit costs. However, additional specificity in relation to going concern disclosures may end up reducing costs and will promote improved financial reporting.
48. While the key driver for the current momentum around the Going Concern project was to respond to the increased uncertainty arising from the economic effects of COVID-19, the benefits of addressing all going concern issues are expected to endure over the long term. This provides increased rationale for standard-setting at an international level to be undertaken by the IASB.

Question for the Board

Does the Board support the following approach when commenting on going concern in its submission on the IASB’s Agenda Consultation?

- Recommending that a project on going concern be added to the IASB work plan – being a large project (Part (d)) as described in the IASB’s RFI.
- Prioritise this project as a high priority.
- recommend that the scope of the potential project include:
 - (a) developing enhanced specific disclosure requirements about the going concern assumption;
 - (b) developing requirements to specify the basis of accounting that applies when an entity is no longer a going concern; and
 - (c) addressing the issues collectively in a single project, which will allow for other going concern issues to be considered (such as those discussed in paragraphs 23–33 of this memo).

Attachment

- 5.5 IASB Educational Material: *Going concern – a focus on disclosure.*

Going concern—a focus on disclosure

This document is intended to support the consistent application of requirements in IFRS® Standards

A fundamental decision management has to make in preparing financial statements applying IFRS Standards is whether to prepare them on a going concern basis. In the current stressed economic environment arising from the covid-19 pandemic, many entities have seen a significant downturn in their revenue, profitability and hence liquidity which may raise questions about their ability to continue as a going concern. For such entities deciding whether financial statements are required to be prepared on a going concern basis may therefore involve a greater degree of judgement than is usual.

Most stakeholders are familiar with the specific discussion of going concern and related requirements in IAS 1 *Presentation of Financial Statements* to disclose material uncertainties relating to an entity's ability to continue as a going concern. However, questions raised about going concern in recent months have highlighted the relevance of other 'overarching' disclosure requirements in IAS 1 that interact with the specific going concern requirements. Considering this interaction is an important step in identifying material disclosures required by IFRS Standards; those disclosures are likely to be relevant for users of financial statements. One aspect of this interaction was highlighted in a [2014 Agenda Decision](#) published by the IFRS Interpretations Committee. This document not only recaps the content of that agenda decision but also highlights other possible interactions that might be relevant.

Assessing going concern

When preparing financial statements, whether annual or interim, IAS 1 requires management to assess the entity's ability to continue as a going concern. The Standard defines going concern by explaining that financial statements are prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

Paragraph 26 of IAS 1 states that factors that management may need to consider when assessing whether the going concern basis of preparation is appropriate are those factors that relate to the entity's current and expected profitability, the timing of repayment of existing financing facilities and potential sources of replacement financing. In the current stressed economic environment, an entity may be affected by a wider range of factors than in the past. IAS 1 requires management to take into account all available information about the future. Therefore, management may need to consider this wider range of factors before it can conclude whether preparing financial statements on a going concern basis is appropriate. For instance, among the factors management may need to consider are the effects of any temporary shut-down or curtailment of the entity's activities, possible restrictions on activities that might be imposed by governments in the future, the continuing availability of any government support and the effects of longer-term structural changes in the market (such as changes in customer behaviour).

When assessing whether to prepare financial statements on a going concern basis, IAS 1 requires management to look out at least 12 months from the end of the reporting period—but emphasises that the outlook is not limited to 12 months. Some national regulations require consideration of going concern for 12 months from the date that financial statements are authorised for issue. Considering time periods longer than 12 months is not inconsistent with the requirements in IAS 1, which establishes a minimum period, not a cap.

A dynamic assessment

Circumstances affecting management’s assessment of the entity’s ability to continue as a going concern might change rapidly in the current environment. Paragraph 14 of IAS 10 *Events after the Reporting Period* explains that management’s assessment of the use of a going concern basis of preparation needs to reflect the effect of events occurring after the end of the reporting period up to the date that the financial statements are authorised for issue. This might require management to update assessments of the going concern basis of preparation and decisions about which disclosures are necessary. If, before the financial statements are authorised for issue, circumstances were to deteriorate so that management no longer has any realistic alternative but to cease trading, the financial statements must not be prepared on a going concern basis.

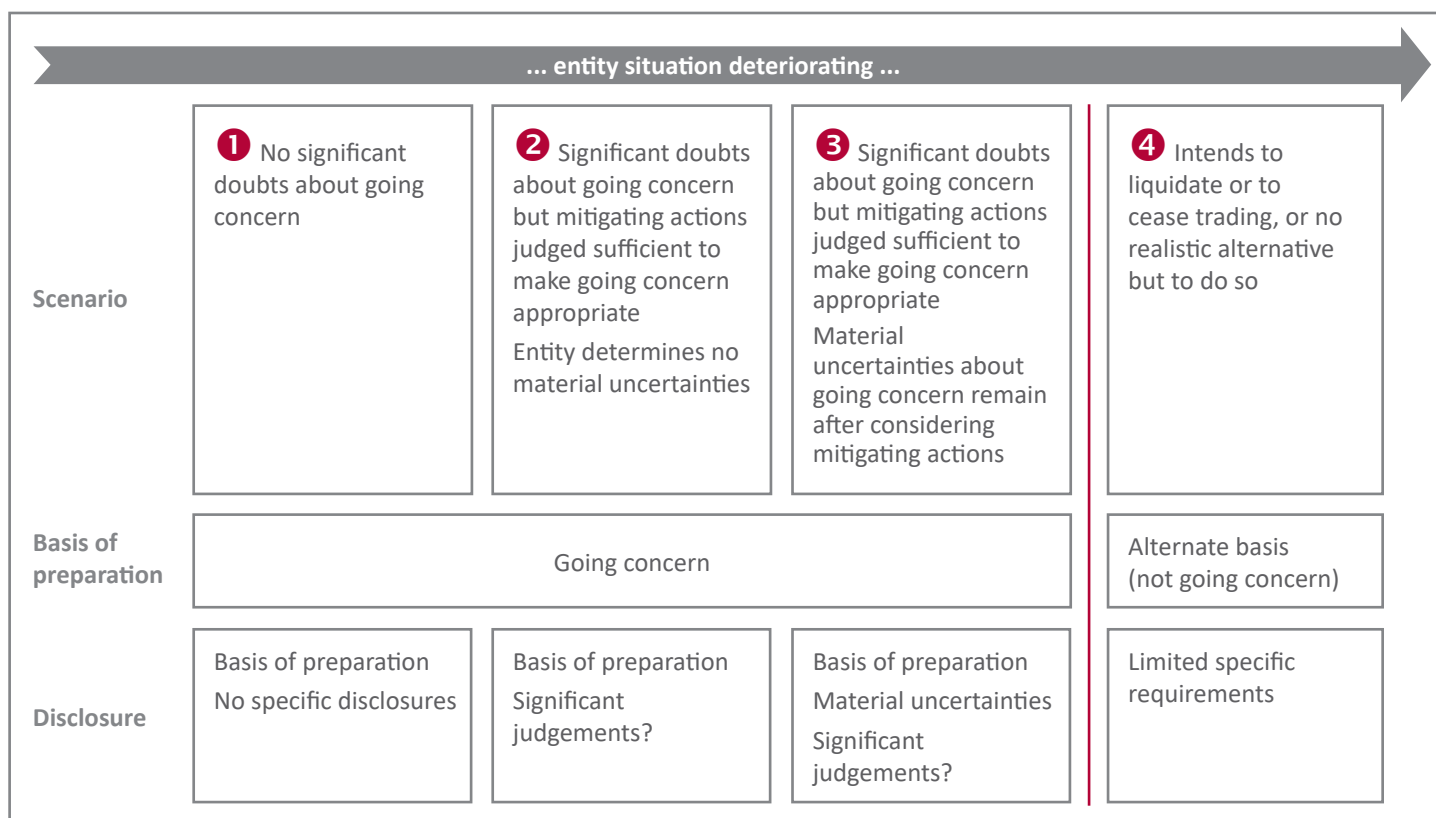
Disclosure is key

Whether or not to prepare financial statements on a going concern basis is a binary decision, but the circumstances in which entities prepare financial statements on a going concern basis will vary widely.

The circumstances could range from when an entity is profitable and has no liquidity concerns to when it is a ‘close call’ to prepare the financial statements on a going concern basis, even after considering any mitigating actions planned by management. Management’s decision will be underpinned by assumptions and judgements that, in the current environment, may involve more uncertainty than in the past. It is important therefore that an entity considers not only the specific disclosure requirements relating to going concern in paragraph 25 of IAS 1 but also the overarching disclosure requirements in IAS 1. These requirements include those in paragraph 122 relating to judgements that have the most significant effect on the amounts recognised in the financial statements. In the current stressed economic environment, users of financial statements are more likely to focus on disclosures relating to going concern. Questions that users might ask could include how the assumptions management has used in reaching its conclusion about going concern relate to assumptions underpinning other aspects of the financial statements.

Applying the requirements in IAS 1

The requirements in IAS 1 can be depicted as set out in the diagram below:



Applying the requirements in IAS 1 continued ...

At one end of the going concern range, in Scenario 1, is an entity that has profitable operations and has no liquidity concerns and for which there are no significant doubts about its ability to continue as a going concern. For such an entity, apart from the need to describe the basis of preparation, there are no specific disclosure requirements relating to going concern. It is also less likely that significant judgements were involved in reaching the conclusion to prepare the financial statements on a going concern basis.

At the other end of the going concern range, in Scenario 3, is an entity that is close to ceasing to be a going concern. Assume the entity is loss-making, demand for its goods or services has decreased rapidly and its funding facilities are due to expire in the next 12 months. In this scenario, management has concluded after considering all relevant information—including the feasibility and effectiveness of the actions it plans to take—that preparing the financial statements on a going concern basis is appropriate. Nonetheless, management concludes there are material uncertainties relating to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern—for example, there might be considerable uncertainty about management's ability to execute its turnaround strategy to address the reduced demand and to renew or replace funding. In such a scenario paragraph 25 of IAS 1 requires an entity to disclose the material uncertainties relating to its ability to continue as a going concern. In doing so, the entity identifies that those uncertainties may cast significant doubt upon its ability to continue as a going concern.

In Scenario 3, the conclusion to prepare the financial statements on a going concern basis is likely to have involved significant judgement. If this is the case, in addition to disclosing the material uncertainties as required by paragraph 25, the entity is also required to apply the disclosure requirements in paragraph 122 relating to the judgement that the going concern basis is appropriate. In applying these requirements, the entity considers what information is material

about (a) the events or conditions that cast significant doubt upon the entity's ability to continue as a going concern and (b) the feasibility and effectiveness of management's actions or plans in response to those events or conditions.

Now consider Scenario 2. Assume that the facts are similar to Scenario 3 except that after considering the feasibility and effectiveness of the actions it plans, management concludes that the material uncertainties are expected to be mitigated—for example, management might have started executing a turnaround strategy that is showing sufficient evidence of success including identifying feasible alternative sources of financing. The Interpretations Committee considered a similar scenario in 2014. In its [Agenda Decision](#) the Committee highlights that if, after considering planned mitigating actions, management's conclusion that there are no material uncertainties involves significant judgement, then the disclosure requirements in paragraph 122 would apply to the judgements made in concluding that no material uncertainties remain.

Another example of overarching disclosure requirements in IAS 1 that could also be relevant, especially in cases of close calls, are the requirements relating to sources of estimation uncertainty in paragraphs 125–133. These paragraphs require an entity to disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

What is an entity required to do if it is not a going concern?

Consider Scenario 4 and an entity that is no longer a going concern. IAS 1 explains that the going concern basis of preparation is no longer appropriate when management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. In such cases, if the entity prepares financial statements applying IFRS Standards, it does not prepare them on a going concern basis.

IAS 1 does not specify an alternate basis for preparing financial statements if the entity is no longer a going concern. Paragraph 25 of IAS 1 requires the entity to disclose the fact that the financial statements have not been prepared on a going concern basis and the reasons why the entity is not regarded as a going concern, as well as disclosing the basis on which the financial statements have been prepared.

A topical matter

As outlined above, the overarching requirements in IFRS Standards already require entities to disclose information about significant judgments related to going concern assessments. However, given the heightened sensitivity in the current environment of going concern assessments and the importance of related disclosure, going concern has been a topic for discussion among accounting standard-setters. For instance, the New Zealand Accounting Standards Board has amended its standards, which are equivalent to IFRS Standards, to specify additional disclosure requirements relating to going concern. The new requirements draw on the overarching requirements in IAS 1 highlighted above—they explicitly require disclosure of information that would be expected to be provided as a result of considering those overarching requirements in the context of a going concern assessment.

Going concern is also a topic under consideration by the International Auditing and Assurance Standards Board (IAASB). In September 2020, the IAASB published a Discussion Paper *Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit*, which is open for consultation until 1 February 2021, and held a related roundtable in September 2020. The Discussion Paper highlights the audit requirements and the requirements in IAS 1 when there are material uncertainties relating to going concern, and explains that the IAASB is interested in perspectives about whether the concept of, and requirements related to, a material uncertainty in the auditing standards is sufficiently aligned with the requirements in IFRS Standards.

The topic of going concern has been identified as a potential agenda item to be covered in the IASB's upcoming agenda consultation, for which it will be publishing a request for information in March 2021. In the meantime, it is important to remember what currently applicable IFRS Standards require in relation to going concern assessments—disclosures about not only material uncertainties but also significant judgements.

IFRS[®] Standards and climate-related disclosures



Nick Anderson

Climate-change is a topic on which investors and other stakeholders increasingly ask the International Accounting Standards Board (Board), why this is not mentioned explicitly in IFRS Standards.

In this update, Nick Anderson, a member of the Board, provides an overview intended to help investors understand what already exists in the current requirements and guidance on the application of materiality, and how it relates to climate and other emerging risks. While climate-change risks and other emerging risks are not covered explicitly by IFRS Standards, the Standards do address issues that relate to them.

This article has been inspired by work from the Australian Accounting Standards Board (AASB) and Audit and Assurance Board (AUASB).

What is this publication about?

The International Accounting Standards Board (Board) is often asked why IFRS Standards don't mention climate change. While the phrase 'climate-change' does not feature in our requirements, IFRS Standards do address issues that relate to climate-change risks and other emerging risks. The Board is also updating its non-mandatory guidance on management commentary, where it would expect companies to address material environmental and societal issues, complementing the information in financial statements.

In April 2019 the Australian Accounting Standards Board (AASB) and Auditing and Assurance Standards Board (AUASB) issued a joint bulletin, 'Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2'¹. The focus of that publication was to illustrate how qualitative external factors, such as the industry in which the company operates, and investor expectations may make such risks 'material' and warrant disclosures in the financial statements, regardless of their numerical impact.

Taking inspiration from the joint AASB-AUASB bulletin, we have prepared this publication to help analysts and investors better understand our requirements and our guidance on the application of materiality.

In the rest of this document we discuss:

- 1 Board guidance on how to make materiality judgements
- 2 applying IFRS Practice Statement 2 *Making Materiality Judgements* to climate-related and emerging risks
- 3 financial reporting considerations when applying IFRS Standards
- 4 disclosing climate-related and other emerging risks in the financial statements
- 5 management commentary: providing context to the financial statements
- 6 summary: materiality judgements should serve investors' information needs

¹ https://www.aasb.gov.au/admin/file/content102/c3/AASB_AUASBJointBulletin.pdf

1 Making materiality judgements

Primary users² need companies to make materiality judgements when they prepare their financial statements. IFRS Standards require companies to make materiality judgements in decisions about recognition, measurement, presentation and disclosure. However, rather than using judgement to decide what information to provide in financial statements, sometimes the disclosure requirements in IFRS Standards are used as if they were items on a checklist. Using the requirements in this way contributes to what many have described as a disclosure problem—namely, too much irrelevant information and not enough relevant information in financial statements. This publication illustrates how companies can use the Practice Statement when they make materiality judgements relating to disclosures about climate-related and other emerging risks.



IFRS Practice Statement 2 *Making Materiality Judgements*

The Practice Statement provides companies with guidance on how to make materiality judgements when preparing their general purpose financial statements in accordance with IFRS Standards.

The Practice Statement:

- provides an overview of the general characteristics of materiality;
- presents a four-step process companies may follow in making materiality judgements; and
- provides guidance on how to make materiality judgements in specific circumstances—namely, how to make materiality judgements about prior-period information, errors and covenants; and how to make such judgements when preparing interim reports.

All companies are required to make materiality judgements in preparing financial statements in accordance with IFRS Standards. However, the Practice Statement, which provides guidance on making materiality judgements, does not change or introduce any requirements in IFRS Standards; companies are not required to comply with it to state that they are complying with IFRS Standards.

² Primary users are existing and potential investors, lenders and other creditors. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently

2 Applying *Making Materiality Judgements* to climate-related risks and other emerging risks

Climate-related risks and other emerging risks are predominantly discussed outside the financial statements. However, as set out in *Making Materiality Judgements*, qualitative external factors, such as the industry in which the company operates, and investor expectations may make some risks 'material' and may warrant disclosures in financial statements, regardless of their numerical impact.

Given investor statements on the importance of climate-related risks to their decision-making, the implication of the materiality definition and the Practice Statement is that companies may need to consider such risks in the context of their financial statements rather than solely as a matter of corporate-social-responsibility reporting.

For example, suppose that a company in an industry likely to be affected by climate-related risks determines that its impairment testing does not need to include a specific assumption regarding such risks. However, taking into account investor comments on the importance of climate-related risks to their investment decisions and reasonable expectations that the recoverable amount of the company's assets could be affected by such risks, when applying the Practice Statement, the company may conclude that it needs to disclose information that explains clearly why the carrying amounts of its assets are not exposed to climate-related risks. Such an explanation may provide material information to investors even though the carrying amounts in the financial statements are not exposed to those risks. Example K in the Practice Statement, which illustrates a similar scenario in relation to a bank's exposure to credit risk, is reproduced on page 8.



The Practice Statement provides the Board's guidance on making materiality judgements. Although it is voluntary, investors may have reason to expect that directors, preparers and auditors will consider the Practice Statement when preparing and auditing financial statements.

Companies applying IFRS Standards when preparing financial statements would consider:

- whether investors could reasonably expect that emerging risks, including climate-related risks, could affect the amounts and disclosures reported in the financial statements. Investors have indicated the importance of information about such risks to their decision-making; and
- what information about the effect of emerging risks, including climate-related risks, on the assumptions made in preparing the financial statements is material, and thus should be disclosed.

The comments in this paper relate to requirements concerning the preparation of financial statements; they do not negate the need to consider other reporting obligations. Equally, disclosures made in other documents will not compensate for the omission of required disclosures in the financial statements and are therefore subject to audit in most jurisdictions.

3 Financial reporting considerations

The potential financial implications arising from climate-related and other emerging risks may include, but are not limited to:

- asset impairment, including goodwill;
- changes in the useful life of assets;
- changes in the fair valuation of assets;
- effects on impairment calculations because of increased costs or reduced demand;
- changes in provisions for onerous contracts because of increased costs or reduced demand;
- changes in provisions and contingent liabilities arising from fines and penalties; and
- changes in expected credit losses for loans and other financial assets.

The following table sets out some requirements in IFRS Standards that could require companies to consider climate-related and other emerging risks when making materiality judgements about what to recognise in the financial statements, about measuring recognised assets and liabilities and about what to disclose.

IFRS Standards	Effect on financial reporting arising from climate-related or other emerging risks
IAS 1 <i>Presentation of Financial Statements</i>	<p>IAS 1 requires disclosure in the notes of information that is not presented elsewhere in the financial statements but is relevant to an understanding of them. Information will be relevant if it could reasonably be expected to influence decisions made by investors.</p> <p>For example, a company may need to explain whether and how it has considered climate-related risks in its impairment calculations even though IAS 36 makes no requirement for such a disclosure. Where other companies in a similar industry have recognised significant write-downs and investors have publicly demanded such information, a company may need to disclose whether climate-related risks have affected the carrying amount of the assets recognised in the financial statements.</p>

continued ...

... continued

IFRS Standards	Effect on financial reporting arising from climate-related or other emerging risks
<p>IAS 36 <i>Impairment of Assets</i></p>	<p>The carrying amount of assets such as property, plant and equipment, assets recognised in relation to mineral resources, intangible assets and goodwill could be overstated if the impairment calculations do not account for the effect of climate-related risks.</p> <p>A company's exposure to climate-related risks could be an indicator that an asset or a group of assets is impaired; that exposure could also affect future estimated cash inflows and outflows used for recoverable amount calculations. IAS 36 requires disclosure of the key assumptions on which cash flow projections have been based and management's approach to determining the value assigned to these key assumptions, in particular, in relation to goodwill or indefinite-life intangible assets.</p> <p>Where climate-related risks could significantly affect the recoverable amount of a company's assets, information about how the effect has been factored into recoverable amount calculations would be relevant for the users of the financial statements. Such information about long-lived assets and assets recognised in relation to mineral resources would be particularly relevant to users. In the extractive industries, investors may look for explanations as to whether a company has considered the effect of climate-related risks in determining whether exploration, or the evaluation of certain areas of interest, should continue.</p>
<p>IAS 16 <i>Property, Plant and Equipment</i> and IAS 38 <i>Intangible Assets</i></p>	<p>Other than impairment, climate-related risks may also affect:</p> <ul style="list-style-type: none"> • whether some expenses relate to items that satisfy the definition of an asset and can be recognised (for example, as property, plant and equipment or an intangible asset); and • the estimated useful lives of assets, and therefore the amount of depreciation or amortisation recognised each year.
<p>IFRS 13 <i>Fair Value Measurement</i></p>	<p>IFRS 13 requires companies to disclose key assumptions used where assets are recognised at fair value. Fair value measurements may incorporate a number of possible scenarios. When the fair value of an asset is affected by climate-related risks including the effect of and potential changes to laws and regulations with respect to managing such risks, a company may need to disclose how it factors climate-related risk into the calculations. Companies in sectors particularly affected by climate-related risks would need to consider disclosing their assumptions regarding such risks, even if they cannot quantify any effects on the financial statements.</p>

continued ...

... continued

IFRS Standards	Effect on financial reporting arising from climate-related or other emerging risks
<p>IFRS 9 <i>Financial Instruments and / IFRS 7 Financial Instruments: Disclosures</i></p>	<p>IFRS 9 impairment requirements use forward-looking information to recognise expected credit losses. For companies applying these requirements, such as banks, determining whether credit risk has increased significantly since initial recognition is a critical step in estimating expected credit losses. Such a determination requires lenders to consider whether any actual or expected adverse changes in a borrower’s regulatory, economic or technological environment have changed significantly the borrower’s ability to meet its debt obligations.</p> <p>When banks invest in projects or lend money to businesses affected by climate-related risks, they will need to consider how the exposure to climate-related risk affects the expected credit losses of these loans and investments. For example, if a bank’s loan portfolio has significant exposure to fossil-fuel-intensive projects, it would identify the extent of this exposure and how climate-related risks could affect the amounts recognised in its financial statements.</p> <p>Investment funds and insurance companies could also hold investments in industries that may be affected by climate-related risk; and they would therefore be exposed to price risk in relation to these investments. IFRS 7 requires disclosure of such a company’s exposure to market risks arising from financial instruments, its objectives in managing these risks and changes from the previous period. Quantitative information, such as an analysis of investments by industry or sector, could specifically identify sectors exposed to climate-related risks and explain the company’s policy of managing its exposure to those sectors.</p>
<p>IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i></p>	<p>Companies are required to provide a brief description of the nature of any contingent liability, and where practicable, an estimate of its financial effect and an indication of the uncertainties relating to the outflow of resources for settling the obligation.</p> <p>Climate-related risks and uncertainties may also affect the best estimate of a provision. Companies must disclose their major assumptions about future events, which may need to include an explanation of how climate-related risks have been factored into the best estimate of the provision.</p> <p>Climate-related risks could have the following effects:</p> <ul style="list-style-type: none"> • recognition of an onerous contract provision for the potential loss of revenues or increased costs postulated in climate-related risk scenarios considered in the best estimate; • an increase of provisions recognised for decommissioning a plant or rehabilitating environmental damage in extractive industries due to regulatory changes or shortened project lives; and • disclosure of a contingent liability for potential litigation and fines or penalties because of environmental and other regulations, where the company may have broken a regulation, but the probability that it will have to make a payment is lower than 50%.

4 Disclosing climate-related and other emerging risks

Even though the Practice Statement is not mandatory, it provides the Board's guidance on making the materiality judgements required when applying IFRS Standards to prepare financial statements.

However, the Practice Statement only applies to the financial statements and not to the other information published by the company. Other forms of corporate communications typically vary by country.

What information is material to financial statements?

According to IFRS Standards, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a reporting entity.

Primary users are existing and potential investors, lenders and other creditors. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who diligently review and analyse the information.



The discussion of material information in IAS 1 emphasises that an assessment of materiality must be made on the basis of size (quantitative) and nature (qualitative factors), or a combination of both. The Practice Statement further emphasises that an item of information could influence primary users' decisions regardless of its size. A quantitative threshold could even reduce to zero, such as when primary users closely scrutinise information about a transaction, other event or condition.

An example from the Practice Statement illustrates that external qualitative factors such as the industry in which the company operates and investor expectations should be considered when making materiality judgements about required disclosures in the financial statements.

Example illustrating—influence of external qualitative factors on materiality judgements

Background

An international bank holds a very small amount of debt originating from a country whose national economy is currently experiencing severe financial difficulties. Other international banks that operate in the same sector as the entity hold significant amounts of debt originating from that country and, hence, are significantly affected by the financial difficulties in that country.

Application

Paragraph 31 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risk arising from financial instruments to which the entity is exposed at the end of the reporting period.

When preparing its financial statements, the bank assessed whether the fact that it holds a very small amount of debt originating from that country was material information.

In making that assessment, the bank considered the exposure to that particular debt faced by other international banks operating in the same sector (external qualitative factor).

In these circumstances, the fact that the bank is holding a very small amount of debt (or even no debt at all) originating from that country, while other international banks operating in the same sector have significant holdings, provides the entity's primary users with useful information about how effective management has been at protecting the bank's resources from unfavourable effects of the economic conditions in that country.

The bank assessed the information about the lack of exposure to that particular debt as material and disclosed that information in its financial statements.

Source: Example K from Practice Statement 2: *Making Materiality Judgements*

In the example about assessing external qualitative factors, the company is operating in an industry that is exposed to debt originating from a country whose national economy is experiencing severe financial difficulties. The fact that other international banks have exposure to such debt creates a reasonable expectation that the reporting bank may also be exposed to such risk. The reporting bank holds only a small amount of the debt. These external qualitative factors are considered in assessing whether disclosure about the small exposure to this risk is material for the reporting bank.

Although the example relates to a bank's exposure to debt risk, it is also relevant to companies exposed to climate-related risks. **Similar external qualitative factors now exist for climate-related risks and may also exist for particular companies in relation to other emerging risks.**

The Task Force on Climate-related Financial Disclosures identifies the following types of company that are likely to be affected by climate-related risks:

- companies in the financial sector—banks, insurance groups, asset owners (investment companies), and asset managers; and
- companies in non-financial industries, such as—energy, transportation, material and buildings and agriculture, foods and forest products.

Task Force on Climate-related Financial Disclosures

The Financial Stability Board Task Force on Climate-related Financial Disclosures will develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.

The Task Force will consider the physical, liability and transition risks associated with climate change and what constitutes effective financial disclosures across industries.

The work and recommendations of the Task Force will help companies understand what financial markets want from disclosure in order to measure and respond to climate-change risks, and encourage firms to align their disclosures with investors' needs.

Learn more about the [Task Force](#)

Other Resources

[Corporate Reporting Dialogue – Driving Alignment in Climate Related Reporting](#)

Given that investors have specifically identified climate-related risks as being used in their decision-making, when companies in the above industries are determining if information is material they are likely to judge that it is necessary to explain whether and how they have considered climate-related risk in their impairment assessments, and how climate-related risks have affected other judgements made in relation to the recognition or measurement of items in the financial statements (see section 3). As Example K implies, a company may need to disclose information about climate-related risks even if the company did not recognise any material impairment or other impact in the financial statements, or, in the extreme, even if a company was not exposed to these risks, but investors would reasonably expect that it was.

The majority of climate-related information is currently disclosed within management commentary and not in the financial statements. For some companies, applying the materiality definition and the principles in the materiality practice statement³ would result in some of this information being reflected within the financial statements.

For example, a company may need to explain its judgement that it was not necessary to factor climate change into the impairment assumptions, or how estimates of expected future cash flows, risk adjustments to discount rates or useful lives have, or have not, been affected by climate change. Financial sector companies may need to consider disclosing to what extent their investment or loan portfolios are exposed to climate risk and how this risk has been factored into the valuation of these assets.

³ The Board has issued two practice statements, the first in 2010 on management commentary and the second in 2017 on making materiality judgements. Practice statements provide non-mandatory guidance to preparers of financial statements prepared using IFRS Standards.

The disclosures in the notes will be most helpful to users of financial statements if the disclosures focus on specific issues and assumptions made that are relevant to the amounts recognised in the financial statements; and if they are not of a boilerplate nature. Section 3 above identifies areas that may be particularly affected. Comments about the company's overall approach to climate-related and other business risks belong in the management commentary or related documents outside the financial statements.

Materiality judgements may also lead to the disclosure of information that is not specifically required by IFRS Standards. As explained in IAS 1 and illustrated in Example C of the Practice Statement, a company is required to consider whether to provide information not specified by IFRS Standards if primary users need that information to understand the effect of transactions, other events and conditions on the company's financial position, financial performance and cash flows.

Example illustrating—materiality judgements that lead to the disclosure of information in addition to the specific disclosure requirements in IFRS Standards

Background

An entity has its main operations in a country that, as part of an international agreement, is committed to introducing regulations to reduce the use of carbon based energy. The regulations had not yet been enacted in the national legislation of that country at the end of the reporting period.

The entity owns a coal fired power station in that country. During the reporting period, the entity recorded an impairment loss on its coal fired power station, reducing the carrying amount of the power station to its recoverable amount. No goodwill or intangible assets with an indefinite useful life were included in the cash generating unit.

Application

Paragraph 132 of IAS 36 *Impairment of Assets* does not require an entity to disclose the assumptions used to determine the recoverable amount of a tangible asset, unless goodwill or intangible assets with an indefinite useful life are included in the carrying amount of the cash generating unit.

Nevertheless, the entity has concluded that the assumptions about the likelihood of national enactment of regulations to reduce the use of carbon based energy, as well as about the enactment plan, it considered in measuring the recoverable amount of its coal fired power station could reasonably be expected to influence decisions primary users make on the basis of the entity's financial statements. Hence, information about those assumptions is necessary for primary users to understand the impact of the impairment on the entity's financial position, financial performance and cash flows. Therefore, even though not specifically required by IAS 36, the entity concludes that its assumptions about the likelihood of national enactment of regulations to reduce the use of carbon based energy, as well as about the enactment plan, constitute material information and discloses those assumptions in its financial statements.

Source: Example C from Practice Statement 2: *Making Materiality Judgements*

Information that users need to understand to make decisions may include the disclosure of assumptions made about climate change in the assessment of an impairment loss for an individual asset even though such disclosure is not required under IAS 36 because no impairment has been recognised or the impairment recognition was not affected by an assumption about climate risk. Similarly, companies may disclose the significant estimates or judgements they have made about climate-related risks even if they currently face no financial impact or significant risk of materially adjusting the carrying amounts of assets and liabilities in the next financial year

and, hence, are not required by IAS 1 to make such disclosures.

As has already been noted, financial reports are prepared for users of financial statements who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. However, the information needs of each primary user may differ and we recognise that we cannot meet the information needs of all primary users. Other parties may also find financial reports useful; however, those reports are not intended to inform all users on all matters that may be of interest to them.

5 Management commentary—providing context to the financial statements

The materiality practice statement notes that financial statements do not, and cannot, provide all the information that primary users need. Narrative reporting, often known as management commentary or management discussion and analysis, can help to fill some information gaps, complementing the financial statements.

The Board is currently updating its *Management Commentary Practice Statement* to set out a rigorous, principle-based approach for explaining a company's purpose, business model, strategy and performance, incorporating the long-term drivers of its success. The Practice Statement is not a mandatory part of IFRS Standards, but companies that choose to follow it, or are required to do so by their regulators, will need to consider both the risks and opportunities facing a company. We would expect management to report on environmental and societal issues to the extent necessary for primary users of financial statements to form their own assessment of the company's longer-term prospects and management's stewardship of the business.

The need to focus disclosures on material issues and to avoid mere boilerplate is a critical consideration in the preparation of management commentary, just as it is in the financial statements.

Management Commentary Project

Read about the [Board's project](#).

6 Summary: Materiality judgements should serve investors' information needs

While climate-change risks and other emerging risks are not covered explicitly by IFRS Standards, the Standards do address issues that relate to them. The potential financial implications arising from climate-related and other emerging risks may include, but are not limited to, requirements

set out in: IAS 1 *Presentation of Financial Statements*; IAS 36 *Impairment of Assets*; IAS 16 *Property, Plant and Equipment*; IAS 38 *Intangible Assets*; IFRS 13 *Fair Value Measurement*; IFRS 9 *Financial Instruments*; IFRS 7 *Financial Instruments: Disclosures*; and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The need for materiality judgements is pervasive in the preparation of financial statements. As set out in IAS 1, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Materiality depends on the nature or magnitude of information, or both. Building on this concept, *Making Materiality Judgements* emphasises that an item of information could influence primary users' decisions regardless of its size, and a quantitative threshold could even reduce to zero, such as when information about a transaction, other event or condition is closely scrutinised by the primary users.

Disclosures in other documents (including presentations, management commentary and sustainability reports) will not compensate for the omission of disclosures that are required to be made in the financial statements and are therefore subject to audit in most jurisdictions.

The Board acknowledges that financial statements do not and cannot satisfy the needs of each primary user and all interested parties. Financial statements focus on common investor needs and are not intended to report to all users on all matters that may be of interest to them.

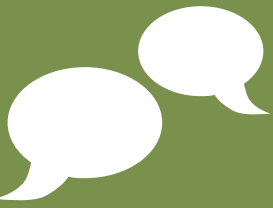
Management commentary or management discussion and analysis complement the financial statements. We would expect management to report on environmental and societal issues to the extent necessary for primary users of financial statements to form their own assessment of the company's longer-term prospects and management's stewardship of the business.

4 Primary users are existing and potential investors, lenders and other creditors. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently.



Find out more

For an overview of the Materiality Practice Statement, read our [Project Summary and Feedback Statement](#) or watch our [video](#) on the [project page](#).



Send us your views

The Management Commentary project aims to publish an Exposure Draft in 2H 2020. To follow the project, visit the [project page](#).



Get in touch

If you would like to discuss this topic or other areas of accounting, please contact Fred Nieto, Technical Staff – Investor Engagement, at fnieto@ifrs.org.

Follow [@IFRSInvestors](#) on Twitter to keep up to speed on changes in the world of IFRS Standards and how these changes may affect investors.

The views expressed in this article are those of the author as an individual and do not necessarily reflect the views of the International Accounting Standards Board (Board) or the IFRS Foundation (Foundation). The Board and the Foundation encourage members and staff to express their individual views. This article has not undergone the Foundation's due process. The Board takes official positions only after extensive review, in accordance with the Foundation's due process.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 11 June 2021

To: NZASB Members

From: Gali Slyuzberg

Subject: ***IASB DP Business Combinations Under Common Control***

Recommendations¹

1. We recommend that the Board PROVIDES FEEDBACK on the first draft of the comment letter on the IASB Discussion Paper DP/2020/2 *Business Combinations Under Common Control* (the DP).

Background

2. The IASB issued the DP in November 2020. The DP explores possible reporting requirements for business combinations under common control (BCUCC). Specifically, the DP sets out the IASB's preliminary views on:
 - (a) the criteria for determining when to apply the acquisition method to a BCUCC transaction, and when to apply a specified book value method, and;
 - (b) how each of these methods should be applied to a BCUCC transaction.
3. In issuing the DP, the IASB aims to reduce diversity in practice, improve transparency in reporting on BCUCC transactions and provide users of financial statements with better information on these transactions.
4. At its April meeting, the Board agreed which DP questions to respond to, and provided feedback on those DP questions. At this meeting, we are seeking the Board's feedback on the first draft of the comment letter to the IASB.

Draft comment letter

5. The draft comment letter (agenda item 6.2) reflects Board members' feedback from the Board's April meeting, as well the polling results and comments from the virtual outreach event that we held in April, and feedback received at the May TRG meeting. We have also considered comments made by participants at the AASB roundtable event on BCUCC, which was held on 5 May and was attended by XRB staff.

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. This feedback is included in boxes in the draft comment letter, to provide context for the draft responses. These boxes will be removed in the final comment letter.
7. We are seeking the Board's views on all draft responses in the comment letter. However, we would like to highlight the following areas where we particularly want to check whether our draft response reflects the Board's views:
 - (a) Question 2, on the proposal that the acquisition method should be applied to BCUCC transactions where the receiving entity's shareholders are affected, and the book value method should be applied to all other transactions. See paragraphs 6–27 of the draft comment letter.
 - (b) Question 3, on the proposal to provide an exception and an exemption from the acquisition method to entities whose non-controlling shareholders are affected by the transaction, but whose shares are privately held. See paragraphs 28–36 of the draft comment letter.
8. We also note that we did not previously discuss with the Board the DP proposals in relation to disclosures. In summary, the DP proposes that:
 - (a) When the acquisition method applies to a BCUCC transaction, the same disclosures as those required under IFRS 3 *Business Combinations* should apply – plus any new disclosure requirements that are added to IFRS 3 as a result of the IASB DP *Business Combinations – Disclosures, Goodwill and Impairment* (published in 2020).
 - (b) When the book value method applies to a BCUCC transaction, some but not all of the abovementioned disclosures should apply.
9. The DP questions that relate to disclosures are Questions 11 and 12. We recommend responding to these questions – mainly to reiterate the Board's concerns about the proposed disclosure requirements in the IASB DP *Business Combinations – Disclosures, Goodwill and Impairment*, which the Board expressed in its comment letter on that DP.
10. The draft response to Questions 10 and 11 is included in paragraphs 53–56 of the draft comment letter. We note that the arguments in paragraph 56(a)–(d) are copied directly from our comment letter on *Business Combinations – Disclosures, Goodwill and Impairment*.

Next steps

11. We will update the comment letter based on the Board's feedback. We will also update the letter for any submissions we receive. Comments to the NZASB are due by 9 July 2021.
12. We will seek the Board's approval of the comment letter at the Board's August meeting. Comments are due to the IASB by 1 September 2021.

Attachments

Agenda item 6.2: Draft comment letter

Agenda item 6.3: IASB DP/2020/1 *Business Combinations Under Common Control* (in the supporting papers)

Agenda item 6.4: IASB Snapshot summary document (in the supporting papers)

Please note: This is the first draft of the comment letter. The boxes entitled 'Summary of Board discussion and feedback to date' are included in this draft to provide context for the draft responses. These boxes will be deleted in the final version of the comment letter.

XX August 2021

Mr Andreas Barckow
Chairman of the International Accounting Standards Board
IFRS Foundation
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Submitted to: www.ifrs.org

Dear Andreas

DP/2020/2 Business Combinations Under Common Control

Thank you for the opportunity to comment on DP/2020/2 *Business Combinations Under Common Control* (the DP). The DP has been exposed for comment in New Zealand and some New Zealand constituents may comment directly to you.

[The main points will be noted in the cover letter. To be completed once the Appendix is updated for the Board's feedback on the draft comment letter in June]

Our recommendations and responses to the specific questions for respondents are provided in the Appendix to this letter.

We would like to take this opportunity to thank IASB Vice Chair Sue Lloyd and IASB staff members Yulia Feygina and Richard Brown for their assistance with an outreach event that we held on the DP with New Zealand constituents.

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

Yours sincerely

Carolyn Cordery
Chair – New Zealand Accounting Standards Board

Appendix:**Question 1**

Paragraphs 1.10–1.23 discuss the Board’s preliminary view that it should develop proposals that cover reporting by the receiving company for all transfers of a business under common control (in the Discussion Paper, collectively called business combinations under common control) even if the transfer:

- (a) is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or
- (b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering.

Do you agree with the Board’s preliminary view on the scope of the proposals it should develop? Why or why not? If you disagree, what transactions do you suggest that the Board consider and why?

Summary of Board discussion and feedback to date*Feedback from NZASB April meeting*

There was some agreement with staff’s preliminary views that:

- The scope of the proposed requirements should be clarified – to explain that it also includes amalgamations and other ‘true mergers’, which might not have a clear ‘receiving entity’ and ‘transferred entity’ and may not represent a transfer of a business from one entity to another.
- Further consideration is needed on how to account for such amalgamations and true mergers.

Draft response to Question 1:

1. The proposed scope of the project seems to include all those transfers of businesses that are currently outside the scope of IFRS 3 and are not addressed by existing IFRS Standards. We think that the scope is comprehensive and consistent with the IASB’s aim of ‘closing the gap’ that currently exists in IFRS Standards, which we view as a positive initiative.
2. However, we think that the scope can be clarified in the following respect. The DP refers to BCUCC transactions as ‘transfers of a business’ between entities under common control, and proposes accounting requirements for the ‘receiving entity’, which obtains control over the transferred business. However, we note that some group restructure scenarios involve the amalgamation of two entities under common control into a single legal entity. In some such amalgamations, it could be argued that there is no clear ‘receiving entity’ or ‘transferred business’, and therefore no ‘transfer of a business’ from one entity to another. We think it

would be useful for the IASB to clarify whether such transactions are in the scope of the proposed BCUCC requirements.

3. Given that the DP aims to 'close the gap' in IFRS Standards, we expect that such amalgamations would be included in the scope of the proposed requirements. However, we think this should be clarified. For example, the definition of 'business combination' in IFRS 3 (for combinations between unrelated parties) specifically includes 'true mergers' or 'mergers of equals'. It may be useful to specifically state that the proposed BCUCC accounting requirements also applies to 'true mergers' or 'mergers of equals' under common control.
4. We also note that in the New Zealand PBE sector, the definition of a 'PBE combination' in PBE IPSAS 40 *PBE Combinations* does not refer to a transfer from one entity to another, but rather to 'the bringing together of separate operations into one public benefit entity'. This definition clearly includes the abovementioned amalgamation scenario and other 'mergers of equals'. If the IASB intended to include such transactions in the scope of the proposed BCUCC requirements, perhaps using similar wording to the PBE IPSAS 40 definition may be helpful.
5. We also think that the IASB may need to give further consideration to how the requirements proposed in the DP would apply to the abovementioned amalgamations and other 'mergers of equals'.

Question 2

Paragraphs 2.15–2.34 discuss the Board’s preliminary views that:

- (a) neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control.

Do you agree? Why or why not? If you disagree, which method do you think should be applied to all such combinations and why?

- (b) in principle, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company, subject to the cost–benefit trade-off and other practical considerations discussed in paragraphs 2.35–2.47 (see Question 3).

Do you agree? Why or why not? If you disagree, in your view, when should the acquisition method be applied and why?

- (c) a book-value method should be applied to all other business combinations under common control, including all combinations between wholly-owned companies.

Do you agree? Why or why not? If you disagree, in your view, when should a book-value method be applied and why?

Summary of Board discussion and feedback to date

Feedback from NZASB April meeting

- There was some concern that applying the acquisition method to BCUCC transactions could lead to inappropriate recognition of internally-generated goodwill, particularly when there is no external evidence of the value of the transferred business (see the next point). One Board member noted that he was not uncomfortable with the acquisition method, but the FMA and other regulators might have a different view.
- A question was raised as to whether the existence of non-controlling shareholders (NCS) – regardless of the size of their interest and whether they were involved in setting the transaction price – is the best test for determining how to account for a BCUCC transaction.
 - When non-controlling shareholders hold significant interest in the receiving entity, then they are more likely to be able to influence the transaction price. In that case, the acquisition method may lead to a reasonable outcome.
 - However, non-controlling shareholders often do not have any input into determining the transaction price – and there is often no external evidence of the value of the transferred business. Careful consideration is needed as to whether the acquisition method would lead to an appropriate outcome in that case.
- Debt holders that hold convertible debt may have similar information needs to non-controlling shareholders.

Feedback from the TRG (May 2021)

- A TRG member noted that some medium-sized entities that undertake a BCUCC ahead of an IPO opt for the acquisition method to recognise internally generated goodwill – with a view to push up the share price and gain a tax advantage. The proposed specific requirements in the DP on when to use the acquisition method and when to use the book value method will help avoid such manipulation.
- However, several TRG members thought that the *substance* of the BCUCC transaction should be a key consideration when determining which accounting method to use – and that there should at least be a ‘substance overlay’ over the proposed requirements in the DP.
 - Determining the substance of the transaction includes considering the parties to the transaction, including whether non-controlling shareholders are involved – but also whether the transaction was conducted at fair value, and whether the transaction forms an integral part of an IPO. By contrast, determining the accounting method for a BCUCC transaction based on the existence or absence of non-controlling shareholders is somewhat like a ‘bright line’ test.
 - In some internal group restructures within family-owned groups, there is sometimes a minor non-controlling interest in the receiving entity – but in substance, the transaction is merely a ‘reshuffling’ of entities under common family control. The book value method would be appropriate for such reorganisations.
- Additional comment from preliminary discussion with the TRG in September 2020 (when we asked whether the NZASB should comment on the then forthcoming proposals):
 - Should the existence of non-controlling shareholders be the determining factor in deciding when to apply the acquisition method? For example, when a receiving entity that has no non-controlling shareholders conducts a BCUCC transaction for the purpose of an upcoming IPO, the DP proposals would require application of the book value method. Is this an appropriate outcome, given that the purpose of the transaction is ultimately to raise funds from the market?

Feedback from the virtual outreach event (April 2021)

- The majority of poll participants (61%) agreed with the IASB’s view that some BCUCC transactions are similar to combinations between unrelated parties, and some are different.
- The majority of poll participants (68%) agreed with IASB’s preliminary views on determining when to apply the acquisition method to a BCUCC transaction and when to apply the book value method. About 16% of poll participants thought that the acquisition method should apply not only when non-controlling shareholders are affected by the BCUCC transaction, but also when lenders and creditors are affected. About 6% thought that different criteria should be used to determine whether the acquisition method or the book value method is applied. The remaining 10% thought that all BCUCC transactions should be accounted for using a book value method.

- Regarding the DP proposal to apply the acquisition method when non-controlling shareholders are affected, a participant noted that it may be worth considering debt holders, particularly if the debt can be converted into shares. The IASB presenters noted that the DP aims to lay the foundation of accounting for BCUCC transactions – whereas more detailed matters such as dealing with convertible debt would be considered at a later stage of the project.

Additional information: AASB roundtable (May 2021)

Participants' comments included the following:

- A question was raised as to why an entity's potential shareholders are being treated differently to an entity's existing non-controlling shareholders. That is, under the DP proposals, a receiving entity with non-controlling shareholders would generally use the acquisition method – but a wholly-owned receiving entity preparing for an IPO, whose financial statements will be read by potential external shareholders, would use the book value method. [*Note: We raised a similar point in our memo to the Board in April*].
- There was a view that investors would prefer the acquisition method, as fair value information better reflects what the investor paid for. However, the participant who held that view also acknowledged that the acquisition method would result in a mix of fair values and book values in the receiving entity's consolidated financial statements (as only the transferred entity's assets and liabilities would be carried at fair value). There was also another view that there is not much appetite for the acquisition method among preparers.

Draft response to Question 2:

Proposal to require the application of the acquisition method to some BCUCC transactions and the book value method for others

6. We agree that some BCUCC transactions are similar in nature to business combinations between unrelated parties while others are different. Therefore, we agree that some BCUCC transactions should be accounted for using the acquisition method and others should be accounted for using the book value method.
7. We also think that the introduction of specific requirements for determining the accounting method for BCUCC transactions is useful. Such criteria should improve comparability between similar types of BCUCC transactions, and reduce an arbitrary choice of accounting method.
8. Furthermore, we have received feedback that some entities that undertake a BCUCC ahead of an IPO opt for the acquisition method to recognise internally generated goodwill – with a view to push up the share price and gain a tax advantage. Having specific requirements on when to use the acquisition method and when to use the book value method would help prevent inappropriate use of the acquisition method.

Whether the main criterion for selecting the accounting method should be based on whether the receiving entity's has non-controlling shareholders that are affected by the transaction

9. The DP proposes requiring the acquisition method for BCUCC transactions where the receiving entity's non-controlling shareholders (NCS) are affected, and the book value method for all other BCUCC transactions.
10. We acknowledge that when the receiving entity has NCS, then there is a change in the ultimate ownership of the transferred business, because the NCS gain a new ownership interest in the transferred business, just as they would have done if the receiving entity acquired a business from outside the group. By contrast, there is no change in the ultimate ownership of the transferred business if the receiving entity does not have NCS.
11. We also acknowledge that if the receiving entity has NCS, these NCS are a key party affected by the transaction – given that they acquire new ownership interest in the transferred business, and the success of the transaction impacts the future dividends they will receive. Therefore, the information needs of NCS are important.
12. However, after considering the practical application of these proposals and possible arguments against basing the selection of the acquisition method primarily on the existence of NCS, we have recommended some changes to the proposals, as explained below.

Information needs of potential shareholders – upcoming IPO

13. We have considered whether entities should also be required to use the acquisition method when a BCUCC transaction is conducted in anticipation of an IPO.
14. If the fair value information provided by the acquisition method is useful to *existing* NCS, this could also be the case for *potential* NCS. The information needs of potential NCS would be relevant for a wholly-owned entity if it is contemplating an IPO after the BCUCC transaction.
15. Having said this, we acknowledge that applying the acquisition method to BCUCC transactions between wholly-owned entities could result in very different accounting outcomes, depending on the legal structure of the BCUCC transaction and which entity is recognised as the acquirer – yet in each case, potential investors are invited to invest in the same pool of resources. This could possibly negate the benefits to potential investors from fair value measurement under the acquisition method.
16. Furthermore, we are aware of the concern that some entities may use the acquisition method to achieve an artificially high share price, by overstating the transferred entity's internally generated goodwill.

Information needs of potential shareholders – convertible debt holders

17. The arguments above also apply to an entity that does not have NCS, but has issued *convertible debt* instruments to its debt holders.
18. Such shareholders are able to convert their debt into equity in the receiving entity, thereby becoming NCS. It could be argued that convertible debt holders are in a similar position to NCS

and have similar information needs as them – even more so than potential shareholders in an IPO situation. This is because convertible debt holders have an *existing right* to convert their debt into an ownership interest in the entity (as long as they meet the conditions specified in their contract with the entity).

19. However, the risk that the acquisition method may result in different accounting outcomes depending on the legal structure of the BCUCC transaction, and that the acquisition method could be used to inflate the entity's share price through the recognition of internally generated goodwill (which could affect the number of shares that debt holders could convert their debt to) also apply in situations where the receiving entity has convertible debt holders.

Significance of NCS's interest and their involvement in determining the transaction price

20. We have some concerns that there could be situations where the acquisition method would not be appropriate despite the existence of NCS in the receiving entity.
21. If NCS hold a significant interest in the receiving entity, and have been involved in determining the transaction price, then the acquisition method is more likely to be appropriate – because it is more likely that the transaction price reflects the price that would have been paid in an external arm's length transaction.
22. However, if NCS do not hold a significant interest in the receiving entity, their involvement in determining the transaction price is likely to be limited. If that is the case, the transaction price may not be a reflection of what would have been paid in an external arm's length transaction. This could result in inappropriate recognition of the transferred entity's internally generated goodwill.
23. Furthermore, from a conceptual perspective: A BCUCC transaction causes a change in the ultimate ownership of the transferred entity when the receiving entity has NCS, this change in ultimate ownership would not be significant if NCS have insignificant interest in the receiving entity. In such a situation, it could be argued that the BCUCC transaction is different to a business combination between unrelated parties – where there is always a significant change in the ultimate ownership of the acquired business.

The substance of the transaction

24. We received feedback that the proposed criteria for determining which accounting method to apply to a BCUCC transaction are rather like a 'bright line' test, and that it would be more appropriate to select the accounting method based on the *substance* of the transaction – or at least there should be a 'substance overlay' over the proposed requirements. Under this view, determining the substance of the transaction would involve considering the involvement external parties (including NCS) in the transaction, whether the transaction was carried out at fair value, and whether it is an integral part of an IPO.

Recommendation

25. After considering the above arguments for and against the proposed criteria for determining which method to apply to a BCUCC transaction, we recommend requiring the acquisition method in the following circumstances.
 - (a) When the receiving entity's NCS are affected by the transaction (as proposed in the DP) *and the NCS were involved in setting the transaction price or there is other evidence that the transaction was conducted at fair value*. This would prevent the acquisition method being used to inappropriately recognise the transferred entity's internally generated goodwill.
 - (b) When the receiving entity (which may or may not have NCS) has *debt holders that hold convertible debt*, or when the BCUCC transaction is an *integral part of an IPO* – but *only if there is evidence that the BCUCC transaction was conducted at fair value*. This would help meet the information need of *potential* shareholders, to the extent that they are interested in the fair value of the group's assets and liabilities – but at the same time would prevent overstatement of goodwill.
26. We recommend that all other BCUCC transactions (i.e. those that do not meet the above conditions) be accounted for using the book value method.
27. We also agree with the proposal to provide an exception and an exemption from the acquisition method as proposed in the DP, but with certain modifications to that proposal – as outlined in our response to Question 3.

Question 3

Paragraphs 2.35–2.47 discuss the cost–benefit trade-off and other practical considerations for business combinations under common control that affect non-controlling shareholders of the receiving company.

- (a) In the Board’s preliminary view, the acquisition method should be *required* if the receiving company’s shares are traded in a public market.

Do you agree? Why or why not?

- (b) In the Board’s preliminary view, if the receiving company’s shares are privately held:

- (i) the receiving company should be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (the optional exemption from the acquisition method).

Do you agree with this exemption? Why or why not? Do you believe that the exemption will be workable in practice? If not, in your view, how should such an exemption be designed so that it is workable in practice?

- (ii) the receiving company should be *required* to use a book-value method if all of its non-controlling shareholders are related parties of the company (the related-party exception to the acquisition method).

Do you agree with this exception? Why or why not?

- (c) If you disagree with the optional exemption (Question 3(b)(i)) or the related-party exception (Question 3(b)(ii)), in your view, how should the benefits of applying the acquisition method be balanced against the costs of applying that method for privately held companies?

Summary of Board discussion and feedback to date*Feedback from NZASB April meeting*

- The distinction between entities whose shares are publicly traded and those whose share are privately held seems to be a practical proposal.
- However, there could be practical challenges in applying the proposed exemption from the acquisition method, particularly in terms of confirming that NCS do not object to the book value method.

Feedback from the TRG (May 2021)

There were mixed views about the proposed ‘publicly traded vs privately held shares’ distinction for the purpose of applying the exception and exemption from the acquisition method.

- One view was that the accounting method for a BCUCC transaction should be determined based on the transaction’s substance, and not on the ownership structure of the receiving entity.

- Another view was that the proposal to provide an exemption from the acquisition method for entities whose shares are privately held would be welcome by such entities. While it is true that accounting standards generally do not provide exemptions from recognition and measurement requirements for entities whose shares are privately held, this is often to the detriment of privately held entities.
- A third view was that it is hard to see the *conceptual* rationale for the proposed exemption from the acquisition method for entities whose shares are privately held – however, from a *pragmatic* perspective, an exemption would make sense if the receiving entity *continues to be privately held* after the transaction.

TRG members highlighted several practical challenges regarding the proposal to provide an exemption from the acquisition method if the entity's NCS do not object to using the book value method.

- An entity may have many individual NCS and they may be widely dispersed. It could be challenging to check with all of them whether they do not object to using the book value method – and it would only take one shareholder's objection to make the entity use the acquisition method.
- Some NCS may not easily understand the implications of using the book value method rather than the acquisition method. One way of explaining this to shareholders is to show what the financial statements would look like under each of the methods – but this would mean that an entity effectively needs to apply the acquisition method when it wishes to be exempt from the acquisition method.
- A shareholder might object to using the book value method when the financial statements have already been prepared.

Additional information: AASB roundtable (May 2021)

Participants' comments included the following:

- Regarding the proposed exemption from the acquisition method, which would apply if NCS do not object to the book value method: What if the NCS do not object to one BCUCC transaction, and then object to another BCUCC transaction? This could lead to lack of comparability.
- Regarding the proposed exception from the acquisition method, which would apply if all NCS are related parties of the receiving entity: Currently, some people struggle with identifying related parties as defined in IFRS Standards – they are likely to struggle with applying the proposed exception from the acquisition method. There was also a view that the proposed exception from the acquisition method lacks conceptual basis.

Draft response to Question 3:*Proposed exception and exemption from the acquisition method for entities whose shares are privately held*

28. We acknowledge that proposing an exception and exemption from the acquisition method for entities whose shares are privately held is a practical way of ensuring that the costs of applying the acquisition method do not outweigh its benefits. Therefore, we agree in principle with the proposal to provide an exception and exemption from the acquisition method for entities whose shares are privately held – subject to the recommendations below.
29. We note that some entities whose shares are privately held may list on the stock exchange soon after the BCUCC transaction. It could be argued that for such entities, the costs and benefits of using the acquisition method are similar to those entities whose shares are already publicly traded at the time of the BCUCC transaction. Furthermore, it could be argued that this is also the case for entities whose shares are not publicly traded but who have publicly traded convertible debt.
30. Therefore, we recommend that the exception and exemption be provided to entities whose shares are privately held *only when it is expected that their shares will continue to be privately held* in the foreseeable future.

Practicality of applying the exemption from the acquisition method

31. The DP proposes an optional exemption from the acquisition method for entities whose shares are privately held, when all NCS have been informed of the proposal to use the book value method and none of the NCS objected. We think there could be practical issues in applying this exemption.
32. Some NCS may not understand the difference between the acquisition method and the book value method without a thorough explanation. We acknowledge that IFRS 10, for example, already contains an exemption from preparing consolidated financial statements for privately-held entities whose NCS do not object to the lack of consolidation. However, it is arguably easier to explain to NCS the difference between consolidated and separate financial statements, as compared to explaining the impact of using the book value method versus the acquisition method. This could lead to challenges when applying the proposed exemption from the acquisition method.
 - (a) If an entity does not provide sufficient explanation on the impact of selecting the book value method as compared to the acquisition method, there is a risk that NCS will not be able to make an informed decision as to whether they object to the book value method or not.
 - (b) On the other hand, the level of information that some shareholders may require to make an informed decision may be a comparison of the two methods in terms of the impact on the financial statements. This would effectively require the entity to apply both the acquisition method and the book value method, which may defeat the cost-benefit rationale of the proposed exemption.

33. We also note the following challenges in relation to the proposed exemption from the acquisition method.
- (a) It only takes one objection from a single non-controlling shareholder to prevent an entity from using the proposed exemption. A shareholder could raise such an objection at any time, including when the financial statements have already been prepared and are substantively ready for publication. This would then require significant changes to the financial statements and would delay publication.
 - (b) An entity's NCS might not object to the book value method for one BCUCC transaction, but then object to the book value method for another similar BCUCC transaction. This could result in inconsistent accounting for similar BCUCC transactions – which is a key issue that the DP is trying to resolve.
34. The above challenges would be exacerbated if the receiving entity has a large number of individual NCS that are widely dispersed, or when the composition of NCS changes regularly.
35. On the other hand, the abovementioned challenges in applying the proposed exemption from the acquisition method may mean that entities would attempt to use this exemption only when they have a small number of NCS, or when NCS are relatively sophisticated investors who are likely to understand the difference between the acquisition method and book value method – which may have been the intended outcome, and therefore may be appropriate. If that is the case, we agree with retaining the exemption.
36. We also recommend adding guidance to explain that attempting to apply the proposed exemption (i.e. checking with NCS that they do not object to the book value method) is most likely to be suitable in situations where the number of NCS is small and/or they are sophisticated investors, for the reasons discussed above. This could help prevent receiving entities from attempting to apply the exemption where the costs of doing so would exceed the benefits.

Whether the proposed exception and exemption from the acquisition method should also apply to entities whose shares are publicly traded

37. In terms of the proposed exemption from the acquisition method: As mentioned above, there are some potential issues in relation to the practical application of the proposed exemption from the acquisition method if there is a large number of NCS. These challenges would also apply, and would probably be exacerbated, for an entity whose shares are publicly traded – as a publicly traded entity is likely to have a large number of NCS. Therefore, we do not think that this exemption needs to be made available to entities whose shares are publicly traded.
38. In terms of the proposed exception from the acquisition method: We think it is unlikely that all of the NCS of an entity whose shares are listed will be related parties of the entity. Therefore, even if the related party exception is extended to entities whose shares are publicly traded, these entities are unlikely to qualify for this exception. We therefore do not think that this exception needs to be extended to entities whose shares are publicly traded.

[Note: The Board has previously agreed not to respond to Question 4]
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Question 5

Paragraphs 3.11–3.20 discuss how to apply the acquisition method to business combinations under common control.

- (a) In the Board’s preliminary view, it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control.

Do you agree? Why or why not? If you disagree, what approach for identifying and measuring a distribution from equity do you recommend and why? In particular, do you recommend either of the two approaches discussed in Appendix C or do you have a different recommendation?

- (b) In the Board’s preliminary view, it should develop a requirement for the receiving company to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, not as a bargain purchase gain in the statement of profit or loss, when applying the acquisition method to a business combination under common control.

Do you agree? Why or why not? If you disagree, what approach do you recommend and why?

- (c) Do you recommend that the Board develop any other special requirements for the receiving company on how to apply the acquisition method to business combinations under common control? If so, what requirements should be developed and why are any such requirements needed?

Summary of Board discussion and feedback to date

Feedback from NZASB April meeting:

Board members generally agreed with the IASB’s proposals on how to apply the acquisition method.

Feedback from the TRG (May 2021)

A TRG member noted that when the acquisition method is considered appropriate for a BCUCC transaction, then all of the requirements specified in IFRS 3 *Business Combinations* should be applied – including the requirement to recognise a ‘bargain purchase’ gain in profit or loss. The member noted that if there is substance to the transaction, then it makes sense to recognise a ‘bargain purchase’ in profit or loss – not as a contribution to equity, as proposed in the DP.

Feedback from the virtual outreach event:

The majority of poll participants (85%) agreed with the IASB’s preliminary view that when applying the acquisition method to a BCUCC transaction, a ‘bargain purchase’ should be recognised as an equity contribution.

Additional information: AASB roundtable (May 2021)

- There were some comments about the asymmetry in this proposal, i.e. if the amount paid for the BCUCC transaction exceeds the fair value of the net assets received, the difference is accounted for as per IFRS 3, but if the amount paid is less than the fair value of the net

assets, then the difference is account for differently to IFRS 3. However, IASB staff noted that the requirements in IFRS 3 are themselves asymmetrical, as paying an amount that exceeds the fair value of the net assets acquired is recognised as goodwill (asset), whereas paying less than the fair value of the net assets is recognised as a gain in profit or loss.

Draft response to Question 5:

39. We agree with the IASB's preliminary view on how the acquisition method should be applied to a BCUCC transaction.
40. Regarding situations where the consideration paid exceeds the fair value of the net assets received:
- (a) We agree that when the consideration exceeds the fair value of the net assets acquired, then it would generally not be possible to apportion this difference between goodwill and a distribution to the owners in a reliable manner.
 - (b) Therefore, the options are either to recognise the full amount of the difference as goodwill (as per IFRS 3), or to recognise this full amount as a distribution to the parent.
 - (c) We agree with the IASB that the difference should be recognised as goodwill, because a distribution from the receiving entity to the ultimate parent would probably be unlikely when the receiving entity has NCS.
41. Regarding situations where the consideration paid is lower than the fair value of the net assets received:
- (a) We are aware of a view that if the economic substance of the BCUCC transaction is such that the acquisition method is considered appropriate, then the acquisition method should be applied exactly as required by IFRS 3 – including the requirements to recognise a 'bargain purchase' gain in profit or loss.
 - (b) However, the DP notes that in a BCUCC transaction, on the rare occasions when the receiving entity pays less than the fair value of the net assets received, the nature of the underpayment is more likely to be a contribution by the controlling party – and different from a situation where a business is acquired from an unrelated party in a 'forced sale', etc.
 - (c) On balance, we also agree that when the consideration paid for the BCUCC transaction is lower than the fair value of the net assets received, then the difference should be recognised as an equity contribution.

Question 6

Paragraphs 4.10–4.19 discuss the Board’s preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company’s book values.

Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

Summary of Board discussion and feedback to date*Feedback from NZASB April meeting*

Board member did not specifically comment on the proposal to use measure the transferred entity’s assets and liabilities using the book values as per the transferred entity’s financial statements (as opposed to the controlling party’s financial statements). However, please see the comments under Question 10 below, in relation to situations where it can be difficult to determine which entity is the ‘transferred entity’ and which is the ‘receiving entity’.

Feedback from the TRG (May 2021)

TRG members reiterated the importance of the transaction’s substance. The book value method is appropriate for BCUCC transaction that in substance are internal reorganisation of the group’s resources, as directed by the group’s parent. Therefore, the receiving entity should recognise the assets and liability of the transferred entity using the ultimate *parent’s book values* – rather than the transferred entity’s book values, as proposed in the DP.

Additional information: AASB roundtable (May 2021)

There were some suggestions for a rebuttable presumption to use book values of the combining entities’ parent, as there are some situations where using the parent’s book values would be more appropriate. For example, if a global group acquires a business externally through one subsidiary, and the next day this business is transferred to another subsidiary as part of a reorganisation, it may be more appropriate to use the values as per the financial statements of the group’s parent. Also, if the transferred entity does not report under IFRS Standards, it would make more sense to use book values as per the parent entity’s financial statements.

Draft response to Question 6:

42. We generally agree with the IASB’s proposals to use book values as per the financial statements of the transferred entity. However, we would recommend considering an exemption from this proposal when common control is ‘transitory’.
43. We are aware of a view that using the controlling party’s book values is more consistent with the substance of BCUCC transactions that are accounted for at book value. That is, transactions for which the book value method is appropriate tend to be internal reorganisations of resources within the group, driven by the parent. Therefore, under this view, applying the parent’s perspective when measuring the transferred entity’s assets and liabilities is appropriate.

44. However, we agree that in general, the book values per the transferred entity's financial statements should be used in applying the book value method, for the following reasons.
- (a) As the DP notes, the *Conceptual Framework for Financial Reporting* focuses on information about transactions and events from the perspective of the entity that prepares the financial statements—in this case, the receiving entity. The DP says that “from that perspective, the book values recorded by the controlling party, arguably, have no relation to the combination between the receiving entity and transferred entity”.
 - (b) We also agree with the IASB that one of the key features of the book value method is that the same information is provided to potential shareholders about the combining entities, regardless of how the transaction is structured. Using the controlling party's book values to measure the assets and liabilities of the transferred entities is not consistent with this feature. It would mean that the assets and liabilities of *one* of the combining entities would be measured at ‘updated’ values – so the values in the consolidated balance sheet would depend on how the transaction is structured, i.e. which entity is the ‘receiving entity’ and which is the ‘transferred’ entity.
 - (c) We acknowledge that the book values per the controlling party's financial statements could be more current than those in the transferred entity's own financial statements. However, it could be argued that if the use of current values is important, then fair value would be even more useful than the book values in the parents' financial statements. However, measuring acquired assets and liabilities at fair value is consistent with the acquisition method, rather than the book value method.
45. However, we recommend considering an exemption from using the transferred entity's book values in situations where the transferring entity recently acquired the transferred entity from an external party, i.e. where common control is ‘transitory’. For example, suppose parent P has subsidiaries A and B. The parent directs its subsidiary A to purchase Entity C from a party outside the group, and soon afterwards directs A to transfer Entity C to subsidiary B. In this situation, the BCUCC transaction seems to be an additional step in the acquisition of C from the external party. Therefore, it would seem appropriate for B to recognise C's assets and liabilities using the amounts recognised in the financial statements of the group's controlling party (P) – which would be based on the fair values of these assets and liabilities as at the date when the group acquired C from the external party – rather than using the book values in C's own financial statements.
46. Providing the exemption suggested above would require the IASB to consider guidance on determining when common control is transitory. For instance, in the example above, would common control be considered transitory only if A transferred C to B before a specific time period has passed? Or would common control be considered transitory in any situation where the transferred business was brought into the group with the intention to conduct a BCUCC?

[Note: The Board has previously agreed not to respond to Questions 7, 8 and 9].

Question 10

Paragraphs 4.57–4.65 discuss the Board’s preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information.

Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

Summary of Board discussion and feedback to date*Feedback from NZASB April meeting*

- The following comments were provided in favour of restating pre-combination information under the book value method (unlike the proposal in the DP):
 - Under the book value method, it may be useful to have the option to include pre-combination information in the financial statements (preferably in the primary financial statements). This information can be useful in IPO situations.
 - In some jurisdiction, pre-combination information may be required by regulators when an entity undertakes an IPO.
- The DP proposes that under the book value method, the receiving entity would present pre-combination information with respect for its own operations only, and would exclude the pre-combination information of the transferred entity. However, in some cases, it may not be clear which entity is the ‘receiving entity’ and which is the ‘transferred entity’. For example, this may be the case in a legal amalgamation. Additional guidance may be required in such circumstances.
- The DP proposes that under the book value method, the receiving entity would present pre-combination information with respect for its own operations only, and would exclude the pre-combination information of the transferred entity. However, in some cases, it may not be clear which entity is the ‘receiving entity’ and which is the ‘transferred entity’. For example, this may be the case in a legal amalgamation. Additional guidance may be required in such circumstances.

Feedback from the TRG

- One member expressed a preference to restate pre-combination information when the book value method applies, to reflect the fact that the transaction would generally relate to a parent reorganising existing subsidiaries within the group, rather than acquiring a new entity into the group.
- The member also noted that the transferred entity’s historical information could be useful.

- TRG members raised questions about the treatment of the *transferred entity's equity reserves of other comprehensive income* (OCI) – such as revaluation reserves relating to property, plant and equipment (PP&E), and cash flow hedge accounting reserves.
 - The DP proposes that under the book value method, the receiving entity should recognise the transferred entity's assets, liabilities, revenue and expenses from the combination date – but does not mention how the transferred entity's existing reserves of OCI should be treated. This may imply that the receiving entity does not recognise the transferred entity's OCI reserves as at the combination date, which could have consequences in the receiving entity's post-BCUCC financial statements. For example:
 - If the receiving entity does not recognise the transferred entity's PP&E revaluation reserve as at the date of the BCUCC, a subsequent reduction in the fair value of the transferred entity's PP&E will have to be recognised as an impairment in profit or loss, rather than a reduction in the revaluation reserve through OCI.
 - If the receiving entity does not recognise the transferred entity's cash flow hedge reserve as at the date of the BCUCC, does this mean that hedge accounting needs to start anew?
 - Therefore, the treatment of the transferred entity's reserves of OCI should be considered and clarified.

Feedback from the virtual outreach event (April 2021)

- All poll participants at the outreach event agreed with the IASB that the primary financial statements should not be restated to include the transferred entity's pre-combination information.
- However, the majority of poll participants (67%) thought that pre-combination information about the transferred entity should be *disclosed in the notes* (see Question 11 and 12 below).
- The remaining 33% thought that pre-combination information on the transferred entity should not be provided at all.

Additional information: AASB roundtable (May 2021)

Participants' comments included the following:

- When a BCUCC transaction is carried out by setting up a 'newco', maybe there should be an exemption from not restating pre-combination information.
- To carry out an IPO, there is a regulatory requirement to provide historical financial information. Not restating pre-combination information in the financial statements would make it more difficult to prepare the historical information required by regulations. While it is possible to make pro-forma adjustments in IPO documents, most prefer to minimise such adjustments and stick to the audited financial statements as much as possible.
- There was also a view that pre-combination information is useful to users.

Additional information: Regulatory requirements in New Zealand in relation to IPOs

We heard that in other jurisdictions, there are some concerns that the proposed requirement not to restate pre-combination information under the book value method could make it more difficult to comply with regulatory requirements for IPOs.

To understand whether this could be an issue in New Zealand, we checked the requirements in the NZX Listing Rules and in the Financial Markets Conduct Regulations 2014 (FMC Regulations).

Our understanding of these requirements is as follows:

- NZX Listing Rules
 - The Listing Rules require entities applying for a listing to provide “copies of the applicant’s annual reports for the last five years, if available” [Rule 1.12.2(i)]. This rule does not specifically require those annual reports to reflect pre-combination information for recent business combinations.
 - The Listing Rules also require applicants that wish to list their shares to provide a “draft offer document” [Rule 1.13.2(b)]. For offers to which the Financial Markets Conduct Act 2013 (FMC Act) applies, the offer document would be a product disclosure statement (PDS). The requirements for the content of a PDS are set out in the FMC Regulations. The requirements of these Regulations are discussed below.
- FMC Regulations
 - The FMC Regulations require an entity to include in its PDS ‘selected financial information’ (revenue, net profit, assets, liabilities, etc.). [Sch 3, cl 35(1)]
 - This information is required for the most recent accounting period, the previous two accounting periods and the next two accounting periods. [Sch 3 cl 35(1), cl 1(2)]
 - If the entity acquired a business/subsidiary during that time, it can either present the required historical financial information as if the business combination was already in place for the past two accounting periods – or, it can provide historical financial information for the acquired business separately. [Sch 3, cl 35(2)-(3)]
 - If an entity is not allowed to restate pre-combination information under the book value method, as proposed in the DP, we do not think that this would cause significant issues in terms of complying with the FMC Regulations. In its PDS, an entity can choose to provide the required pre-combination historical information for the transferred entity separately.
 - Even if an entity opts for showing ‘pro-forma’ historical information as if the combination was already in place for the past two years, this would only need to be done for the selected financial information required by the FMC Regulations (rather than the full primary financial statements), and would need to be done in the PDS with a reconciliation to the financial statements (rather than in the financial statements themselves).

Draft response to Question 10:

47. We acknowledge that, as the DP notes, restating comparatives as if the receiving entity had always controlled the transferred entity would involve preparing financial statements for a 'hypothetical' group that did not exist in practice.
48. However, we recommend that the IASB consider providing an option for entities to disclose pre-combination information in the notes to the financial statements, for the following reasons.
- (a) We think that pre-combination information could be useful to users of financial statements, especially in IPO situations.
 - (b) We have received comments that restating pre-combination information under the book value method would be appropriate, given that the transaction would generally represent an internal reorganisation of existing subsidiaries by the parent entity – which is different to the acquisition of a new business into the group.
 - (c) Two thirds of participants at our virtual outreach event thought that pre-combination information about the transferred entity should be included in the notes to the financial statements.
 - (d) Furthermore, we are aware that in some jurisdictions, there are concerns about the proposal not to restate pre-combination information because this information may be required by regulators when an entity undertakes an IPO. Our understanding is that this would not necessarily cause an issue in New Zealand.
49. If there is an option to include restated pre-combination information in the notes to the financial statements, entities would be able to do so if this is required for compliance with regulations around IPOs, or if the benefits to users from providing this pre-combination information in the notes would outweigh the costs of providing it.
50. We also think that the IASB may need to further consider situations where the BCUCC transaction involves setting up an intermediate parent (sometimes referred to as 'newco'), which obtains control over the existing subsidiaries – for example, in preparation for a spin-off or an IPO. It could be argued that in some such cases, the newly created company is merely a continuation of the subsidiaries that it acquired – and a continuation of the existing group structure. On this basis, it could be argued that in this situation comparatives should be restated, i.e. the pre-combination information of the acquired subsidiaries should be included in the financial statements of the newly created intermediate parent.
51. In addition, we note that the proposal not to restate pre-combination information implies that the receiving entity should present pre-combination information with respect to *its own operations*, but that it should not restate this information to include the transferred entity. This seems to be underpinned by an assumption that it would always be possible to identify a 'receiving entity' and a 'transferred entity'. However, there could be BCUCC transactions where it is not clear which entity is the 'receiving entity' and which is the 'transferred entity'. This could be the case in a legal amalgamation, where two entities become a single legal

entity, and in other ‘merger of equals’ situations. In such cases, it could be difficult to determine which entity’s pre-combination information should be presented in the primary financial statements. We recommend that the IASB considers whether to require pre-combination information to be restated in such situations, or otherwise provides guidance on how to determine which entity is the receiving entity.

52. We also consider the IASB should clarify *how* the *transferred entity’s equity reserves of other comprehensive income* (OCI) – such as revaluation reserves relating to property, plant and equipment (PP&E), and cash flow hedge accounting reserves – should be treated at the combination date. The DP proposes that under the book value method, the receiving entity should recognise the transferred entity’s assets, liabilities, revenue and expenses from the combination date – but does not mention how the transferred entity’s existing reserves of OCI should be treated. This may imply that the receiving entity does not recognise the transferred entity’s OCI reserves as at the combination date, which could have consequences in the receiving entity’s post-BCUCC financial statements. For example, if the receiving entity does not recognise the transferred entity’s PP&E revaluation reserve as at the date of the BCUCC, a subsequent reduction in the fair value of the transferred entity’s PP&E will have to be recognised as an impairment in profit or loss, rather than a reduction in the revaluation reserve through OCI. Also, if the receiving entity does not recognise the transferred entity’s cash flow hedge reserve as at the date of the BCUCC, does this mean that hedge accounting needs to start anew?

Question 11

Paragraphs 5.5–5.12 discuss the Board’s preliminary views that for business combinations under common control to which the acquisition method applies:

- (a) the receiving company should be required to comply with the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*; and
- (b) the Board should provide application guidance on how to apply those disclosure requirements together with the disclosure requirements in IAS 24 *Related Party Disclosures* when providing information about these combinations, particularly information about the terms of the combination.

Do you agree with the Board’s preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

Question 12

Paragraphs 5.13–5.28 discuss the Board’s preliminary views that for business combinations under common control to which a book-value method applies:

- (a) some, but not all, of the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, are appropriate (as summarised in paragraphs 5.17 and 5.19) [please see ‘Note on Question 12(a)’ below];

- (b) the Board should not require the disclosure of pre-combination information; and
- (c) the receiving company should disclose:
 - (i) the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received; and
 - (ii) the component, or components, of equity that includes this difference.

Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

Note on Question 12(a):

In the IASB's preliminary view, when the book value method applies to a BCUCC transaction, the following disclosure requirements should apply.

- (a) The requirement in IFRS 3 to provide information that would help users of financial statements evaluate the nature and financial effect of the combination;
- (b) The proposed requirement to provide information to help users understand the benefits expected from the combination, as proposed in the DP *Business Combinations – Disclosures, Goodwill and Impairment*, and;
- (c) The following specific disclosure requirements.
 - (i) The name and a description of the transferred entity, the combination date, the percentage of voting equity interests transferred to the receiving entity, the primary reasons for the combination and a description of how the receiving entity obtained control [paragraphs B64(a)–(d) of IFRS 3];
 - (ii) The recognised amounts of each major class of assets received and liabilities assumed, including information about recognised amounts of liabilities arising from financing activities and defined benefit pension liabilities [paragraph B64(i) of IFRS 3 and the related preliminary view discussed in the DP *Business Combinations – Disclosures, Goodwill and Impairment*];
 - (iii) The carrying amount of any non-controlling interest in the transferred entity [paragraph B64(o) of IFRS 3];
 - (iv) Aggregate information for individually immaterial combinations that are material collectively [paragraph B65 of IFRS 3];
 - (v) Information about combinations that occur after the end of the reporting period but before the financial statements are authorised for issue [paragraph B66 of IFRS 3];
 - (vi) The amount and an explanation of any gain or loss recognised in the current reporting period that relates to assets and liabilities received in a BCUCC that occurred in the current or previous reporting period, if such disclosure is relevant to understanding the receiving entity's financial statements [paragraph B67(e) of IFRS 3]; and
 - (vii) Whatever additional information is necessary to meet the disclosure requirements discussed in points (a) and (b) above [paragraph 63 of IFRS 3].

In the IASB's view, other disclosures required by IFRS 3 should not be required for BCUCC transactions to which the book value method applies.

Summary of Board discussion and feedback to date

Feedback from the virtual outreach event

The majority of poll participants (67%) thought that when the book value method applies, pre-combination information about the transferred entity should be disclosed in the notes.

Comments made by the Board in other submissions

The BCUCC DP proposes that any new disclosures arising from the DP *Business Combinations – Disclosures, Goodwill and Impairment* should also apply to BCUCC transactions when the acquisition method is used. In its submission on the DP *Business Combinations – Disclosures, Goodwill and Impairment*, the NZASB did not agree with the proposed disclosures on the subsequent performance of acquisitions and on expected synergies.

Draft response to Questions 11 and 12:

53. In relation to Question 12(b), which proposes that the IASB should not require the disclosure of pre-combination information: As noted in our response to Question 10, we recommend that the IASB consider providing an option for entities to disclose pre-combination information in the notes to the financial statements.
54. In relation to disclosure requirements for BCUCC transactions in general, we agree in principle that when the acquisition method applies, disclosure requirements should be similar to those required for business combinations between unrelated parties – whereas when the book value method applies, some of these disclosures should not be required.
55. However, as noted in our response to the IASB’s DP *Business Combinations – Disclosures, Goodwill and Impairment*, we have expressed concerns about the proposed disclosures on the subsequent performance of acquisitions and expected synergies. These concerns also apply to BCUCC transactions.
56. As noted in our comment letter on *Business Combinations – Disclosures, Goodwill and Impairment*, we do not agree that the proposed disclosures on the subsequent performance of acquisitions and expected synergies should be included in the financial statements, for the following reasons:
 - (a) We are concerned that the subjective nature of the disclosures on the subsequent performance of acquisitions may lead to ineffective disclosures in the financial statements, and these disclosures may be challenging to audit. Furthermore, disclosures about synergies may be based on information that lacks accuracy and completeness.
 - (b) We think that the cost of preparing the disclosures and having them audited would significantly increase costs for preparers of financial statements, and we are not convinced that these costs are outweighed by the possible benefits of the disclosures.

- (c) There is a risk that the proposed disclosures would be provided in such a generic way so as not to be useful to investors (for example, due to concerns about commercial sensitivity).
- (d) While the DP proposes relatively extensive disclosures in relation to business acquisitions, we note that no such disclosures are proposed in relation to organic growth, which may be equally as significant to the entity and of as much interest to investors as growth through business acquisitions. Arguably, it would be beneficial for investors to understand how successfully management is running the business as a whole and creating value for investors – be it through acquisitions or organic growth.



Cover Memo

Project	Insurance Activities in the Public Sector	Meeting	AASB (M181)/ NZASB June 2021
Topic	Applying AASB 17/NZ IFRS 17 in public sector entities	Agenda item	AASB 14.1 NZASB 8.1
		Date	7 June 2021
Contacts	Angus Thomson athomson@asb.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asb.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Board deliberation

June 2021 Board meetings – attachments

- For the June AASB and NZASB meetings, staff have prepared papers on the following topics:
 - Discounting and inflating:** consider the discount and inflation rates applicable to measuring insurance liabilities and related presentation and disclosure issues under AASB 17/PBE IFRS 17 *Insurance Contracts* (Agenda Paper AASB 14.2/NZASB 8.2); and
 - PAA eligibility:** consider the criteria for being eligible to apply the ‘simplified’ premium allocation approach (PAA) to measuring liabilities for remaining coverage under AASB 17/PBE IFRS 17 (Agenda Paper AASB 14.3/NZASB 8.3).

Project topics¹

- The topics outlined in the table below were identified at the February 2021 meetings of the Boards as needing to be addressed in order to progress the project.
- Staff note that some redeliberation of particular topics is likely to be required at a future Board meeting:
 - because the topics are interrelated and there may be a need to adjust decisions on topics considered early in the project to accommodate later decisions; and
 - although the Boards have, so far, arrived at largely the same conclusions, there are some cases of different decisions between the Boards. Staff will endeavour to reconcile the differences as part of future Board discussions.

¹ The AASB project summary is available [here](#).



4. The following table shows:
- the Board meetings at which topics have been, and are expected to be, considered; and
 - other activities needed to progress the project;
- with comments on progress against the timetable identified in February 2021.

Activity / Topic	AASB	NZASB	Comment
Scope: public sector activities to which AASB 17/PBE IFRS 17 should apply	April 2021	April 2021	
Risk adjustment: relevance and measurement	April 2021	May 2021	
Discounting/inflating: used to measure insurance liabilities	June 2021	June 2021	
PAA eligibility: criteria for using 'simplified' measure of liabilities for remaining coverage	June 2021	June 2021	
Reporting entities: identifying 'insurance entities' that should prepare financial statements	Planned September 2021	Planned October 2021	
Non-insurance costs: classification	Planned September 2021	Planned October 2021	
Onerous contracts: basis for recognition	Planned September 2021	Planned October 2021	
Investments: measurement for those backing insurance liabilities	Planned September 2021	Planned October 2021	
Targeted redeliberation on scope and risk adjustment	Planned September 2021	Planned October 2021	
Agree on Consultation document	Planned November 2021	Planned December 2021	Originally September 2021
Issue Consultation document	Planned February 2022	Planned February 2022	Originally October 2021
Consider feedback on Consultation document and proposals for addressing issues raised	Planned April 2022	Planned April 2022	Originally February 2022
Address any sweep issues and agree on revised Standards	Planned May-July 2022	Planned May-July 2022	Originally April 2022
Issue revised Standards	Planned September 2022	Planned September 2022	Originally May 2022

5. Depending on the nature and extent of any amendments to the Standards and the Scope of the Standards, there may be a need to extend the existing mandatory initial application date of AASB 17/PBE IFRS 17 for public sector entities beyond reporting periods beginning on or after 1 January 2023.
6. If the existing date applied, the first-affected annual reporting periods would be those ending on 30 June 2024, with comparative information for the year ending 30 June 2023.



Staff paper

Project	Insurance Activities in the Public Sector	Meeting	AASB (M181)/NZASB June 2021
Topic	Discounting and inflating under AASB 17 / NZ IFRS 17 by public sector entities	Agenda item	AASB 14.2 NZASB 8.2
		Date	7 June 2021
Contacts	Angus Thomson athomson@asab.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asab.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Board deliberation

Objective of this paper

In respect of the measurement of a liability for incurred claims, the objective of this paper is for the AASB and the NZASB to decide whether public-sector-specific modifications or guidance is needed in AASB 17/PBE IFRS 17 *Insurance Contracts* regarding:

- (a) the discounting requirements; and
- (b) the requirements for presenting the impacts of inflation in the statement of profit or loss and other comprehensive income.

This staff paper is set out in six sections:

- [Section 1](#) sets out the basis for discounting and inflating under AASB 1023/PBE IFRS 4
- [Section 2](#) sets out the basis for discounting and inflating under AASB 17/PBE IFRS 17
- [Section 3](#) sets out the basis for discounting under AASB 137/PBE IAS 37
- [Section 4](#) outlines the existing discounting and inflating practices of public sector entities with activities that might be within the scope of AASB 17/PBE IFRS 17 and feedback received from recent stakeholder engagement
- [Section 5](#) provides an analysis of the discounting requirements in AASB 17/PBE IFRS 17 for public sector entities
- [Section 6](#) provides an analysis of the inflating requirements in AASB 17/PBE IFRS 17 for public sector entities.

Staff are recommending there be no public sector modifications to AASB 17/PBE IFRS 17 relating to discounting or inflating. However, staff expect the issues and reasoning for taking no action to be explained in a Basis for Conclusions.



Abbreviations for Standards identified in this paper are referenced in full in [Appendix B](#).

Background comments on discounting and inflating claims

Almost all premiums/levies received by public sector entities with activities that might be within the scope of AASB 17/PBE IFRS 17 would be received prior to coverage commencing or early in the coverage period. In addition, public sector entities with activities that might be within the scope of AASB 17/PBE IFRS 17 are likely to apply the premium allocation approach (PAA) when measuring the liability for remaining coverage.¹ Discounting is not typically expected to apply to premiums/levies under the PAA.²

Discounting is most likely to apply to claims liabilities, which in some cases may remain outstanding for decades. Claims inflation also needs to be taken into account in measuring claims liabilities because the costs associated with settling claims can change over time. Discounting (in the absence of negative rates) reduces the claims liabilities and inflating (in the absence of negative rates) increases the claims liabilities.

1. Discounting and inflating in accordance with AASB 1023/PBE IFRS 4

1.1 AASB 1023.6.1/PBE IFRS 4 (Appendix D.6.1) requires expected future cash flows to be discounted at a risk-free rate.

6.1 The outstanding claims liability shall be discounted for the **time value of money using risk-free discount rates** that are based on current observable, objective rates that relate to the nature, structure and term of the future obligations.

It is implicit in this requirement that the discount rate does not incorporate the entity's own credit risk. Although not explicitly stated, discounting typically would not be applied to claims expected to be settled within one year of the end of the reporting period.

1.2 AASB 1023.5.1.2/PBE IFRS 4 (Appendix D.5.1.2) comments on inflation.

5.1.2 The longer the expected period from the end of the reporting period to settlement, the more likely it is that the ultimate cost of settlement will be affected by inflationary factors likely to occur during the period to settlement. These factors include changes in specific price levels, for example, trends in average periods of incapacity and in the amounts of court awards for successful claims. For claims expected to be settled within one year of the end of the reporting period, the impact of inflationary factors might not be material.

Inflation is therefore more than simply price inflation. It also includes inflation in costs from all likely sources.

1 Subject to deliberations by the Board on June 2021 agenda paper 14.3/8.3 on PAA eligibility.

2 [Appendix C](#) outlines the very limited cases in which discounting might apply to the liability for remaining coverage when the PAA is applied.



Australia

1.3 Existing actuarial practice is guided by Australian Professional Standard PS 302 *Valuations of General Insurance Claims*.³

1.4 PS 302 requires discount rates to be determined by reference to a ‘replicating portfolio’.

‘Replicating Portfolio’ means a notional portfolio of current, observable, market-based, fixed-interest investments of highest credit rating, which has the same payment profile (including currency and term) as the relevant claim liability being valued. [section 3.1]

1.5 Practice largely involves applying sovereign bond yields for durations that match the relevant claims liabilities, with extrapolation when needed. This is probably driven to some extent by wanting to align with Australian Prudential Regulation Authority (APRA) prudential requirements. Prudential Standard 340 *Insurance Liability Valuation*⁴ states:

28. The rates to be used in discounting the expected future claims payments of insurance liabilities denominated in Australian currency for a class of business are derived from yields of Commonwealth Government Securities (CGS), as at the calculation date, that relate to the term of the future insurance liability cash flows for that class.
29. Where the term of the insurance liabilities denominated in Australian currency exceeds the maximum available term of CGS, other instruments with longer terms and current observable, objective rates are to be used as a reference point for the purpose of extrapolation. ...
30. For foreign insurance liabilities not denominated in Australian currency, the risk-free discount rate must be based on the yields of highly liquid sovereign risk securities with current observable, objective rates, in the currency of the insurance liabilities ...

1.5 PS 302 requires allowance to be made for ‘claim inflation’.

10.2.1 The Member must allow for any future escalation of Claim Payments (often called “claim inflation”). Whether the allowance is explicit or implicit will depend on the valuation methods being used. The escalation assumptions must consider:

- (a) wage and/or price inflation; and
- (b) superimposed inflation (any residual claim inflation arising for reasons other than wage and/or price inflation).

New Zealand

1.6 Existing actuarial practice is guided by New Zealand actuarial Professional Standard No. 30 *Valuations of General Insurance Claims*.⁵ PS No. 30 takes a more direct approach than PS 302:

Discount rates used must be based on risk-free rates of appropriate duration, having regard to the liabilities, as at the Valuation Date. [paragraph 10.5.2]

3 Professional Standard PS 302 *Valuations of General Insurance Claims*, the latest version of which was issued in March 2021 by the Actuaries Institute

4 APRA Prudential Standard 340 *Insurance Liability Valuation*, July 2019.

5 Professional Standard No. 30 *Valuations of General Insurance Claims*, the latest version of which was issued in December 2017 by the New Zealand Society of Actuaries.



- 1.7 The PS 30 requirement (paragraph 10.2.1) to allow for ‘claim inflation’ is identical to the requirement in PS 302.
- 1.8 However, individual public sector entities do not have any discretion in determining discount rates and any consumer price (CPI) components⁶ of inflation rates. The New Zealand Treasury publishes a table of risk-free discount rates and consumer price index (CPI) assumptions that must be used for the purpose of preparing the financial statements of the Government of New Zealand.⁷ ⁸ These rates also apply to all Government reporting entities submitting valuations to Treasury for measuring insurance claims liabilities under PBE IFRS 4.⁹
- 1.9 The New Zealand Treasury risk-free discount rate methodology uses as its starting point the market yield curve of New Zealand Government Bonds as the most appropriate proxy for the return on a very safe asset.

Staff comment

- 1.10 Despite the differing ways in which the requirements are expressed, practice in both jurisdictions is centred largely on applying sovereign bond yields for durations that match the relevant claims liabilities, with extrapolation when needed.

2. Discounting and inflating under AASB 17/PBE IFRS 17

Discounting

- 2.1 AASB 17/PBE IFRS 17.36 requires estimated future cash flows to be discounted for the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts.

- 36 An entity shall adjust the estimates of future cash flows to reflect the **time value of money and the financial risks related to those cash flows**, to the extent that the financial risks are not included in the estimates of cash flows. ... :
- (a) reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;
 - (b) be consistent with observable current market prices (if any) for financial instruments with cash flows whose characteristics are consistent with those of the insurance contracts, in terms of, for example, timing, currency and liquidity; and
 - (c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.

6 As noted in paragraph 1.2, inflation under PBE IFRS 4 is a broader notion than consumer price inflation.

7 <https://www.treasury.govt.nz/information-and-services/state-sector-leadership/guidance/reporting-financial/discount-rates/discount-rates-and-cpi-assumptions-accounting-valuation-purposes>

8 Both forward and spot rates are provided up to 2101 (80 years hence). New Zealand Treasury notes that: (a) ideally, forward rates should be used for the accounting valuations; however, (b) the ability to use forward rates will be dependent on the type of valuation model used; and (c) the model must be able to cope with different discount rates for each year in order to use forward rates.

9 The rates also apply to measuring employee benefits under PBE IPSAS 25 *Employee Benefits*, and building a risk-adjusted discount rate for measuring student loans.



- 2.2 In addition, under a fulfilment cash flows model, as applies under AASB 17/PBE IFRS 17, liabilities are measured without reference to the entity's own credit risk. That is, no adjustment is made to discount rates (or expected cash flows) to reflect the risk that the entity will not settle the liability. The Basis for Conclusions to IFRS 17 notes:

BC197 IFRS 17 requires an entity to disregard its own credit risk when measuring the fulfilment cash flows. ...

- 2.3 Despite the difference in language between AASB 1023.6.1/PBE IFRS 4 (Appendix D.6.1) and AASB 17/PBE IFRS 17.36, the only significant difference appears to be an explicit requirement to adjust discount rates upwards for illiquidity. This is evident from the application guidance in AASB 17 /PBE IFRS 17.B80 & B81, which outlines two possible approaches (bottom-up and top-down) to determining discount rates.

B80 Hence, for cash flows of insurance contracts that do not vary based on the returns on underlying items, an entity may determine discount rates by **adjusting a liquid risk-free yield curve** to reflect the differences between the liquidity characteristics of the financial instruments that underlie the rates observed in the market and the liquidity characteristics of the insurance contracts (a bottom-up approach).

B81 Alternatively, an entity may determine the appropriate discount rates for insurance contracts based on a yield curve that reflects the current market rates of return implicit in a fair value measurement of a reference portfolio of assets (a top-down approach). An entity shall adjust that yield curve to eliminate any factors that are not relevant to the insurance contracts, but is not required to **adjust the yield curve for differences in liquidity characteristics** of the insurance contracts and the reference portfolio.

Liquidity premium¹⁰

- 2.4 In concept, the size of a liquidity premium has a positive correlation with:
- (a) the length of time over which claims (cash flows) are expected to be paid; and
 - (b) the predictability of the cash flows.

Accordingly, the longer the time to expected settlement and the more predictable are the cash flows, the larger is the liquidity premium.

- 2.5 Larger liquidity premiums would mean lower liabilities, all other things being equal. Accordingly, it would be expected that insurance liabilities measured under AASB 17/PBE IFRS 17.36 would be lower, on average, than under AASB 1023.6.1/PBE IFRS 4 (Appendix D.6.1).

- 2.6 The IFRS 17 Basis for Conclusions includes the following on 'liquidity':

Liquidity

BC193 Discussions of the time value of money often use the notion of risk-free rates. Many entities use highly liquid, high-quality bonds as a proxy for risk-free rates. However, the holder can often sell such bonds in the market at short notice without incurring significant costs or affecting the market price. This means that the holder of such bonds effectively holds two things:

¹⁰ The term 'liquidity premium' is used here – it is sometimes referred to as 'illiquidity premium'.



- (a) a holding in an underlying non-tradable investment, paying a higher return than the observed return on the traded bond; and
- (b) an embedded option to sell the investment to a market participant, for which the holder pays an implicit premium through a reduction in the overall return.

In contrast, for many insurance contracts, the entity cannot be forced to make payments earlier than the occurrence of insured events, or dates specified in the contract.

[Appendix A](#) to this Staff Paper includes further extracts from the IFRS 17 Basis for Conclusions as background on liquidity premiums.

- 2.7 In preparing for the application of AASB 17, private sector insurers appear to be considering various approaches to liquidity premiums, ranging from applying a zero premium to applying various prudential benchmarks.
- 2.8 For prudential reporting purposes, the APRA LPS 112 *Capital Adequacy: Measurement of Capital*¹¹ sets an illiquidity premium for life insurers.

Until 1 December 2013, APRA's illiquidity premium (in basis points) added to the risk-free forward rates for the first 10 years after the reporting date was:

15% x AA spread + 15% x A spread [LPS 112, Attachment H, paragraph 7].

From 1 December 2013, APRA's illiquidity premium (in basis points) added to the risk-free forward rates for the first 10 years after the reporting date is:

33% x A spread 3 year [[APRA letter dated 27 March 2014](#) to: All CEOs and Appointed Actuaries of life insurers (including friendly societies)].

- 2.9 APRA Prudential Standard LPS 112, paragraph 7, also notes:

The spreads must be obtained from "Table F3 Capital Market Yields and Spreads – Non-Government Instruments" published by the RBA on its website. "AA spread" and "A spread" are the spreads over bonds issued by the Australian Government for corporate bonds with broad credit ratings (as determined by Standard and Poor's) of AA and A respectively.

If the RBA ceases to publish this information, an alternative method of calculating the illiquidity premium may be used with the prior written approval of APRA.

The maximum illiquidity premium is 150 basis points and the minimum is zero.

- 2.10 There is no equivalent APRA document on liquidity premiums for general insurers.
- 2.11 The relationship between financial reporting and prudential reporting is still being considered by APRA, and it is not clear whether APRA will maintain these Prudential Standards once AASB 17 is in force.

Inflating

- 2.12 AASB 17/PBE IFRS 17.B59 requires insurers to take inflation into account when relevant.

B59 ... , if cash flows allocated to a group of insurance contracts are sensitive to inflation, the determination of the fulfilment cash flows shall reflect current estimates of possible future inflation rates. Because inflation rates are likely to be

¹¹ APRA LPS 112 [Capital Adequacy: Measurement of Capital](#), January 2013.



correlated with interest rates, the measurement of fulfilment cash flows shall reflect the probabilities for each inflation scenario in a way that is consistent with the probabilities implied by the market interest rates used in estimating the discount rate ...

- 2.13 The requirements relating to inflation rates are much less stringent than the requirements relating to discount rates. However, the need for consistency between the discount and inflation rates applied indirectly introduces some additional rigour to the inflation rate requirements.

Insurance service result versus insurance finance income/expense

- 2.14 AASB 17/PBE IFRS 17 requires the ‘underwriting result’ to be presented in two components.

AASB 17/PBE IFRS 17	AASB 1023/PBE IFRS 4
Insurance service result [80(a)]	Underwriting result
Insurance finance income and expenses [80(b)] – includes impact on insurance liabilities of changes due to discount rates and some types of inflation	

- 2.15 The initial impact of discounting fulfilment cash flows affects the insurance service result; however, under AASB 17/PBE IFRS 17.87(a), the subsequent discount rate changes are presented in insurance finance income and expenses. These subsequent changes include:
- (a) the effect of the time value of money – that is, the impact on insurance liabilities of the unwinding of the discount as time passes; and
 - (b) and changes in the time value – that is, the impact on insurance liabilities of changes to discount rates.¹²

- 2.16 The initial impact of inflating fulfilment cash flows affects the insurance service result; however, under AASB 17/PBE IFRS 17.B128, **only some** of the subsequent impacts of inflation rate changes are presented in insurance finance income and expenses.

B128 Paragraph 87 requires an entity to include in insurance finance income or expenses the effect of the time value of money and financial risk and changes therein. For the purposes of IFRS 17:

- (a) assumptions about inflation based on an index of prices or rates or on prices of assets with inflation-linked returns are assumptions that relate to financial risk;

12 At its June 2020 meeting, the AASB 17 *Insurance Contracts* Transition Resource Group considered where the impacts of discounting fulfilment cash flows should be presented. The Group effectively concluded that, while the initial impact of discounting is presented within the ‘insurance service result’, the subsequent impacts of discounting (unwinding of the impact of discounting and the impact of changes in discount rates) are included in ‘insurance finance income and expenses, based on the IFRS 17 Illustrative Examples and Effects Analysis [https://www.aasb.gov.au/admin/file/content102/c3/Minutes_TRG_22JUN20_FINAL.pdf].

- (b) assumptions about inflation based on an entity’s expectation of specific price changes are not assumptions that relate to financial risk; ...¹³

2.17 Table 2-1 outlines two possible interpretations of the distinction between AASB 17/PBE IFRS 17.B128(a) versus (b). There may be other possible interpretations that staff have not identified.

Table 2-1
<p>Interpretation A: changes in insurance liabilities resulting from changes in inflation assumptions are:</p> <p>(a) ‘insurance finance income and expenses’ [under B128(a)] when the assumption is an index based on prices or rates alone; and</p> <p>(b) ‘insurance service result’ [under B128(b)] when the assumption is based on both prices/rates and non-price factors.</p> <p>For example:</p> <ul style="list-style-type: none"> • minimum hourly wage rates would be indices based only on price/rate factors and, therefore, impact on ‘insurance finance income and expenses’ while • Average Weekly Earnings (AWE: Australia) and Median Weekly Earnings (MWE: New Zealand) are indices based on a price factor (wage rates) and a non-price factor (hours worked) and, therefore, impact on ‘insurance service result’.
<p>Interpretation B: changes in insurance liabilities resulting from changes in inflation assumptions are:</p> <p>(a) ‘insurance finance income and expenses’ [under B128(a)] when the assumption is any index related mainly to price or rate changes; and</p> <p>(b) ‘insurance service result’ [under B128(b)] when the assumption is based on ‘superimposed inflation’, which is a reasonably well-established notion in insurance accounting (see paragraphs 1.5 and 4.9).</p> <p>For example:</p> <ul style="list-style-type: none"> • minimum hourly wage rates and AWE/MWE would be indices based on price/rate factors and, therefore, impact on ‘insurance finance income and expenses’; while • estimated escalations in court awards and other environmental factors are non-price factors and, therefore, impact on ‘insurance service result’.

2.18 One possible benefit of separately presenting ‘insurance service result’ from ‘insurance finance income and expenses’ could be greater transparency around the impact of discount rates and inflation rates on financial performance. However, the uncertainty around the meaning of AASB 17/PBE IFRS 17.B128 is a potential concern – please see Section 6.

2.19 Staff do not consider that the requirements in AASB 17/PBE IFRS 17.B128 are aimed at identifying ‘real’ discount rates. This is because the discount rates are already supposed to take into account the impact of inflation when relevant, and AASB 17/PBE IFRS 17.B74 says:

- B74 Estimates of discount rates shall be consistent with other estimates used to measure insurance contracts to avoid double counting or omissions; for example: ...
- (c) nominal cash flows (ie those that include the effect of inflation) shall be discounted at rates that include the effect of inflation; and
- (d) real cash flows (ie those that exclude the effect of inflation) shall be discounted at rates that exclude the effect of inflation.

¹³ AASB 17/PBE IFRS 17.B128(c) relates to transactions that are not conducted by public sector entities in Australia and New Zealand.



3. Discounting under AASB 137/PBE IAS 37

3.1 AASB 137/PBE IAS 37.47 requires estimated future cash flows to be discounted for the time value of money.

47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted.

3.2 Some entities interpret this requirement as being the same or similar to the discounting requirements in AASB 1023/PBE IFRS 4.

3.3 Other entities interpret this requirement as being different from the discounting requirements in AASB 1023/PBE IFRS 4. A key potential difference is that the focus of AASB 1023/PBE IFRS 4 (and AASB 17/PBE IFRS 17) is from the entity perspective because an insurer is expected to fulfil its insurance liabilities. In contrast, the focus of AASB 137.36/PBE IPSAS 19.44 is on settlement.

36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

3.4 A settlement amount involves both the entity and the counterparty (or a third-party transferee) agreeing on the terms, which could include:

- (a) a counterparty (or third-party) agreeing to settle for less than face value, for example, because the entity is not creditworthy,¹⁴ or
- (b) a counterparty (or third-party) demanding more than face value to accept the liability to compensate for uncertainty.

3.5 AASB 137/PBE IPSAS 19 do not include specific requirements on applying inflation rates to measure provisions. Some may interpret the requirement in AASB 137.36/PBE IPSAS 19.44 to use a 'best estimate' as meaning that expected inflation should be taken into account; however, this is not explicit.

4. Discounting and inflating practice among relevant public sector entities and stakeholder feedback

Discounting practice

4.1 Most public sector entities that have activities which might fall within the scope of AASB 17/PBE IFRS 17 and are currently applying AASB 1023/PBE IFRS 4, appear to derive their discount rates from national government bond yields. This is consistent with practice among for-profit private sector insurers currently applying AASB 1023/PBE IFRS 4.

¹⁴ In theory, 'own credit risk' should have little or no impact on discount rates for entities in the public sector, given the creditworthiness of government entities in Australia and New Zealand.



- 4.2 Most of the entities currently applying AASB 137 also appear to derive their discount rates from national government bond yields. A small number of entities applying AASB 137 are using higher discount rates.
- 4.3 Many of the claims liabilities are cash flow projections over decades. Accordingly, relatively small changes in discount rates can lead to large changes in liability measurements.

Feedback on discounting

- 4.4 Most of the public sector entities that would potentially be within the scope of AASB 17/PBE IFRS 17 operate on a break-even basis. Typically, this involves breaking even in the long-run on an overall basis, including the impact of investment returns on assets held to meet liabilities. Accordingly, when determining the amount of premiums or levies to be charged to participants, the expected return on assets is taken into account.
- 4.5 The long-run return on assets is generally higher than the 'time value of money' and, therefore, all other things being equal:
- (a) premiums/levies can appear to be unsustainably low; and
 - (b) insurance liabilities can appear to be unsustainably high relative to the assets available to meet them.
- 4.6 Some of the stakeholders recently consulted by staff consider that it would be appropriate to discount insurance liabilities using the long-run investment returns, which would line up with the approach to pricing and, in their view, would enable the entity to better present its economic position.¹⁵ Please also refer to the discussion in Section 5.
- 4.7 Some of the stakeholders recently consulted by staff expressed serious concerns about the impact on their entities' reported financial position and performance due to the volatility of discount rates from period to period. This has been exacerbated by the low level of government bond rates; whereby small changes in rates have a relatively large impact on liability measurement. Many regard this volatility as a distraction from their entities' overall results.
- 4.8 Please note that the stakeholder feedback identified above applies in respect of both AASB 1023/PBE IFRS 4 and AASB 17/PBE IFRS 17. That is, some stakeholders consider that the existing and new Standards both require:

¹⁵ In order to help address these concerns, some entities include additional information in their financial statements.

- (a) Some entities show separately (sometimes in a note to the financial statements):
 - (i) those components of reported outcomes that are regarded as being within the entity's capacity to manage; and
 - (ii) those reported outcomes that are not regarded as being within the entity's capacity to manage. Changes in discount rates are regarded as being outside the entity's capacity to manage and, accordingly, the related movements in liabilities are regarded as being outside the entity's capacity to manage.
- (b) Some entities present metrics aimed at indicating the relationship between the available funding, which is typically provided by a pool of investments, relative to the liabilities. This can include 'funding ratios' of investment assets and insurance liabilities remeasured using discount rates higher than those applied under AASB 1023/PBE IFRS 4.



- (a) discount rates that are too low and, therefore, liabilities being measured at amounts that are higher than they should be; and
- (b) frequent discount rate changes and, therefore, liability measurement volatility that clouds underlying reported outcomes.

These stakeholders acknowledged that, using the period-to-period investment rate of return would also result in volatility and, instead, a long-run (averaged) rerun would need to be applied to resolve both of these concerns.

Practice and feedback on inflating

- 4.9 Most public sector entities that have activities which might fall within the scope of AASB 17/PBE IFRS 17 and are currently applying AASB 1023/PBE IFRS 4, appear to derive their assumptions about inflation in the same manner as private sector for-profit insurers.
- (a) Historical price changes and current price trends are used to inflate costs expected to be incurred in paying future claims. An example would be historical rates of medical and para-medical cost inflation in the case of injuries and acquired disabilities.
 - (b) Knowledge about regulation, court awards, and technological changes and other environmental factors are also used to inflate costs expected to be incurred in paying future claims. An example would be expected increases in the average sum awarded by courts for certain types of acquired disabilities. Another example, would be expected technological developments that might make more expensive, or less expensive, treatments available to injured claimants. This type of inflation is sometimes referred to as ‘superimposed inflation’.¹⁶
- 4.10 In many cases, entities have negotiated multi-year agreements with service providers (for example, for medical services) and would have a degree of certainty over inflation rates for those periods. However, many of their liabilities extend well beyond those negotiated agreements.
- 4.11 There was general satisfaction with the requirements of AASB 17/PBE IFRS 17 and AASB 1023/PBE IFRS 4 on inflation. However, staff have not specifically discussed the presentation requirements in AASB 17/PBE IFRS 17.B128 with public sector stakeholders.

5. Analysis on discounting

Independent liability measurement and fulfilment cash flows

- 5.1 Conventionally, assets and liabilities are measured independently. That is, for example, the measurement of a liability is based on the liability’s inherent characteristics, not on the characteristics of any assets that might be available to settle the liability. Consistent with this general convention, AASB 17/PBE IFRS 17 requires that:

B78 Discount rates shall include only relevant factors, ie factors that arise from the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts. ...

¹⁶ AASB 1023.5.2.11/PBE IFRS 4 (Appendix D.5.2.11 refers to ‘superimposed inflation’.



- 5.2 Accordingly, it would be inconsistent with AASB 17/PBE IFRS 17 to measure insurance liabilities based on the expected return on assets available to support the liability, unless those assets are a ‘replicating portfolio’, which is a **theoretical portfolio** of assets providing cash flows that exactly match the cash flows from the liability in all scenarios.
- 5.3 A notional ‘replicating portfolio’ typically would be very different from the actual investment portfolio held by the relevant public sector entities. Among public sector entities, actual investment portfolios are typically designed to achieve maximum returns for the risks taken – they are not designed to match the cash flows on the underlying liabilities. Accordingly, a replicating portfolio approach would not be available to resolve the concerns of public sector stakeholders. Further background on the replicating portfolio approach is in [Appendix D](#) to this paper.

Any private sector versus public sector differences?

Source of discount rates

- 5.4 Under AASB 1023/PBE IFRS 4, most private sector insurers in Australia and New Zealand typically make reference to sovereign bond yields in determining their discount rates in much the same way as public sector entities applying AASB 1023/PBE IFRS 4. It seems likely that the same sources of yield will be used in determining their discount rates under AASB 17/PBE IFRS 17 and, accordingly, the source of discount rates is unlikely to be different between the sectors and would not be a basis for a public sector modification.

Underwriting losses

- 5.5 Many private sector commercial insurers routinely make underwriting losses and only achieve profits (overall) after taking into account their investment earnings. Those private sector insurers also factor their expected investment returns into the determination of their premiums. Accordingly, in general terms, the use of relatively lower discount rates in measuring liabilities compared with expected investment returns used in pricing is not unique to the public sector and would not be a basis for a public sector modification.
- 5.6 However, in theory, the gap between:
- (a) long-run investment returns; and
 - (b) the discount rates applied under AASB 1023/PBE IFRS 4 (and to be applied under AASB 17/PBE IFRS 17);

could typically be larger for public sector entities, relative to their private sector counterparts. This is because the investment choices made by APRA/RBNZ-regulated private sector insurers are constrained by prudential capital penalties imposed when insurers make more risky investments. Public sector entities may be less constrained in their investment choices.

Staff view – a wider issue

- 5.7 To a large extent the same discounting issues from applying AASB 17/PBE IFRS 17 that face public sector insurers also apply in the for-profit and not-for-profit private sector.
- 5.8 In addition, concerns about the impact on public sector entities’ reported financial position and performance due to the volatility of discount rates from period to period is not confined to AASB 1023/PBE IFRS 4 (or AASB 17/PBE IFRS 17).



- 5.9 The same concerns arise in respect of the accounting for:
- (a) employee benefits, particularly defined benefit plan liabilities (under AASB 119/PBE IPSAS 39); and
 - (b) accounting for provisions (under AASB 137/PBE IPSAS 19).
- 5.10 Any solution to concerns about discount rates would probably need to be addressed broadly across all the affected asset and liability types – rather than being something that the Boards should tackle in the context of the insurance project.

Question DI1

- 5.11 Do the Boards agree that there are no public sector specific reasons for modifying the discounting requirements of AASB 17/PBE IFRS 17 and, therefore, no further work on this issue should be conducted in the context of the project on applying AASB 17/PBE IFRS 17 in the public sector?

6. Analysis on inflating

- 6.1 Given that:
- (a) all the discount rate impacts are included in ‘insurance finance income and expenses’; and
 - (b) discounting and inflating will (in the absence of negative rates) have opposing effects;
- it is important that the inflation impacts included in ‘insurance finance income and expenses’ be identified in a way that achieves a sensible outcome.
- 6.2 The issues facing public sector insurers regarding inflation are essentially the same as those facing private sector insurers, including the uncertainty around which types of inflation impacts are within ‘insurance finance income and expenses’ and which are not (see discussion of AASB 17/PBE IFRS 17.B128 in paragraphs 2.14 to 2.19).
- 6.3 Accordingly, although it may seem worthwhile to seek to provide guidance, there is no public sector specific basis for doing so. In theory, the industry practice to be developed on this topic will be able to be applied by public sector entities. Staff will continue to monitor developments in the industry.

Question DI2

- 6.4 Do the Boards agree that, at this stage, no further work on the inflation assumptions that impact on ‘insurance service result’ versus ‘insurance finance income and expenses’ should be conducted in the context of the project on applying AASB 17/PBE IFRS 17 in the public sector?

- 6.5 Appendix E shows an example of how the classification of the impacts of inflation could affect the reporting of results.



Appendix A

Extracts from IFRS 17 Basis for Conclusions

- BC194 The Board concluded that, in principle, the discount rate for a group of insurance contracts should reflect the liquidity characteristics of the items being measured. Thus, the discount rate should equal the return on the underlying non-tradable investment (see paragraph BC193(a)), because the entity cannot sell or put the contract liability without significant cost. There should be no deduction in the rate for the implicit premium for the embedded put option, because no such put option is present in the liability.
- BC195 The Board concluded that it is not appropriate in a principle-based approach:
- (a) to ignore the liquidity characteristics of the item being measured, or to use an arbitrary benchmark (for example, high-quality corporate bonds) as an attempt to develop a practical proxy for measuring the specific liquidity characteristics of the item being measured; or
 - (b) to provide detailed guidance on how to estimate liquidity adjustments.
- BC196 However, in response to feedback suggesting that it may be difficult to determine a liquidity premium in isolation, the Board observed that in estimating liquidity adjustments, an entity could apply either of the following:
- (a) a 'bottom-up' approach based on highly liquid, high-quality bonds, adjusted to include a premium for the illiquidity.
 - (b) a 'top-down' approach based on the expected returns of a reference portfolio, adjusted to eliminate factors that are not relevant to the liability, for example market and credit risk. The Board expects a reference portfolio will typically have liquidity characteristics closer to the liquidity characteristics of the group of insurance contracts than highly liquid, high-quality bonds. Because of the difficulty in assessing liquidity premiums, the Board decided that in applying a top-down approach an entity need not make an adjustment for any remaining differences in liquidity characteristics between the reference portfolio and the insurance contracts.



Appendix B – Abbreviations

PBE IFRS 4 *Insurance Contracts* [PBE IFRS 4]

PBE IFRS 17 *Insurance Contracts* [PBE IFRS 17]

AASB 4 *Insurance Contracts* [AASB 4]

AASB 1023 *General Insurance Contracts* [AASB 1023]

AASB 17 *Insurance Contracts* [AASB 17]

AASB 119 *Employee Benefits* [AASB 119]

PBE IPSAS 39 *Employee Benefits* [PBE IPSAS 39]

AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* [AASB 137]

PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* [PBE IPSAS 19]



Appendix C – PAA and discounting

C1 Under the PAA, discounting only arises for a ‘significant financing component’ – please see the table below.

AASB 17		Comment
55	Using the premium allocation approach , an entity shall measure the liability for remaining coverage as follows:	
55(a)	on initial recognition, the carrying amount of the liability is:	
55(a)(i)	the premiums, if any, received at initial recognition;	Agenda paper 6 IFRS 17 TRG May 2018 clarifies this: “means premiums actually received at the reporting date. It does not include premiums due or premiums expected.”
55(a)(ii)	minus any insurance acquisition cash flows at that date, unless the entity chooses to recognise the payments as an expense ...;	These are also ‘actual’ cash flows.
55(a)(iii)	plus or minus any amount arising from the derecognition at that date of:	
55(a)(iii)(1)	any asset for insurance acquisition cash flows applying paragraph 28C	This is any deferred acquisition costs incurred and recognised prior to the contract’s initial recognition.
55(a)(iii)(2)	any other asset or liability previously recognised for cash flows related to the group of contracts as specified in paragraph B66A	This could include a ‘pre-coverage’ liability relating to premium received prior to the contract’s initial recognition.
55(b)	at the end of each subsequent reporting period, the carrying amount of the liability is the carrying amount at the start of the reporting period:	
55(b)(i)	plus the premiums received in the period;	Agenda paper 6 IFRS 17 TRG May 2018 clarifies this: “means premiums actually received at the reporting date. It does not include premiums due or premiums expected.”
55(b)(ii)	minus insurance acquisition cash flows; unless the entity chooses to recognise the payments as an expense applying paragraph 59(a);	These are also ‘actual’ cash flows.
55(b)(iii)	plus any amounts relating to the amortisation of insurance acquisition cash flows recognised as an expense in the reporting period; unless the entity chooses to recognise insurance acquisition cash flows as an expense ...;	Relates to any accrued acquisition cash flows that are being amortised in relation to the relevant contracts.
55(b)(iv)	plus any adjustment to a financing component, applying paragraph 56	Relates to unwinding of any ‘significant financing component’ that initially adjusts the



AASB 17		Comment
		LfRC. The 'discount rate' = the rate that would have been used on initial recognition under the general measurement model. Please see paragraphs C2 to C5.
55(b)(v)	minus the amount recognised as insurance revenue for services provided in that period (see paragraph B126); and	Premium revenue is credited to income and debited to the LfRC regardless of whether the premium cash has been received.
55(b)(vi)	minus any investment component paid or transferred to the liability for incurred claims.	Not relevant to public sector contracts.

- C2 AASB 17/ PBE IFRS 17.56 explains that a 'significant financing component' which adjusts the LfRC would be based on the same discount rate used to discount incurred claims cash flows (for the equivalent relevant period). That is, a discount rate representing the time value of money and the financial risks related to the cash flows, which is generally taken to be a risk-free rate adjusted for illiquidity.
- C3 Entities are not required to discount the LfRC if, at initial recognition, the entity expects the time between providing services and the related premium due date is no more than a year. That is, a financing component need only be recognised when the premium is expected to be received a year or more after the coverage relating to that premium is provided. A time gap of this length is rare in a retail insurance setting – the most likely application is in a commercial-scale reinsurance setting.
- C4 Presumably, an entity could choose to recognise a financing component in the LfRC if the time between providing services and the related premium due date is less than a year.
- C5 The impact of initially recognising a financing component would be to have a lower LfRC than would otherwise be the case. As the financing component unwinds, the LfRC is increased (credit) and a financing expense (debit) is recognised within 'insurance finance income and expenses' [AASB 17/PBE IFRS 17.87(a)]. 'Insurance finance income and expenses' is a separate line item from 'insurance service result' [AASB 17/PBE IFRS 17.80].



Appendix D – Replicating portfolios

The IFRS 17 Basis for Conclusions notes:

BC204 ... A replicating portfolio is a theoretical portfolio of assets providing cash flows that exactly match the cash flows from the liability in all scenarios. If such a portfolio exists, the appropriate discount rate(s) for the replicating portfolio would also be the appropriate discount rate(s) for the liability. If a replicating portfolio existed and could be measured directly, there would be no need to determine separately the cash flows and the discount rate for the part of the liability replicated by that portfolio. The measurements of the replicating portfolio and the replicated cash flows arising from the contracts would be identical.

Accordingly, for an asset portfolio to be a ‘replicating portfolio’, it would need to possess all the characteristics of the insurance liabilities. That would include zero (or at least an immaterial level of) credit risk.



Appendix E – Example Presentation of insurance finance income and expense

- E1 The IFRS 17 Effects Analysis includes an example that shows where the impacts of (positive) discounting are presented in the income statement.¹⁷ The IFRS 17 Effects Analysis does not illustrate the impacts of inflating.
- E2 The illustrative example in the Table below uses different numbers, but essentially the same line item ‘labels’, as the IFRS 17 Effects Analysis example. The Table also adds a line item to show the impact of unwinding (positive) inflation on the incurred claims liability. The Table does not attempt to show the impacts of unwinding negative discount/inflation rates or the impacts of changes in discount/inflation rates.
- Scenario A shows all the impact of unwinding the inflation of the incurred claims liability in the ‘net financial result’
- Scenario B shows all the impact of unwinding the inflation of incurred claims liability in the ‘insurance service result’
- Scenario C shows some of the impact of unwinding the inflation of incurred claims liability in the ‘insurance service result’ and some in the ‘net financial result’.
- All Scenarios are based on inflation being positive.

<i>IASB EG</i>	<i>Scenario A</i>	<i>Scenario B</i>	<i>Scenario C</i>
Insurance revenue	10,000	10,000	10,000
Incurred claims other expenses	(11,000)	(11,000)	(11,000)
Release from risk adjustment	300	300	300
Insurance finance income (inflation unwind)	-	180	80
Insurance service result	(700)	(520)	(620)
Investment income	760	760	760
Insurance finance expense (discount unwind)	(250)	(250)	(250)
Insurance finance income (inflation unwind)	180	-	100
Net insurance financial result¹⁸	690	510	610
Profit or loss	10	10	10

- E3 Given the significance attributed to the ‘insurance service result’ versus the ‘net financial result’ by some stakeholders, the interpretation of how different types of inflation are classified (discussed in paragraphs 2.14 to 2.19 of this paper) is important to those entities.

¹⁷ From IFRS 17 *Insurance Contracts Effects Analysis* (May 2017), page 123.

¹⁸ The example in the Effects Analysis uses the term ‘net financial result’, but IFRS 17 itself does not. Most of the large firms’ illustrative financial statements have adopted the term ‘net insurance financial result’ (which is also not used in IFRS 17).



Staff paper

Project	Insurance Activities in the Public Sector	Meeting	AASB (M181)/NZASB June 2021
Topic	Eligibility for the PAA under AASB 17 / NZ IFRS 17 for public sector entities	Agenda item	AASB 14.3 NZASB 8.3
		Date	7 June 2021
Contacts	Angus Thomson athomson@asb.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asb.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Addressing specific technical issues for board deliberation

Objective of this paper

The objective of this paper is for the AASB and the NZASB to **decide** whether public-sector-specific modifications or guidance is needed in AASB 17/PBE IFRS 17 *Insurance Contracts* regarding the eligibility for application of the ‘premium allocation approach’ to measuring liabilities for remaining coverage.

Note about terminology

AASB 17/PBE IFRS 17.53 refers to the ‘premium allocation approach’ (**PAA**), which is a simplified approach to measuring a liability for remaining coverage for an eligible group of insurance contracts. The ‘unsimplified’ measurement approach has no official name, but insurance industry stakeholders typically refer to the ‘general measurement model’, ‘general model’ or ‘fulfilment cash flows model’. This paper uses the abbreviation ‘**GMM**’.

Abbreviations for Standards identified in this paper are referenced in full in [Appendix B](#).

Structure of this paper

This staff paper is set out in five sections:

- [Section 1](#) compares the GMM and the PAA in AASB 17/PBE IFRS 17
- [Section 2](#) compares the PAA in AASB 17/PBE IFRS 17 with the (unearned premium) approach in AASB 1023/PBE IFRS 4
- [Section 3](#) sets out the eligibility criteria for applying the PAA
- [Section 4](#) provides background on coverage periods among public sector entities
- [Section 5](#) analyses issues relevant to PAA eligibility in the public sector.

Staff are recommending the following.

- PAA1 It would be appropriate to provide guidance to the effect that an entity’s practical ability to fully price for risks/benefits also includes the ability of its controlling government (Minister) to decide on pricing/benefits [paragraph 5.15].
- PAA2 It would be appropriate to provide guidance to the effect that an entity’s monopoly status (and obligation to stand-ready to insure future participants/policyholders), of itself, does not affect the coverage period [paragraph 5.21].
- PAA3 It would be appropriate that public sector entities:
- (a) apply AASB 17/PBE IFRS 17.34(b)(i) alone in assessing their eligibility for the PAA (that is, the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio);
 - (b) need not also meet the condition in AASB 17/PBE IFRS 17.34(b)(ii) (that is, the pricing of the premiums up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date) [paragraph 5.35].
- PAA4 Assuming PAA3 = ‘yes’, public sector entities should be required to disclose information about the manner in which long-run pricing is determined when that pricing takes into account risks relating to future coverage periods [paragraph 5.36].

Background

Under AASB 17/PBE IFRS 17, the GMM must always be applied to measure a liability for incurred claims. However, for eligible groups of contracts, an insurer can apply either the GMM or the PAA to measure a liability for remaining coverage.

Liabilities for remaining coverage (relative to liabilities for incurred claims) are of less significance in the public sector compared with the private sector (please see Appendix 1). Nonetheless, the measurement of liabilities for remaining coverage is still a material matter for many public sector entities.

1. Comparison of the GMM and the PAA

- 1.1 Table 1-1 provides a high-level comparison of the initial measurement requirements of the GMM and the PAA in AASB 17/PBE IFRS 17. Costs of acquiring insurance contracts are ignored for the sake of simplicity and, in any case, they are not typically a material feature of public sector arrangements.

Table 1-1 – initial measurement of insurance contracts		
GMM	PAA	Comments
An insurer estimates: <ul style="list-style-type: none"> • an unbiased expected value for cash inflows (premiums, levies, etc.) and cash outflows (claims, attributable expenses, 	An insurer defers as a liability any cash (premiums, levies, etc.) actually	Under the PAA, the insurer needs to consider whether the amounts received and deferred as a liability are expected to be

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Table 1-1 – initial measurement of insurance contracts		
GMM	PAA	Comments
<p>etc.) related to the contract PV of future cash flows</p> <ul style="list-style-type: none"> an adjustment for the time value of money a risk adjustment. <p>Any expected profit (excess of inflows over outflows and the risk adjustment) is ‘contractual service margin’ (CSM) which must be separately identified and recognised over the coverage period [AASB 17/PBE IFRS 17.44].</p> <p>Any expected loss (deficiency of inflows over outflows and the risk adjustment) is a ‘loss component’ (negative CSM) which is recognised immediately in profit or loss. However, the loss component needs to be tracked to address the ongoing accounting for the liability and possible subsequent adjustments to the loss component [AASB 17/PBE IFRS 17.49 & 50].</p>	<p>received¹ [AASB 17/PBE IFRS 17.55].</p> <p>It is assumed the insurer has priced a risk adjustment into the premium – so no additional amount is provided for risk, unless the contracts are onerous.</p> <p>It is assumed the insurer has priced a profit into the premium – but there is no need for it to be separately identified.</p>	<p>sufficient to meet the cash outflows.</p> <p>If they are not, the insurer would immediately recognise a loss. Although this means the insurer needs to also apply aspects of the GMM, most contracts are sold with a view to profit.</p> <p>Accordingly, typically, it will be clear when an onerous contact assessment is needed.</p>

1.2 Table 1-2 provides a high-level comparison of the subsequent measurement requirements of the GMM and the PAA AASB 17/PBE IFRS 17. Costs of acquiring insurance contracts are ignored.

Table 1-2 – subsequent recognition of insurance contracts		
GMM	PAA	Comments
Liability components – liability run-off and revenue recognition		
<p>For the purposes of subsequent recognition, there are potentially different components of a liability for remaining coverage.</p>	<p>There is essentially only the one component (leaving aside acquisition costs, which are not addressed in this Table).</p>	<p>Under the GMM versus the PAA, the liability components might be run off (and revenue recognised) in different patterns.</p>
<p>The liability for remaining coverage reduces over the coverage period (and revenue is recognised) based on provision of ‘promised services’ [AASB 17/PBE IFRS 17.B121-B124].</p>	<p>The liability for remaining coverage reduces over the coverage period (and revenue is recognised) based on the passage of time, or the</p>	<p>For example, the provision of ‘promised services’ might be related to bearing risk, while ‘coverage units’ used to</p>

1 IFRS 17 Transition Resource Group May 2018 Agenda Paper 6 *Implementation challenges outreach report* includes a response on what ‘premiums received’ means. Paragraph A.5 of Agenda Paper 6 says: “Response – ‘Premiums, if any, received’ as included in paragraphs 55(a)(i) and 55(b)(i) of IFRS 17 means premiums **actually received** at the reporting date. It does not include premiums due or premiums expected”.



Table 1-2 – subsequent recognition of insurance contracts		
GMM	PAA	Comments
Liability components – liability run-off and revenue recognition		
CSM (profit) is recognised over the coverage period based on ‘coverage units’, which represent the quantity of insurance contract services provided [AASB 17/PBE IFRS 17.B119].	pattern of expiry of risk, if that is materially different [AASB 17/PBE IFRS 17.B126].	recognise the CSM are based on the number of employees at risk (in a workers’ compensation contract). The IASB has made clear that coverage units are not related to the expiry of risk [IFRS 17.BC279(a)]. Accordingly, under the GMM, it is often necessary to run off each component separately. The PAA does not present the same complications.
Liability discounting – and expense recognition		
The liability changes due to the unwinding of the impact of discounting are presented separately within ‘insurance finance income or expense’ [AASB 17/PBE IFRS 17.41(c)]. The discount rate applying to fulfilment cash flows is a current rate [AASB 17/PBE IFRS 17.36]. The discount rate applying to the CSM is a historical rate as at initial contract recognition date [AASB 17/PBE IFRS 17.B72(b)].	There is no need for discounting of cash flows (unless there is a significant financing component, which would rarely be the case [AASB 17/PBE IFRS 17.56]).	If the GMM is applied to measure the liability for remaining coverage, an insurer needs to track multiple discount rates – the current rate ² and the historical rates (for the CSM) relevant to each annual generation of contracts. When an insurer has multiple generations of contracts in-force, it must track multiple generations of discount rates.

- 1.3 There is widespread recognition in the general insurance industry that, for most types of insurance contracts, the GMM is more complex and more costly to implement and maintain than the PAA. The GMM applies to measuring liabilities for incurred claims, regardless of whether it (or the PAA) is applied to measuring liabilities for remaining coverage. However, many of the complications in the GMM stem from the accounting for the CSM, which only arises in liabilities for remaining coverage.

2. Comparison of the PAA and AASB 1023/PBE IFRS 4 approach

- 2.1 Table 2-1 provides a high-level comparison of the PAA under AASB 17/PBE IFRS 17 and the AASB 1023/PBE IFRS 4 unearned premium (UEP) approach.

² The same current rate is applied to the liability for incurred claims.

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Table 2-1		
PAA	UEP	Comments
Initial recognition		
An insurer defers as a liability any cash (premiums, levies, etc.) actually received [AASB 17/PBE IFRS 17.55].	An insurer defers as a liability any premiums, levies, etc. received or receivable [AASB 1023/PBE IFRS 4.4.2].	AASB 1023/PBE IFRS 4 involves recognising all the expected contracted premiums as a liability (not only those ‘actually received’). Premium receivables are recognised under AASB 1023/PBE IFRS 4, but not under AASB 17/PBE IFRS 17.
It is assumed the insurer has priced a risk adjustment into the premium – so no additional amount is provided for risk, unless the contracts are onerous. It is assumed the insurer has priced a profit into the premium – but there is no need for it to be separately identified.		
Subsequent recognition		
The liability for remaining coverage reduces (and revenue is recognised) over the coverage period based on the passage of time, or the pattern of expiry of risk, if that is materially different [AASB 17/PBE IFRS 17.B126]. At any given time, the liability represents premium received, adjusted for premium recognised as revenue.	The liability reduces (and revenue is recognised) over the contract period based on the passage of the incidence of risk [AASB 17/PBE IFRS 17.4.3]. At any given time, the liability represents ‘unearned premium’.	In practice, the revenue recognition requirements are effectively the same. However, the use of ‘premiums received’ versus ‘unearned premiums’ means that the liabilities can be very different. In particular, when coverage is provided in advance of receiving premiums, AASB 17/PBE IFRS 17 results in assets for remaining coverage, which do not arise under AASB 1023/PBE IFRS 4.

- 2.2 Insurers’ balance sheets are expected to be ‘smaller’ under AASB 17/PBE IFRS 17 than under AASB 1023/PBE IFRS 4 because applying AASB 17/PBE IFRS 17 does not result in recognising premium receivable assets or premium liabilities relating to cash not yet received.
- 2.3 This impact on the balance sheet of moving from the UEP approach to the PAA is likely to be less significant for most public sector entities that currently apply AASB 1023/PBE IFRS 4, compared with private sector insurers in Australia and New Zealand because:
- (a) liabilities for remaining coverage are typically a much smaller proportion of the total balance sheet for public sector entities – see [Appendix A](#); and
 - (b) public sector entities tend to receive most of their premiums/levies before coverage is provided.

3. Eligibility criteria for applying the PAA

3.1 Provided the contracts meet the relevant eligibility criteria, an entity can choose to apply the PAA, rather than the GMM. In practice, most insurers plan to apply the PAA whenever feasible and, given the choice, are not intending to apply the GMM.³

3.2 AASB 17/PBE IFRS 17.53 outlines the eligibility criteria:

- 53 An entity may simplify the measurement of a group of insurance contracts using the premium allocation approach set out in paragraphs 55–59 if, and only if, at the inception of the group:
- (a) the entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the one that would be produced applying the requirements in paragraphs 32–52; or
 - (b) the coverage period of each contract in the group (including insurance contract services arising from all premiums within the contract boundary determined at that date applying paragraph 34) is one year or less.

The same eligibility criteria apply to reinsurance contracts held [AASB 17/PBE IFRS 17.69].

3.3 AASB 17/PBE IFRS 17.53(a) is based on materiality. AASB 17/PBE IFRS 17.53(b) is a ‘practical expedient’ that means an entity need not do the work needed to establish there is no material difference between the PAA and GMM liabilities for remaining coverage when contracts have coverage periods of a year or less.

3.4 For contracts with coverage periods longer than a year, it is necessary to (at least periodically) forecast the likely PAA and GMM liabilities for remaining coverage for the life of the coverage period.

For example, assume a domestic builder contract with a six-year coverage period.

The liabilities for remaining coverage for each of the next six years would each need to be estimated under both approaches.

Those estimated liabilities in each period would need to be materially the same to be eligible for the PAA.

The choice is made when a group of contracts is initially recognised. Accordingly, if the PAA has been chosen at inception, it is not relevant if the liabilities for remaining coverage subsequently prove to be materially different. However, this would indicate that future groups of similar contracts would not be eligible for the PAA.

Unit of account

3.5 The PAA accounting policy choice is applied on a group of contracts basis. AASB 17/PBE IFRS 17.16 requires an entity to divide a portfolio of insurance contracts issued into a minimum of three categories:

- (a) a group of contracts that are onerous at initial recognition, if any;
- (b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and

³ A possible exception might be a private sector insurer that must apply the GMM to determine most of its liabilities for remaining coverage and does not wish to maintain two separate systems of measurement.

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(c) a group of the remaining contracts in the portfolio, if any.

However, there is a lack of clarity around what (b) means. Accordingly, most entities are assuming that all the contracts not captured within (a) are either within (b) or (c), with the result that only two classifications are being identified (onerous versus non-onerous).

3.6 The diagram below is a simple representation of the units of account used in AASB 17/PBE IFRS 17.

Portfolio = insurance contracts subject to similar risks and managed together	Group of contracts issued in year 1	Non-onerous contracts
		Onerous contracts
	Group of contracts issued in year 2	Non-onerous contracts
		Onerous contracts

3.7 It is possible that a group of ‘contracts’ with a coverage period longer than a year that is issued between 1 July 2021 and 30 June 2022 is eligible for the PAA, while a subsequent group issued between 1 July 2022 and 30 June 2023 is ineligible for the PAA. However, it would be expected that, provided there are no significant changes to the nature of the coverage, that groups of contracts would consistently (year after year) either be eligible or ineligible for the PAA.

4. Background on coverage periods among public sector entities

Arrangements between public sector entities and their ‘policyholders’

4.1 Table 4-1 shows the ‘contractually-stated’ coverage periods of arrangements across a selection of public sector entities.

Table 4.1		
Entity	Coverage	Comments
Accident Compensation Commission (NZ)	one year	Some standardised periods apply, such as 1 April to 31 March for earners’ coverage and 1 July to 30 June for motor vehicle coverage
Earthquake Commission (NZ)	one year	The period is tied to the underlying (private sector) householders’ insurance contracts, which are typically for one year



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Table 4.1			
Entity		Coverage	Comments
iCare (NSW):	Dust Diseases Care	one year	
	Lifetime Care	one year	
	Construction risks	up to ten years	Depends on the nature of the projects
	Home Building Compensation	six years	From the time work is completed
	Workers' Insurance	one year	
	Sporting Injuries Scheme	one year	
	Building Insurers' Guarantee	seven years	
	Self-insurance Corp.	one year	
WorkSafe (QLD)		one year	
WorkSafe (VIC)		one year	
WorkCover [RiskCover Fund] (WA)		one year	
ReturnToWorkSA (SA)		one year	
ComCare (Australia)		one year	
Victorian Managed Insurance Authority (VIC)		various	Mostly one year, but domestic building insurance is seven years and construction risks up to ten years
South Australian Finance Authority (SA) [SAicorp Division]		mainly one year	Domestic building insurance is seven years under a three-year fronting arrangement with a private sector insurer
Insurance Commission (WA)	Risk Cover Fund	one year	There are also three-year dust diseases contracts, but they are not material
	Third Party Insurance Fund	one year	
	Motor Vehicle Catastrophic Injury	one year	
Transport Accident Commission (VIC)		one year	
Motor Accident Insurance Board (TAS)		one year	
Nominal Defendant (QLD)		one year	
National Injury Insurance Agency (QLD)		one year	
Queensland Building & Construction Commission		six years	
Lifetime Support Authority (SA)		one year	



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Table 4.1		
Entity	Coverage	Comments
Australian Reinsurance Pool Corporation	one year	The period is tied to the underlying (private sector) commercial property insurance contracts, which are typically for one year

- 4.2 Most of the above arrangements would, based on the contractually-stated coverage period (please refer to Section 5), automatically be eligible to be accounted for using the PAA.
- 4.3 For arrangements that have coverage periods longer than a year, an assessment would need to be made to determine eligibility.

Arrangements between public sector entities and reinsurers

- 4.4 Table 4-2 shows the ‘contractually-stated’ coverage periods of reinsurance contracts held by a selection of public sector entities. Please note that most of the relevant stakeholder entities periodically review their circumstances to determine whether holding reinsurance contracts is worthwhile. However, fewer than a quarter of the relevant stakeholder entities typically hold reinsurance contracts at any given time.

Table 4.2		
Entity	Coverage	Comments
Earthquake Commission (NZ)	up to five years	
iCare Self Insurance Corporation	various	Can be longer than one year when they relate to multi-year projects
Victorian Managed Insurance Authority (VIC)	various	Can be longer than one year when they relate to multi-year projects
Insurance Commission (WA) Risk Cover Fund	one year	
Queensland Building & Construction Commission	one year	

A note on reinsurance contract coverage periods

- 4.5 There are various ways in which types of reinsurance contracts held can be classified. In relation to coverage periods, it is important to distinguish between:
 - (a) risks-attaching reinsurance; and
 - (b) losses occurring (or claims incurred) reinsurance.

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4.6 The following example helps to illustrate the distinction.

	<i>Risks attaching basis</i>	<i>Claims incurred basis</i>
Contract period	1 July 2020 to 30 June 2021	1 July 2020 to 30 June 2021
Insured events/losses covered	Events/losses on contracts incepting any time between 1 July 2020 to 30 June 2021	Events/losses occurring any time between 1 July 2020 to 30 June 2021
Event/loss occurs 31 March 2021 under contract incepting 15 Sept 2020	Covered	Covered
Event/loss occurs 31 July 2021 under contract incepting 15 Sept 2020	Covered	Not covered
Event/loss occurs 31 March 2021 under contract incepting 15 May 2020	Not covered	Covered

4.7 Using the example above, for the reinsurance contract held covering **risks attaching** in a particular year and assuming all the underlying (reinsured) contracts are annual:

- (a) the first contract covered by the reinsurance contract could be written on 1 July 2020 and an insured event might occur on 1 July 2020
- (b) the last contract covered by the reinsurance contract could be written on 30 June 2021 and an insured event might occur on 30 June 2022.

Accordingly, the reinsurance contract covers **insured events spanning two years**, which means **the coverage period is two years – even though all the underlying reinsured contracts have one-year coverage periods**.

4.8 Using the example above, for a reinsurance contract covering **claims incurred** in a particular year:

- ~ the first insured event covered by the reinsurance contract could occur on 1 July 2020; and
- ~ the last insured event covered by the reinsurance contract could occur on 30 June 2021.

Accordingly, the reinsurance contract held covers **insured events spanning only one year**.

5. Analysis of issues relevant to PAA eligibility in the public sector

5.1 As noted above, contracts with a coverage period of a year or less can automatically be accounted for using the PAA. For longer coverage periods, an assessment is needed of whether the PAA liability for remaining coverage would be materially different from the GMM liability for remaining coverage.

5.2 The longer the coverage period, the more likely it is that the two liabilities might differ and AASB 17/PBE IFRS 17.54 says:

- 54 The criterion in paragraph 53(a) is not met if at the inception of the group an entity expects significant variability in the fulfilment cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred. Variability in the fulfilment cash flows increases with, for example:



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- (a)⁴ the extent of future cash flows relating to any derivatives embedded in the contracts; and
- (b) the length of the coverage period of the group of contracts.

The same guidance applies to reinsurance contracts held [AASB 17/PBE IFRS 17.70].

Coverage period and ‘contract boundary’

5.3 AASB 1023/PBE IFRS 4 presumes that the contractually-stated coverage period is the relevant period of the contract for accounting purposes.

5.4 AASB 17/PBE IFRS 17 does not make this same presumption. Instead, there are contract boundary requirements for determining the cash flows within a contract that have a number of possible implications, including implications for determining coverage periods.

34 Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with insurance contract services (see paragraphs B61–B71). A substantive obligation to provide insurance contract services ends when:

- (a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or
- (b) both of the following criteria are satisfied:
 - (i) the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and
 - (ii) the pricing of the premiums up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.

5.5 A key issue is whether the ‘contractually-stated’ coverage periods (please refer to Section 4) are the same as the coverage periods that would be determined applying the requirements of AASB 17/PBE IFRS 17.

5.6 AASB 17/PBE IFRS 17.34(a) relates to individual policyholders and would usually only be applicable for large risks that are individually underwritten. This might be relevant for large construction risks underwritten by some public sector entities.

5.7 AASB 17/PBE IFRS 17.34(b) relates to portfolios of contracts. Most of the public sector arrangements being addressed in this project would involve pricing risks/benefits on a portfolio basis.

5.8 Based on AASB 17/PBE IFRS 17.34, a coverage period could be either longer or shorter than the contractually-stated term, as illustrated in the following examples.

- (a) A contract with a stated term of one year and a \$100 premium is accompanied by an option for a second year of coverage for another \$100 premium. The initial contract would be regarded as a contract for two years of coverage because the insurer does not have the practical ability to fully reprice the risk/benefits for the second year.

4 Staff are not are that sub-paragraph (a) would apply to any relevant public sector arrangements in Australia or New Zealand.



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- (b) A contract with a stated term of ten years involves ten annual premiums that are reset each year to reflect current expected risks/benefits. Although the insurer is obliged to keep accepting premiums and providing coverage for ten years, each year (up to a possible ten years) would be regarded as a separate coverage period because the insurer has the practical ability to reprice risk/benefits each year.

5.9 It is important to note that an entity might have the 'practical ability' to fully price for risks/benefits, but choose not to use that ability. In the private for-profit sector, insurers routinely choose to:

- (a) under-price in order to gain, or maintain, market share;
- (b) over-price when market conditions permit.

The requirement in AASB 17/PBE IFRS 17.34 is based on the existence of the insurer's practical ability to fully price for risks/benefits, not the manner in which the insurer might choose to use that ability.

5.10 The pricing of levies/premiums for many public sector entities is based on achieving a break even result over the long-term. Accordingly, the actual amounts charged in any given period will often be less than, or more than, the expected present value of the risks being borne and likely benefits to be paid. Depending on the circumstances, the entity might be regarded as:

- (a) not having the practical ability to fully price for risks/benefits each year; or
- (b) having the practical ability to fully price for risks/benefits each year, but choosing not to exercise that ability.

Who holds the 'practical ability'?

5.11 The price/levy decision-making power may reside with the entity itself, or it might reside with the government (for example, the relevant Minister).

- (a) Literally, if the entity does not have the price/levy decision-making power, it could be interpreted that the entity does not have the practical ability to fully price for risks/benefits each year and has contracts with multi-year coverage periods. These multi-year coverage periods may result in the entity's arrangements being ineligible to be accounted for using the PAA.
- (b) Alternatively, the entity and its controlling government⁵ (Minister) might be considered collectively to have the price/levy decision-making power and any failure to fully price for risks/benefits each year would be regarded as a choice made by the entity and not a lack of a practical ability to fully price for risks/benefits each year.

5.12 Even when the entity and its controlling government (Minister) are considered collectively to have the price/levy decision-making power, there may be cases when the government (Minister) is constrained politically. Staff note that the 'practical ability' benchmark is effectively modified by AASB 17/PBE IFRS 17.B64, which says (in part):

B64 ... An entity has that practical ability in the absence of constraints that prevent the entity from setting the same price it would for a new contract with the same

⁵ Under existing (or substantively enacted) legislation.



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characteristics as the existing contract issued on that date, or if it can amend the benefits to be consistent with the price it will charge. ...

- 5.13 That is, provided the constraints (political or commercial) apply to new (current) as well as existing arrangements, they are not regarded as constraints that affect an insurer's practical ability to fully price for risks/benefits in relation to the existing arrangements.

Staff view on long-run pricing and decision-making power

- 5.14 Staff consider that, for the avoidance of doubt, it would be appropriate to provide guidance to the effect that an entity's practical ability to fully price for risks/benefits also includes the ability of its controlling government (Minister) to decide on pricing and benefits. Staff support this approach for the following reasons.
- (a) The approach seems reasonable given that the government (Minister) is the sole 'owner' and controller of the public sector entity and users of the financial statements would know, when relevant, that the ultimate decision-making power lies with the government (Minister).
 - (b) Without guidance:
 - (i) entities might need to engage in costly analysis in consultation with their auditors to determine how long-run pricing affects the entity's 'practical ability'; and
 - (ii) inconsistent determinations about 'practical ability' might be made by different entities in similar circumstances.

Question PAA1

- 5.15 Do the Boards agree that it would be appropriate to provide guidance to the effect that an entity's practical ability to fully price for risks/benefits also includes the ability of its controlling government⁶ (Minister) to decide on pricing/benefits?

Monopoly status, long-run pricing and future risks

The impact of monopoly status (alone)

- 5.16 It seems reasonable to presume that the IASB developed IFRS 17 largely with competitive markets in mind [IFRS 17.BC167 & BC168(a)].
- 5.17 All of the public sector entities that are the subject of the joint AASB/NZASB project are monopolies or near monopolies,⁷ and are not able to withdraw from the market they serve without a change of legislation.

⁶ Under existing (or substantively enacted) legislation.

⁷ The reference to 'near monopoly' relates mainly to schemes such as the workers' compensation schemes that operate in most Australian states, from which 'approved' large employers can be excluded on meeting certain conditions.



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- 5.18 For a not-for-profit public sector entity, a monopoly position can mean:
- (a) the power to charge above-market levies/premiums; but
 - (b) the responsibility to keep insuring participants/policyholders in perpetuity, or at least until there is legislative change and/or structural changes to the markets served.
- 5.19 The responsibility to keep insuring participants/policyholders might have consequences for the 'contract boundary'; and the 'coverage period' of the public sector entities arrangements.
- (a) One view is that this responsibility means the contract boundary (and coverage period) extends over multiple years, even though the contractually-stated coverage period might be, for example, one year.
 - (b) An alternative view is that this year's participants/policyholders may or may not continue to be participants/policyholders next year and, accordingly, the responsibility to maintain the scheme over the long term is not relevant to determining coverage periods.

Staff view on the impact of monopoly status (alone)

- 5.20 Staff consider that, for the avoidance of doubt, it would be appropriate to provide guidance to the effect that an entity's monopoly status (and obligation to stand-ready to insure future participants/policyholders), **of itself**, does not affect the coverage period. Staff support this approach for the following reasons.
- (a) The approach seems reasonable under the principles in AASB 17/PBE IFRS 17 given that typically there is turnover among participants/policyholders over successive years, even though it may be limited. For example, in respect of compulsory third party (personal injury) insurance, at the margin, some motor vehicles registered and insured in the current year may be deregistered and uninsured in the following year.
 - (b) Without guidance:
 - (i) entities might need to engage in costly analysis in consultation with their auditors to determine how monopoly status affects the entity's 'practical ability'; and
 - (ii) inconsistent determinations about 'practical ability' might be made by different entities in similar circumstances.

Question PAA2

- 5.21 Do the Boards agree that it would be appropriate to provide guidance to the effect that an entity's monopoly status (and obligation to stand-ready to insure future participants/policyholders), of itself, does not affect the coverage period?

The impact of monopoly status and long-run pricing (together)

- 5.22 The pricing of levies/premiums for many public sector entities is based on achieving a break even result over the long-term. Accordingly, in some cases, the actual amounts charged in any given period might be regarded as being the result, in part, of taking into account the risks that relate to periods after the current contract period. In these cases, the criterion in AASB 17/PBE IFRS 17.34(b)(ii) would not be met and the arrangements would involve a multi-

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year coverage period, even though the contractually-stated coverage period might be one year.

- 5.23 The long-run focus of pricing for many public sector entities might be based solely on past experience and not be influenced by projections of risk relating to future periods. This is likely to be the case for entities providing coverage for risks that evolve only slowly over time in their nature and level of severity. For example, typically this would be expected to include Worker's Compensation and Transport Accident risks.
- 5.24 The long-run focus of pricing for other public sector entities might be based, at least in part, on projections of risk relating to future periods. For example, this might be the case for entities providing coverage for risks that are scheduled to change, and possibly when an entity insures for losses arising from infrequent severe events.
- 5.25 Table 5-1 outlines two possible (highly-simplified) examples where the contract boundary might be regarded as being longer than the explicit contractual term due to monopoly status.

Table 5-1	
<i>Example</i>	<i>Comment</i>
A legislative change has been made to significantly increase benefits relating to certain types of injuries that occur after July 2025, and the entity is gradually increasing levies/premiums over the 2022 to 2024 financial years in order to establish reserves to help fund the higher benefits.	In this case, the current-year pricing is taking into account risks that relate to periods after the current period. Accordingly, the contract boundary (and coverage period) could be determined as extending from 2022 until 2025 and possibly beyond.
An entity insures against losses from what is projected to be a one-in-20-year event and charges levies/premiums for one-year contracts each year over a 20-year period that are designed to meet the expected benefits that will need to be paid.	In a competitive (private sector) market context, the entity would not be regarded as taking into account the risks that relate to periods after the current contract period because the entity would be regarded as considering the risk of loss for each one-year period. Policyholders could obtain the same coverage from a different insurer in a subsequent year. Accordingly, the contract boundary (and coverage period) would be determined as being one year. In a monopoly public sector context, the current-year pricing could be regarded as taking into account risks that relate to periods after the current period. Accordingly, the contract boundary (and coverage period) could be determined as being 20 years.

- 5.26 The Boards could choose to override this feature of AASB 17/PBE IFRS 17.34 and deem the coverage periods for cases such as those outlined in Table 5-1 to be the contractually-stated term.
- 5.27 Alternatively, the Boards could choose to not override this feature of AASB 17/PBE IFRS 17.34 and either:
 - (a) allow entities to make their own interpretation without further guidance; or



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- (b) provide guidance to assist public sector entities in a monopoly position in applying AASB 17/PBE IFRS 17.34 in relation to long-run pricing and future risks.
- 5.28 The implications of not overriding this feature of AASB 17/PBE IFRS 17.34 for the examples noted in Table 5-1 above might be as follows.
- (a) Public sector entities may need to estimate the average time that a participant/policyholder is expected to keep participating in the scheme to determine a coverage period for the purposes of AASB 17/PBE IFRS 17.
 - (b) The estimated coverage periods may be sufficiently long that they introduce a level of cash flow volatility that makes the arrangements ineligible to be accounted for using the PAA.
 - (c) The level of uncertainty around the estimated coverage periods may be, of itself, sufficiently large that it introduces cash flow volatility that makes the arrangements ineligible to be accounted for using the PAA.
- 5.29 Staff note that the monopoly or near monopoly status of public sector entities, coupled with their inability to withdraw from the markets they serve without a change of legislation, is a set of circumstances unique to the public sector. Accordingly, it would be within the Boards' policy frameworks⁸ to make modifications to address the issues arising from these circumstances.

Staff view on monopoly status and long-run pricing (together)

- 5.30 Staff consider that, by providing some direction to the affected public sector entities, the Boards could have a cost-beneficial impact on the application of AASB 17/PBE IFRS 17.34(b)(ii) on the basis of the following.
- (a) The costs of having public sector entities:
 - (i) estimating average times that a participant/policyholder is expected to keep participating in the scheme to determine a coverage period; and/or
 - (ii) estimating coverage periods based on expectations about whether the relevant insured event is, for example: (i) a one-in-ten-year event or (ii) a one-in-twenty-year event;seem likely to exceed any potential benefits.
 - (b) The accounting information that would result from applying the GMM in these circumstances may not be useful and would be costly to implement, particularly if all the other arrangements conducted by the entity are eligible for the PAA.
- 5.31 In relation to paragraph 5.30(a), it seems highly likely that the relevant public sector entities' estimates would prove to be different from the actual coverage periods, which could trigger a need to consider the contract modification requirements in AASB 17/PBE IFRS 17. If this were the case, the entity would need to consider whether the extent of change to the originally-determined coverage periods results in 'a modification of an insurance contract' under AASB 17/PBE IFRS 17.72 and 73. For example, if actual events establish that the arrangements have a substantially different contract boundary than the originally-determined boundary, the

⁸ [AASB Not-for-Profit Entity Standard-Setting Framework](#) and [New Zealand Accounting Standards Framework](#).

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existing arrangements would need to be derecognised and new arrangements recognised using the revised boundary [AASB 17/PBE IFRS 17.72(a)(iii)].

- 5.32 In relation to paragraph 5.30(b), if a public sector entity had to apply the GMM the following simple example attempts to illustrate some possible implications.

<p>Assume, for example, an entity determines that it expects (on average) to provide coverage to participants for 20 consecutive one-year periods. Under the GMM, the public sector entity would measure its liability for remaining coverage based on a 20-year coverage period.</p>
<p>In theory, the entity would need to estimate all the fulfilment cash flows for the next 20 years – including levies/premiums and claims/benefits (and other claim/benefit-related costs) in order to apply the GMM.</p>
<p>AASB 17/PBE IFRS 17.22 requires, as a minimum, contracts issued within a year to be a separate ‘group of contracts’. That is, as a minimum, annual cohorts of contracts are the basic unit of account [AASB 17/PBE IFRS 17.22].</p> <p>In the first year that an entity applies AASB 17/PBE IFRS 17, the entity would need to, as a minimum, identify the contracts issued in that year-one cohort.</p> <p>In the second year the entity applies AASB 17/PBE IFRS 17, it would need to identify whether participants acquiring a contract are:</p> <ul style="list-style-type: none"> • ‘renewing’ from the previous year and should be included in the year-one cohort; or • are ‘new’ participants and should be included in the year-two cohort. <p>The same process would need to be applied in each of the subsequent 18 years, unless the estimated coverage period changes.</p> <p>This is likely to be a significant departure from the way in which the entity manages the business. While it may not produce very different financial reporting outcomes compared with accounting at a portfolio level (that incorporates all the annual cohorts), there seems unlikely to be much benefit for users of the financial statements to justify the additional cost.</p>

- 5.33 Staff consider that public sector entities should be able to apply AASB 17/PBE IFRS 17.34(b)(i) alone to be eligible for the PAA (that is, the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio), and not need to also meet the condition in AASB 17/PBE IFRS 17.34(b)(ii).
- 5.34 In cases such as those outlined in Table 5-1, the coverage period uncertainties might be best addressed via disclosures. By way of illustration, in the context of the (highly-simplified) examples outlined in Table 5-1, the entity could disclose information about the following.
- A decision has been made to significantly increase benefits relating to certain types of injuries that occur after July 2025, and the entity is gradually increasing levies/premiums over 2022 to 2024 financial years in order to establish reserves to meet the higher benefits on a sustainable basis.
 - The entity sets charges levies/premiums based on a 20-year timeframe with a view to insuring against losses from what is projected to be a one-in-20-year event.



Question PAA3

- 5.35 Do the Boards agree it would be appropriate that public sector entities:
- (a) apply AASB 17/PBE IFRS 17.34(b)(i) alone in assessing their eligibility for the PAA (that is, the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio);
 - (b) need not also meet the condition in AASB 17/PBE IFRS 17.34(b)(ii) (that is, the pricing of the premiums up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date)?

Question PAA4

- 5.36 Assuming the Boards concur with PAA3, do the Boards agree that public sector entities should be required to disclose information about the manner in which long-run pricing is determined when that pricing takes into account risks relating to future coverage periods?



Appendix A

Coverage versus incurred claims liabilities

The table below compares some typical cases among public sector entities with two private sector New Zealand insurers, the three largest listed Australian general insurers, and the largest listed Australian health insurer.

<i>Entity reports 2020</i>	<i>Coverage liability (A)</i>	<i>Claims liability (B)</i>	<i>A/A+B</i>
Accident Compensation Comm	NZD 3,482 million	NZD 61,463 million	5.4%
Earthquake Commission	NZD 265 million	NZD 1,263 million	17.3%
ComCare	nil ⁹	AUD 2,867 million	0.0%
Lifetime Care (iCare NSW)	nil ¹⁰	AUD 7,354 million	0.0%
Transport Accident Comm (VIC)	AUD 783 million	AUD 21,374 million	3.5%
WorkCover Queensland	AUD 12 million	AUD 3,487 million	0.0%
Southern Cross Group	NZD 139 million	NZD 13 million	91.4%
FMG	NZD 179 million	NZD 93 million	65.8%
Insurance Australia Group	AUD 6,276 million	AUD 10,584 million	37.2%
QBE Group (half-year)	AUD 7,799 million	AUD 20,836 million	27.2%
SunCorp	AUD 5,219 million	AUD 10,598 million	33.0%
Medibank Private	AUD 746 million	AUD 639 million	54.0%

Appendix B – Abbreviations

PBE IFRS 4 *Insurance Contracts* [PBE IFRS 4]

PBE IFRS 17 *Insurance Contracts* [PBE IFRS 17]

AASB 4 *Insurance Contracts* [AASB 4]

AASB 1023 *General Insurance Contracts* [AASB 1023]

AASB 17 *Insurance Contracts* [AASB 17]

9 The levies received by ComCare are typically all expired by the balance date of 30 June, because ‘policies’ run from 1 July to 30 June each year.

10 The levies received by Lifetime Support are typically all expired by the balance date of 30 June, because ‘policies’ run from 1 July to 30 June each year.



**NZ ACCOUNTING
STANDARDS
BOARD**

Memorandum

Date: 11 June 2021

To: NZASB Members

From: Joanne Scott, Gali Slyuzberg, Judith Pinny and Tracey Crookston

Subject: **Measurement**

Purpose and introduction¹

1. This session has three purposes:
 - (a) to seek feedback on selected Specific Matters for Comment (SMCs) in the IPSASB measurement-related EDs (see Table 1);
 - (b) to identify differences between the depreciated replacement cost (DRC) used in current PBE Standards and the proposed cost approach to estimating current operational value (COV) in the EDs (see Table 3); and
 - (c) to update the Board on comments received from Board members and the Technical Reference Group (TRG). These comments have been noted as background information in the draft comment letter.

Recommendations

2. We recommend that the Board:
 - (a) PROVIDES FEEDBACK on the draft responses to the SMCs highlighted in Table 1;
 - (b) NOTES the comparison between DRC and the cost approach to estimating current operational value (COV); and
 - (c) NOTES the comments received from Board members and the TRG.
3. Table 1 identifies which SMCs we would like feedback on. In some cases (for example, ED 76) we are seeking feedback on comments received since the previous meeting. In other cases (for example, ED 78 SMC 7 and ED 79) we are seeking feedback on proposed comments to the IPSASB. We have spent quite a lot of time on infrastructure assets and ED 79 and are hoping that these sections of the letter are reasonably complete (subject to feedback from the Board and comments from constituents).

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 SMCs	Feedback sought?
SMC	ED 76 Conceptual Framework Update	
SMC 1	Measurement hierarchy	Seeking feedback on comments received since the previous meeting (see the background information under the SMCs), and on draft responses prepared to date.
SMC 2	Fair value as a measurement base	
SMC 3	Current operational value as a measurement base	
SMC 4	Description of value-in-use	
SMC 5	Delete measurement bases – market value and replacement cost	
SMC 6	Delete measurement bases – net selling price, cost of release, assumption price	
SMC 7	Other issues	
SMC	ED 77 Measurement	
SMC 1	Initial measurement	The Board agreed not to comment
SMC 2	Subsequent measurement – historical cost or current value	
SMC 3	Historical cost guidance	
SMC 4	Historical cost – no measurement technique needed	
SMC 5	Current operational value – principle	Yes
SMC 6	Current operational value – definition and guidance	Yes
SMC 7	Current operational value – location assumption	Not at this stage
SMC 8	Current operational value – use of income approach	Yes
SMC 9	Fair value	Yes
SMC 10	Cost of fulfillment	Not at this stage
SMC 11	Disclosure – Located in individual IPSASs	
SMC 12	Disclosure – Any that should be located in ED 77?	
SMC 13	Disclosure – Consistency across standards	
SMC 14	Disclosure – Level of detail for recurring versus non-recurring	
SMC 15	Disclosure – Inputs to fair value hierarchy	
SMC	ED 78 Property, Plant and Equipment	
SMC 1	Relocation and restructuring	Not at this stage
SMC 2	Current value model – accounting policy choice	Yes
SMC 3	Characteristics of heritage assets	The Board agreed not to comment
SMC 4	Characteristics of infrastructure assets	See ED 76 SMC 1 ²
SMC 5	Disclosure of unrecognised heritage items	Not at this stage
SMC 6	IG for heritage assets	
SMC 7	IG for infrastructure assets	Yes
SMC	ED 79 Non-current Assets Held for Sale and Discontinued Operations	
SMC 1	Additional disclosure	Yes
	Other comments	Yes

² The Board previously agreed not to comment on this SMC. However, the Board may wish to reconsider this decision, depending on the outcome of the Board’s discussion on ED 76 SMC 1.

Background

4. The Board has agreed to comment on the following four EDs:
 - (a) ED 76 *Conceptual Framework Update: Chapter 7, Measurement of Assets and Liabilities in Financial Statements*;
 - (b) ED 77 *Measurement*;
 - (c) ED 78 *Property, Plant and Equipment*; and
 - (d) ED 79 *Non-current Assets Held for Sale and Discontinued Operations*.
5. At the May meeting the Board agreed to comment on a number of SMCs and provided feedback on how to approach those SMCs.
6. We have since received feedback from a couple of Board members. We have included these comments under the relevant SMC in the draft comment letter at agenda item 9.2. This feedback included the following points:
 - (a) We should comment on all the SMCs in ED 76 because of the importance of the Conceptual Framework for setting future standards.
 - (b) There is duplication between ED 76 and ED 77. To avoid the risk of inconsistency between the two, ED 76 should be as brief as possible.
 - (c) ED 76 and ED 77 should explicitly acknowledge that depreciation/amortisation and impairment are an integral part of subsequent measurement, even if individual standards deal with the requirements for specific types of assets.
 - (d) Could argue that the IPSASB has measurement models and bases the wrong way around.
 - (e) COV: is it trying to express the service capacity of an asset, the service potential of the asset that is needed by an entity, or an asset's contribution to an entity's service objectives?
7. The TRG had a preliminary discussion about the EDs at its meeting on 25 May. The TRG report is available at agenda item 11.2. We have included TRG feedback as background information in the draft comment letter.

DRC versus COV cost approach

8. The biggest impact of the EDs is likely to be on assets measured using DRC. The last set of agenda papers mentioned some of the differences between the DRC requirements in PBE IPSAS 17 *Property, Plant and Equipment* and the COV proposals in ED 77 but did not do a direct comparison. This memo compares the two. First, some background on why we have New Zealand specific guidance on DRC and when it is used might be helpful.

PBE Standards

9. PBEs applying PBE IPSAS 17 may use DRC to estimate the fair value of assets. It is used when market transactions and market information are not available, which is the case for most

infrastructure assets and some other specialised assets in the public sector. It is a cost approach to estimating fair value. It may also be referred to as optimised depreciated replacement cost or the cost of a modern equivalent asset.

10. The following extract explains why the NZASB added application guidance on DRC to PBE IPSAS 17. The actual DRC guidance is in Table 3 of this memo.

Extract from PBE IPSAS 17 Basis for Conclusions

BC12. In certain circumstances, IPSAS 17 permits the use of depreciated replacement cost as a means of estimating the fair value of an asset. Public benefit entities in New Zealand frequently use depreciated replacement cost to estimate the fair value of property, plant and equipment, including infrastructure assets. The NZASB noted that neither IPSAS 17 nor IPSAS 21 provide guidance on this topic at the level of detail previously provided in NZ IAS 16. The NZASB agreed that guidance on this topic was required in order to enhance the consistency of asset valuations in financial statements.

BC13. The NZASB noted that the International Valuation Standards Council had recently issued Technical Information Paper 2 *The Cost Approach for Tangible Assets (TIP 2)*³ which provides guidance on the application of the cost approach to valuation, including application of the depreciated replacement cost method. The NZASB noted the desirability of aligning, to the extent possible, the guidance in PBE IPSAS 17 with that issued by the international valuation profession. The NZASB agreed that, with the exception of the measurement of land, the guidance in Appendix A should be consistent with TIP 2.

BC14. The NZASB decided that, where land is under-utilised, the fair value of the land should be determined by reference to its highest and best use. The NZASB noted that this could result in different measures for some assets than under TIP 2, but considered that continuation of this existing requirement was appropriate in the New Zealand environment. The NZASB noted that TIP 2 acknowledges that there may be a higher value for an alternative use, but cautions that the cost approach may or may not provide an appropriate measure of market value in such cases.

NZ IFRS

11. For-profit entities applying NZ IAS 16 *Property, Plant and Equipment* may also use a cost approach to estimate the fair value of assets, but they must do so in accordance with NZ IFRS 13 *Fair Value Measurement* and the definition of fair value in that standard.

Extracts from NZ IFRS 13

cost approach A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

...

11 A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:

- (a) the condition and location of the asset; and
- (b) restrictions, if any, on the sale or use of the asset.

...

B8. The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

³ TIP 2 has since been withdrawn.

- B9. From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives). In many cases the current replacement cost method is used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

ED 76 and ED 77

12. An entity can use the cost approach as a technique to estimate fair value or COV. Table 2 summarises what ED 77 says about the objective of fair value and COV measurements, the selection of techniques and the use of the cost approach.

Table 2 ED 77 Fair value and COV proposals

ED 77 Fair value	ED 77 COV
<p>Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.</p> <p>Exit, market-based measurement.</p> <p>Reflects the perspective of market participants.</p>	<p>Current operational value is the value of an asset used to achieve the entity’s service delivery objectives at the measurement date.</p> <p>An entry value and includes all the costs that would necessarily be incurred when obtaining the asset.</p> <p>Reflects the value of an asset in its current use, rather than the asset’s highest and best use.</p> <p>Is entity-specific.</p>
<p>Definition of cost approach – same for fair value and COV</p> <p>Cost approach is a measurement technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).</p>	
<p>Characteristics of the Asset or Liability</p> <p>32. A measurement basis is applied to a particular asset or liability. Therefore, when applying the measurement basis, an entity shall take into account the characteristics of the asset or liability at the measurement date (for example, for fair value measurement the characteristics are considered if market participants would take those characteristics into account when pricing the asset or liability). Such characteristics include, for example, the following:</p> <ul style="list-style-type: none"> (a) The condition and location of the asset; and (b) Restrictions, if any, on the sale or use of the asset. <p>...</p> <p>43. The cost approach reflects the amount that would be required currently to replace the service provided by an asset (often referred to as current replacement cost) through the acquisition, construction, or development of a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes.</p> <p>44. The cost of a substitute asset of comparable utility is calculated as the cost of a modern equivalent asset—that is, a notional asset providing an equivalent service as the existing asset while using the latest technology available.</p>	
<p>Appendix C</p> <p>The section on highest and best use is almost identical to that in IFRS 13 paragraphs 27–30.</p>	<p>Appendix B</p> <p><i>General requirements for COV include:</i></p> <p>Current use, not highest and best use</p>

<p>ED 77 Fair value</p>	<p>ED 77 COV</p>
	<p>Disregard potential alternative uses Assume same location as asset's current location Entity specific, entry price Assume asset is used to full capacity Use price of equivalent restricted asset if available No reduction for a restriction if no equivalent restricted asset available Least costly manner</p>
<p>Measurement techniques</p> <ul style="list-style-type: none"> • Market • Cost • Income 	<p>Measurement techniques</p> <ul style="list-style-type: none"> • Market • Cost • Income
<p>Choosing a technique Multiple techniques permitted Use technique that is appropriate Maximize the use of relevant observable inputs The objective of using a measurement technique is to <i>estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants</i> at the measurement date under current market conditions. [...]</p>	<p>Choosing a technique Multiple techniques permitted Use technique that is appropriate Maximize the use of relevant observable inputs The objective of using a measurement technique is to <i>estimate the value of the asset used to achieve the entity's present service delivery objectives</i> at the measurement date under current market conditions. [...]</p>
<p>Cost approach guidance (paragraphs C33 to C34) Identical to IFRS 13 paragraphs B8 and B9.</p>	<p>Cost approach guidance (paragraphs B29–B30)</p> <ul style="list-style-type: none"> • Consider current replacement cost • Amount to replace the asset <p>Modern equivalent asset</p> <ul style="list-style-type: none"> • Notional asset providing equivalent service, adjusted for obsolescence and optimisation • Reproduction cost appropriate in some circumstances • Assume works commissioned at measurement date • Obsolescence <ul style="list-style-type: none"> ○ Physical ○ Functional ○ Economic <p>Might need to consider obsolescence collectively</p>
	<p>Implementation Guidance See Section C5 on modern equivalent asset. It says that cost approach = DRC (in some valuation standards).</p>

13. Some comments about the cost approach guidance in ED 77:
- (a) The definition of the cost approach in ED 77 is the same as IFRS 13. It refers to ‘service capacity’. However, ED 77 paragraph 43 refers to the amount required to ‘replace the service provided by an asset’. We do not know what the phrase in ED 77 paragraph 43 means. There is more than one possible interpretation.
 - (b) Paragraph 44 (which is a general paragraph covering all the measurement bases) refers to a modern equivalent asset. IFRS 13 does not use the words modern equivalent asset, but IFRS 13 paragraph B9 talks about a substitute asset of comparable utility, adjusted for obsolescence.

Comparison of DRC and ED 77 COV cost approach

14. The Board indicated that a comparison of the DRC requirements in PBE IPSAS 17 and the proposals in ED 77 would be helpful. See Table 3 for a comparison. The comparison draws on general COV requirements and cost approach guidance in ED 77.

Table 3 DRC versus COV

DRC as per PBE IPSAS 17	COV cost approach as per ED 77
<p>DRC is a cost approach that is used to estimate fair value under the revaluation model in PBE IPSAS 17. It is commonly applied to infrastructure assets and other specialised assets.</p> <p>DRC is not the only method that may be used to estimate fair value. Reproduction cost, restoration cost or service units approaches may also be used.</p>	<p>A cost approach may be used to estimate COV. ED 77 mentions reproduction/ restoration cost as a subset of the cost approach.</p> <p>ED 77 does not mention the service units approach. That may not have much impact in New Zealand as we are not aware of the service units approach being applied by PBEs.</p>
<p>AG1. Adjustments to assets, apart from land, are normally considered for the following types of obsolescence:</p> <ul style="list-style-type: none"> (a) Physical obsolescence; (b) Functional obsolescence; and (c) External obsolescence. 	<p>Mentions the same types of obsolescence <i>but does not mention land</i>.</p> <p>See paragraphs 43 and B36.</p> <p>The Alternative View (paragraph AV16) says there is a lack of clarity in ED 77 about accounting for surplus capacity (please refer to the discussion below on paragraph AG20 of PBE IPSAS 17). Paragraph AV16 refers to B36.</p>
<p>AG2. All types of obsolescence are measured by making comparisons between the subject asset and the asset of equal utility upon which the cost estimate is based.</p>	<p>No exact equivalent – probably implied by paragraph B32, which requires COV to be estimated by calculating the cost of a modern equivalent asset.</p>
<p>AG3. This guidance discusses three types of obsolescence and proposes that an entity shall identify a separate adjustment for each form of obsolescence. In practice PBEs may not always be able to separately identify adjustments for each form of obsolescence. In particular, it may be difficult for PBEs to distinguish between functional obsolescence and external obsolescence. In such cases the adjustments for obsolescence may need to be considered collectively.</p>	<p>Paragraph B37 is equivalent to AG3.</p>

DRC as per PBE IPSAS 17	COV cost approach as per ED 77
Bases of Value	
<p>AG4. The term depreciated replacement cost is often used to describe the application of the cost approach to property, plant and equipment. In the case of PBE IPSAS 17, depreciated replacement cost may be used to estimate the fair value of an asset. Application of depreciated replacement cost in estimating fair value for financial reporting purposes should, wherever possible, be based on the market prices of inputs.</p>	<p>No direct equivalent.</p> <p>ED 77 permits the use of a cost approach to estimate COV (Appendix B) and fair value (Appendix C).</p> <p>The COV cost approach guidance in ED 77 is not this explicit. Paragraph B31 says that COV <i>may</i> be established by reference to the market buying price of components to build a school. Because the description of COV says that it is entity specific and reflects entry prices it is not clear that an entity should base COV wherever possible on market prices of inputs.</p> <p>In contrast, the fair value cost approach guidance in ED 77 is identical to that in IFRS 13 and is clear that it is based on what a market participant would pay (see ED 77 paragraph C34 and IFRS 13 paragraph B9).</p>
<p>AG5. For example, the replacement cost, the level of utility required from the asset, the assessment and measurement of different types of obsolescence and depreciation profiles should, as far as is possible, be based on market observations of inputs such as material costs and labour costs.</p>	<p>No equivalent.</p>
<p>AG6. If the purpose of the valuation requires an entity-specific basis of value, e.g. investment value, the cost input will still be based on cost that would be incurred by the entity in replacing the asset, and therefore will normally be no different from the cost calculation for market value, unless the entity is in a situation where it could either procure a replacement asset at a lower cost, or would incur higher costs, because of factors specific to its situation. However, the entity's actual operating experience of the subject asset and intentions for future utilisation could result in a significant difference in the measurement of obsolescence.</p>	<p>No equivalent. This isn't essential in a description of the COV cost approach but it would be helpful to understand how COV cost approach differs from fair value cost approach.</p>

DRC as per PBE IPSAS 17	COV cost approach as per ED 77
<p>Land</p> <p>AG7. In instances where land is underutilised, the fair value of the land shall be determined by reference to the highest and best use of such land. For example, in a case where specialised facilities are located in a prime central business district site but the operation would be able to be run from a smaller sized and/or less valuable alternative site offering the same service potential, the fair value of the land would be the market value of the entire central business district-located site.</p>	<p><i>ED 77 differs.</i></p> <p>Paragraph 25 says that COV reflects the value of an asset in its current use (not its highest and best use).</p> <p>Paragraph B4 says that current use may be, but is not necessarily, highest and best use.</p> <p>B6. The asset’s current operational value assumes that the entity will continue to meet its service delivery objectives from the same location in which the asset is currently situated or used.</p> <p>B7. The current operational value of a building reflects the value of the building in its current location. For example, a hospital operating in a city center that could now be situated in the suburbs, because of the migration of the population, is measured based on the value of the hospital in its current location (e.g., if the cost approach is applied, construction costs, permits, regulations, etc. are based on costs incurred at the current location).</p> <p><i>In some senses this ED 77 is similar because it says to focus on the current location, but on the other hand it says current use rather than highest and best use.</i></p> <p><i>Compared to PBE IPSAS 17, ED 77 could lead to lower land values.</i></p> <p><i>On the other hand, paragraphs B10–B11 of ED 77 require an asset’s surplus capacity to be included in determining the COV of the asset. Paragraph B12 says that the COV of land “shall reflect the value of the land actually held, in terms both of size and location. If the services could be provided from a site measuring three hectares, but the actual site measures five hectares, the land is measured based on its actual size.” This is similar to the guidance in paragraph AG7 of PBE IPSAS 17.</i></p>
<p>AG8. The fair value of land would normally be determined from market-based evidence. However, in the rare instances where extensive works have been carried out in order to prepare land for use in the entity’s operations, available market evidence will normally relate to land of the same size and in the same general vicinity but which is priced for uses that are sub-optimal relative to the use for which the works were carried out. In these rare instances the fair value of the land shall be determined by having regard to the replacement cost of the land. For example, a customs department or marine research entity may acquire a section of seabed, fill it in and</p>	<p>No equivalent guidance in the body of the ED.</p> <p><u>Implementation Guidance</u></p> <p>Section C5 says “the entity should instruct the valuation specialist to assume that the land on which an MEA [modern equivalent asset] would be constructed is ready for development to the same extent that an alternative site would be ready for development. That is, any site clearance costs to make the existing site ready for development would be ignored.”</p> <p><i>Compared to PBE IPSAS 17, ED 77 could lead to lower asset values.</i></p>

DRC as per PBE IPSAS 17	COV cost approach as per ED 77
<p>build a seawall in order to produce flat land for use in the entity’s operations. The reclaimed land is in the precise location where the entity requires land. Market evidence may exist for other land of the same size and in the same general vicinity as the reclaimed land, but that other land is not suitable for the use intended by the entity. Thus, the market evidence on the fair value of that other land is not relevant to the reclaimed land, and the best indicator of the fair value of the reclaimed land is the replacement cost of that land. A similar situation occurs when a local authority carries out extensive works constructing new roads.</p>	
<p>Physical Obsolescence</p> <p>AG9. Physical obsolescence is any loss of utility due to the physical deterioration of an asset or its components resulting from its age and normal usage that results in loss of value.</p> <p>AG10. Some physical obsolescence can be corrected or ameliorated by maintenance and repair. Other forms of physical obsolescence cannot be corrected or ameliorated, i.e., the deterioration in condition cannot be remedied, either at all or cost effectively. The measurement of physical obsolescence that can be remedied is the cost to remedy it. Physical obsolescence that cannot be remedied can be measured by considering the asset’s age, expected total and remaining life where the adjustment for physical obsolescence is equivalent to the proportion of the expected total life consumed.</p> <p>AG11. The value of an asset will not be below its value for an alternative use, including for scrap, salvage or recycling, less the costs of clearance, decommissioning and any decontamination required.</p>	<p><i>ED 77 guidance is briefer.</i></p> <p><i>Impact of difference?</i></p> <p>Paragraph B36(a)</p> <p>Physical obsolescence relates to any loss of service capacity due to the physical deterioration of the asset or its components resulting from its age and use. In assessing physical obsolescence, an entity should also consider any probable future routine, regular maintenance, as such maintenance may provide insight into the asset or its components’ useful lives and their rate of deterioration.</p>
<p>Functional Obsolescence</p> <p>AG12. Functional obsolescence is any loss of utility resulting from inefficiencies in the subject asset compared to its replacement that results in a loss of value. There are two forms of functional obsolescence:</p> <ul style="list-style-type: none"> (a) Excess capital cost which can be caused by changes in design, materials of construction, technology or manufacturing/construction techniques resulting in the availability of modern equivalent assets with lower capital costs than the subject asset; and (b) Excess operating cost which can be caused by improvements in design or excess capacity resulting in the availability of modern equivalent assets with lower operating costs than the subject asset. 	<p><i>ED 77 guidance is briefer.</i></p> <p><i>Impact of difference?</i></p> <p>Paragraph B36(b)</p> <p>Functional obsolescence relates to any loss of service capacity resulting from inefficiencies in the asset that is being valued compared with its modern equivalent – is the asset suitable for its current function? Functional obsolescence might occur because of advances or changes in the design and/or specification of the asset, or because of technological advances. For example, advances in health care technology might mean that the asset in use is outdated, or technological advances in educational material could mean that chalk/white boards would be replaced by digital screens. Such advances will need to be incorporated into the assessment of functional obsolescence.</p>

DRC as per PBE IPSAS 17	COV cost approach as per ED 77
<p>AG13. Functional obsolescence can arise due to either:</p> <ul style="list-style-type: none"> (a) The design or specification of the asset no longer being the most appropriate for delivery of the service for which it was originally intended as it may be inadequate or over-engineered; (b) The technology used in the asset having been superseded; or (c) A combination of both of the above factors. <p>AG14. For inadequate items, functional obsolescence is measured by considering the cost of correcting the inadequacy compared with the value gained. For over-engineered or “super-adequate” items, functional obsolescence is measured by the excess capital cost compared with the modern equivalent asset.</p>	
<p>External Obsolescence</p> <p>AG15. External obsolescence is any loss of utility value caused by economic or locational factors external to the asset that results in a loss of value. It may be called economic obsolescence when the external factors relate to changes in supply or demand for the asset or for products or services produced by the asset. Changes in the way goods and services are delivered in a sector may give rise to external obsolescence. When considering demand for the asset or for the products or services produced from the asset, demand both by policy makers in seeking to further public policy objectives and demand evidenced by the recipients of the products or services produced by the asset should be taken into account.</p>	<p><i>ED 77 guidance is briefer.</i></p> <p><i>Impact of difference?</i></p> <p>Paragraph B36(c)</p> <p>Economic obsolescence relates to any loss of utility caused by economic or other factors outside the control of the entity.</p>
<p>AG16. The external obsolescence adjustment is deducted after physical deterioration and functional obsolescence. External obsolescence should be measured at the lowest level possible.</p>	<p>No equivalent.</p>
<p>AG17. An example of external obsolescence is where the subject asset has excess capacity compared to the reasonably foreseeable demand. In such circumstances it may be possible to make the appropriate adjustment using the cost-to-capacity method.</p>	<p>No equivalent.</p> <p>Paragraphs B10 to B11 (shown in the next row) discuss surplus capacity.</p> <p>The Alternative View (paragraph AV16) says there is a lack of clarity in ED 77 about accounting for surplus capacity (please refer to the discussion below on paragraph AG20 of PBE IPSAS 17).</p>
<p>AG18. The cost-to-capacity method can be used to address both functional and external obsolescence depending on the cause of the lack of utility. The cost-to-capacity method can be used as a method to:</p> <ul style="list-style-type: none"> (a) Estimate the replacement cost for an asset with one capacity where the replacement 	<p>Surplus Capacity</p> <p>B10. Surplus capacity exists when an asset is not used to its maximum capacity. For example, an entity owns a building, but only utilizes 80% of the space available. The remaining 20% is left vacant.</p> <p>B11. Since current operational value reflects the value of the asset consumed in providing</p>

DRC as per PBE IPSAS 17	COV cost approach as per ED 77
<p>costs of an asset or assets with a different capacity are known; or</p> <p>(b) Estimate the replacement cost for a modern equivalent asset with capacity that matches foreseeable demand where the subject asset has excess capacity (as a means of measuring the penalty for the lack of utility to be applied as part of an external obsolescence adjustment).</p>	<p>the service at the prevailing prices, current operational value assumes the asset is used to its full capacity, subject to any tests for impairment in accordance with IPSAS 21 or IPSAS 26.</p> <p>B12. For example, the current operational value of land shall reflect the value of the land actually held, in terms both of size and location. If the services could be provided from a site measuring three hectares, but the actual site measures five hectares, the land is measured based on its actual size.</p>
<p>AG19.No obsolescence adjustment is made in respect of surplus capacity that, while rarely or never used, is necessary for stand-by or for safety purposes.</p>	<p>No equivalent.</p>
<p>AG20.If the whole entity or operating unit is affected by adverse external factors, this will be evident in the drop in demand for the goods and services produced by the asset and therefore an overall measure of external obsolescence can be determined by reference to the performance of the entity or unit. The way in which performance is assessed will depend on whether the entity or unit holds cash-generating or non-cash-generating assets. In order to estimate the value of an individual asset the overall external obsolescence will have to be allocated to individual assets. Cash or cash equivalents do not suffer obsolescence and are not adjusted. Marketable assets are not adjusted below their market value determined using the market approach.</p>	<p>No direct equivalent.</p> <p>Paragraphs B11 and B36 are related.</p> <p>The Alternative View (paragraph AV16) says that Mr. Beardsworth and Mr. Blake are concerned that ED 77 does not provide guidance on (a) how to classify a reduction in an asset’s use resulting from a reduction in demand for its services as either a potential source of impairment or a potential reduction in the asset’s current operational value, and (b) whether a difference in classification might cause a difference in the asset’s carrying amount. They consider that this lack of clarity could lead to current operational value being overstated or understated, depending upon how an entity interprets the proposed requirements.</p>
<p>AG21. In determining depreciated replacement cost, the extent of any obsolescence adjustment for surplus capacity depends on whether that surplus capacity has an alternative use to the current use of the asset. Where there is no alternative use, the value of the surplus capacity is zero. Where there is an alternative use, the value of the surplus capacity is the value of the highest and best alternative use of that capacity. To illustrate the distinction between surplus capacity not having an alternative use to the current use of the asset and that which does, consider the following example. Assume depreciated replacement cost is to be determined for a network of water pipes where the pipe diameter is greater than currently required or ever expected to be required (including that necessary for stand-by or for safety purposes). There is also a discrete segment of the piping network that is similarly not required for the current use of the asset but which can be closed off and used for other purposes, such as a liquid storage facility. In this case, an obsolescence adjustment would be made</p>	<p>ED 77 differs. It says that surplus capacity is included when determining the asset’s COV. Paragraph B11 of ED 77 says “current operational value assumes the asset is <i>used to its full capacity</i>, subject to any tests for impairment in accordance with IPSAS 21 or IPSAS 26”.</p> <p>The Alternative View (paragraph AG17) says “Furthermore, they consider it is important to clarify that when an asset includes surplus capacity that is severable from the asset (e.g. surplus land that could be sold or leased separately), the unit of account for measurement should be bifurcated – with the severable part of the asset that is surplus to operating requirements classified and measured as an asset held for its financial capacity.</p>

DRC as per PBE IPSAS 17	COV cost approach as per ED 77
<p>in respect of the surplus diameter of the piping. The surplus segment of the piping network would be valued at its highest and best alternative use.</p>	
<p>AG22. In determining depreciated replacement cost, an adjustment for obsolescence and relevant surplus capacity is applied only to the extent that it reflects the most probable use of the asset that is physically possible, appropriately justified, legally permissible and financially feasible.</p>	<p>No equivalent in Appendix B on COV. Paragraph C15 on fair value discusses highest and best use in terms of physically possible, legally permissible and financially feasible.</p>

15. Table 3 shows that there are a few clear differences, but other differences are harder to identify.
- (a) Highest and best use for underutilised land is a clear difference that could lead to lower asset values under ED 77. However, please note the point below on surplus capacity.
 - (b) It is not possible to say what impact the differences in the descriptions of obsolescence and proposed requirements about adjustments for obsolescence would have.
 - (c) There could be differences in how surplus capacity is treated. ED 77 says surplus capacity should be included in the asset’s measurement, but it is not clear what is envisaged. As noted above, the ED says that COV should be reduced for ‘external obsolescence’, which can arise when there is a reduction in demand for the services that the asset can provide – but such reduction in demand might also be regarded as a potential source of surplus capacity, which the ED says should be included when determining the asset’s COV (subject to impairment). See ED 77 paragraphs B10 to B12 and BC36 and the Alternative View (paragraphs AV16 and AV17).

Next steps

16. We will commence outreach. At the August meeting we plan to have a complete draft of the comment letter.

Attachment

Agenda item 9.2: Draft comment letter

Accessing the EDs

The At A Glance documents and EDs were distributed to Board members in April. They are available on the [XRB](#) website.

- ED 76 *Conceptual Framework Update: Chapter 7, Measurement of Assets and Liabilities in Financial Statements*
- ED 77 *Measurement*
- ED 78 *Property, Plant and Equipment*
- ED 79 *Non-current Assets Held for Sale and Discontinued Operations*



NZ ACCOUNTING
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Note for Board attention

This is a partial draft. Notes to the Board underneath each SMC heading indicate whether we are seeking feedback on that SMC, and if so, what we are seeking feedback on.

Table 1 in the memo lists the SMCs we are seeking feedback on.

The SMCs on which we are seeking feedback at this meeting are highlighted in blue. For those SMCs where we have drafted a response, the draft response itself is also highlighted in blue.

The SMCs on which we are not seeking feedback at this meeting (either because the Board decided not to comment on them, or because we intend to seek the Board's feedback at a future meeting) are highlighted in grey.

[xx October 2021]

Mr Ross Smith
Program and Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA

Submitted to: www.ifac.org

Dear Ross

IPSASB Measurement-related Exposure Drafts

Thank you for the opportunity to comment on Exposure Drafts 76 to 79 (the EDs). The EDs have been exposed in New Zealand and some New Zealand constituents may comment directly to you.

Possible key points for cover letter

- *General support for the proposal to bring IFRS 13 fair value requirements into IPSAS*
- *Agreement that fair value as per IFRS 13 is not appropriate for some public sector assets*
- *Concern/disagreements with current operational value*
- *The limitations of the proposed additional guidance on heritage and infrastructure assets*

Public benefit entities in New Zealand (general text often used in submissions)

In commenting on the EDs we have thought about the needs of public benefit entities (PBEs) in New Zealand, including both public sector and not-for-profit entities such as charities. We have referred solely to public sector entities in a few places – this is because we have more information about the views of public sector entities on certain issues.

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

Yours sincerely

Carolyn Cordery

Chair – New Zealand Accounting Standards Board

APPENDIX A: Responses on ED 76 Conceptual Framework Update: Chapter 7, Measurement of Assets and Liabilities in Financial Statements

General comments on ED 76 and ED 77

Seeking feedback from the Board on this comment. It was added to reflect feedback from a Board member querying the duplication between ED 76 and ED 77.

The IPSASB is proposing to include descriptions of measurement bases in ED 76 and ED 77, along with more detailed guidance in ED 77. We acknowledge that this is consistent with the original contents of Chapter 7 of the Conceptual Framework. It is also consistent with the fact that the IASB discusses fair value in its Conceptual Framework as well as in IFRS 13 *Fair Value Measurement*.

However, IFRS 13 provides more guidance on only one measurement basis in the IASB’s Conceptual Framework. ED 77 would provide guidance on four measurement bases.

This introduces the risk of inadvertent inconsistencies between the descriptions in ED 76 and ED 77. One way to reduce this risk would be to repeat the ED 76 descriptions as identical text in ED 77, possibly as boxed text. Another way would be to keep the descriptions in ED 76 as brief as possible.

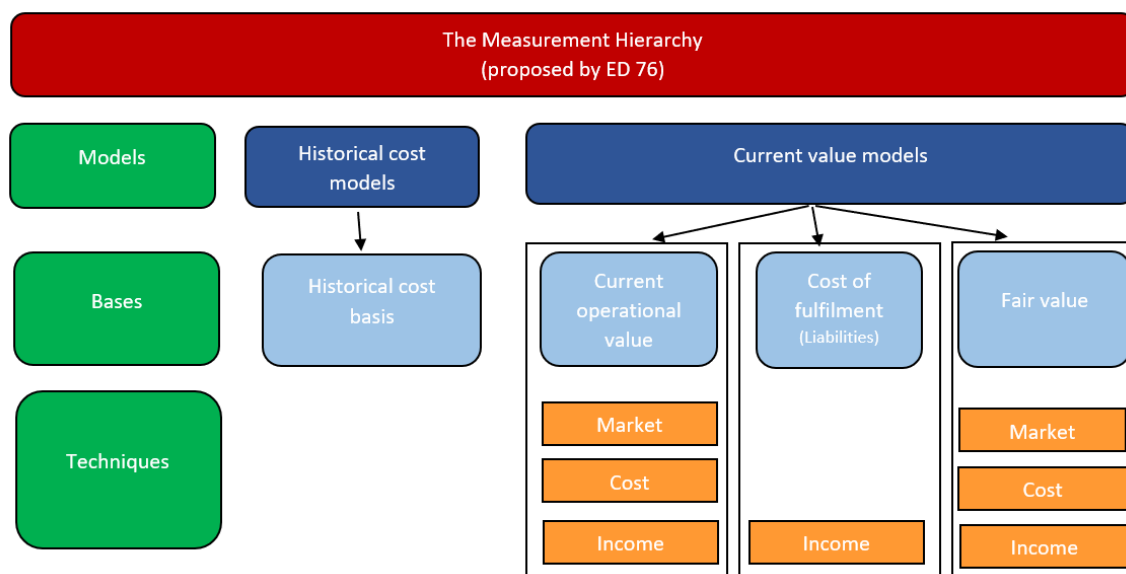
ED 76 SMC 1: Measurement hierarchy

Seeking feedback from the Board on this SMC. The background information outlines feedback from a Board member.

SMC 1: ED 76 proposes a measurement hierarchy. Do you agree with the three-tier hierarchy? If not, why not? How would you modify it?

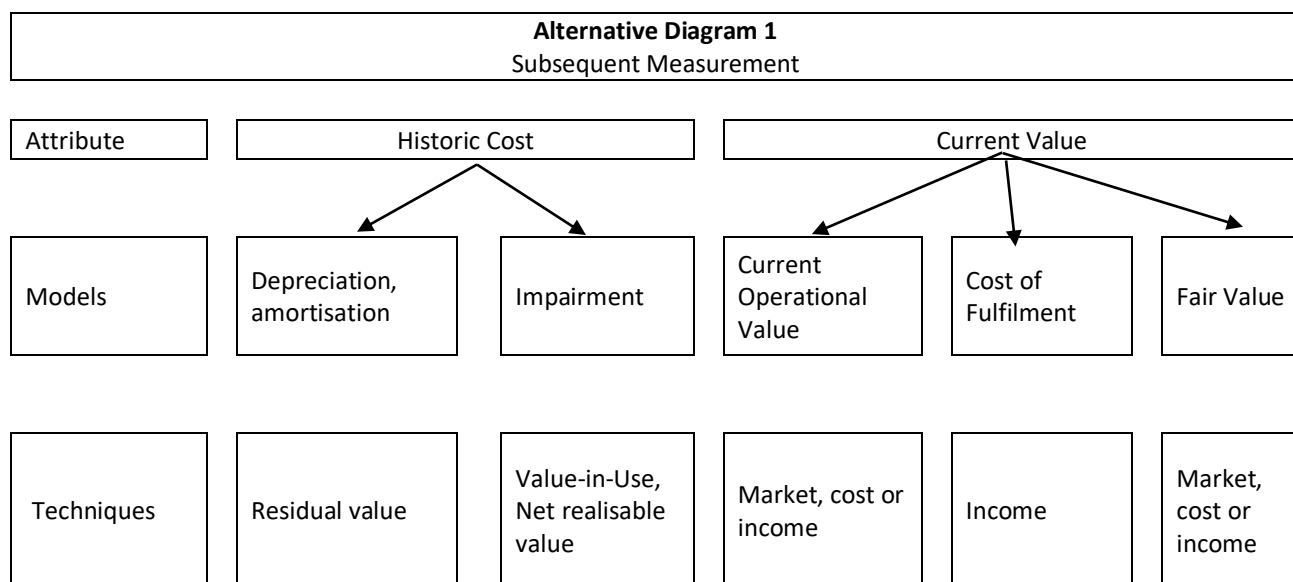
Background information

- The Board has agreed to comment on SMC 2.
- Measurement hierarchy as proposed in ED 76

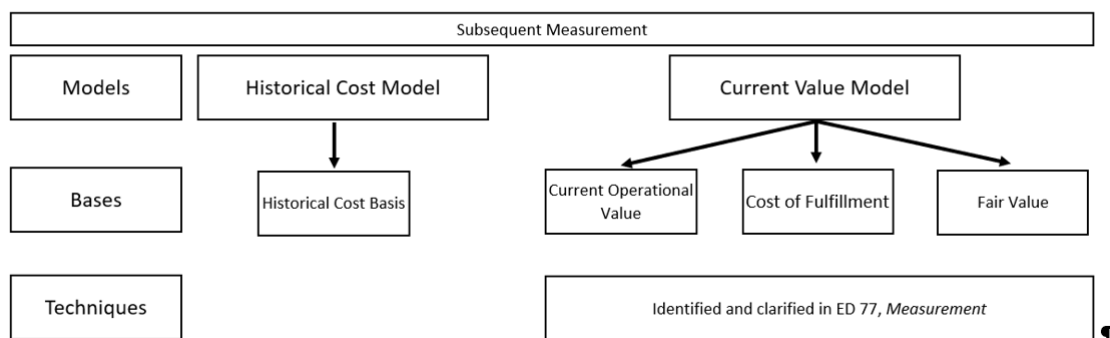


- **Models and bases:** A Board member suggested that the IPSASB has models and bases the wrong way around. In some frameworks, bases sit at a higher level than models. Given that the use of the terms bases and models has not been consistent in the past is it necessary to make this distinction now? We have commented on the terms bases versus models as we note that there is some consistency between the IPSASB’s proposed use of terms and the IASB’s use of terms. However, the IASB has not limited itself to using terms to imply a consistent level of a hierarchy as the IPSASB is proposing to do.
 - IAS 16 *Property, Plant and Equipment* refers to the historical cost model and the revaluation model. However, IAS 40 refers to the cost model and the fair value model.
 - The IASB Conceptual Framework refers to ‘measurement bases’ (for example, CF.6.23 and 6.83). However, IFRS 13 also refers to a ‘fair value measurement approach’ (IFRS 13.B2).
 - IFRS 13 refers to the market approach and cost approach as valuation techniques (for example, IFRS 13.B5).
- **Historic cost not fully explained:** A Board member has suggested an alternative to Diagram 1 in ED 76 (shown below). Diagram 1 from ED 76 is shown immediately below that. This alternative highlights that depreciation/amortisation and impairment are important aspects of subsequent measurement. Standards that require or permit historical cost require either depreciation/ amortisation or impairment. Both depreciation/amortisation and impairment include valuation concepts (such as value in use and net realisable value).

[We have drafted a comment along these lines but haven’t suggested elevating depreciation/amortisation and impairment to the same level as COV and fair value.]



→ **Diagram 1: The measurement hierarchy for subsequent measurement and the relationship between the three levels**



- Measurement isn't defined:** One way to make it clear what the IPSASB means when it refers to subsequent measurement – and to clarify that depreciation and amortisation are part of subsequent measurement – would be to define 'measurement' as the process involved in determining the carrying amounts of assets and liabilities. Then, in ED 77 the IPSASB could link the discussion of depreciation, amortisation, and impairment to the concept of service delivery objectives. [We haven't actioned this comment in the draft responses. Feedback welcome.]
- Value in use:** If the Board thinks value in use should be shown as a separate measurement basis, it would affect the response to this SMC. See ED 76 SMC 4 for more detail about value in use.

Draft response

The hierarchy does not show some of the fundamental components of subsequent measurement. We would modify the proposed measurement hierarchy to show that depreciation/amortisation and impairment are fundamental components of subsequent measurement under historical cost. Both depreciation/amortisation and impairment include valuation concepts (such as value in use and net realisable value). We are not suggesting that the Conceptual Framework should get into any detail about these concepts – this detail is appropriately addressed at standards level. However, the Conceptual Framework should acknowledge that different techniques are used within standards.

The risk of omitting depreciation/amortisation and impairment from the hierarchy is that it could imply that the IPSASB is talking about subsequent measurement in gross terms. The fact that the choice between depreciation/amortisation and impairment is determined at standards-level does not affect the fact that they are part of applying historical cost. We accept that it is possible to debate whether depreciation and impairment are 'techniques' but they contain measurement concepts and should be shown in any diagram depicting subsequent measurement.

The ED refers to 'the historical cost model'. There is not a single historical cost model. The use of depreciation/amortisation or impairment in subsequent measurement has different implications for the financial statements.

If revaluations are not conducted every year, then depreciation/amortisation and impairment are also part of the subsequent measurement of revalued assets. It is not possible to discuss current operational value without reference to whether that value incorporates depreciation or not.

ED 76 SMC 2: Fair value as a measurement base

Seeking feedback from the Board on this SMC.

The background information outlines some feedback from the TRG.

SMC 2: Do you agree with the proposed inclusion of fair value as a measurement basis for assets and liabilities with the same definition as in IFRS 13, *Fair Value Measurement*, in the Conceptual Framework?

If not, why not?

Background information

- The Board has agreed to comment on SMC 2.
- Both the NZASB and AASB commented on the 2013 ED that led to Chapter 7 of the IPSASB Conceptual Framework. Both the NZASB and AASB said they thought the IPSASB should adopt fair value as a measurement basis (rather than market value). The AASB 2013 comment letter did acknowledge that fair value [as per IFRS 13] does not seem to reflect a clearly understandable measurement objective or concept of capital. We have included an extract from that comment letter because it touches on the difficulties associated with specialised assets.

Extract from AASB 21013 comment letter on IPSASB Measurement ED

As mentioned in the paragraph immediately above, the AASB acknowledges that 'fair value', as defined and explained in IFRS 13, does not seem to reflect a clearly understandable measurement objective or concept of capital. This is because, although 'fair value' is defined as an exit price, it is explained as being estimated using market selling prices or market buying prices, depending on the circumstances. As acknowledged above, IFRS 13 only uses market buying prices to estimate the fair value of a non-financial asset when they provide the best evidence of the asset's market selling price, using the assumption that the market participant buyer already holds complementary assets. However, market selling prices and market buying prices are fundamentally different in concept and reflect different concepts of capital. By assuming that the market participant buyer already holds complementary assets, the notion of 'fair value' in the guidance in IFRS 13 implicitly focuses on the price at which buyers and sellers meet, and does not address those fundamental conceptual differences (e.g. that when an entity holds highly specialised assets, there might not exist another market participant with complementary assets, in which case 'exit price' determined on the above-mentioned assumption would not faithfully reflect the 'current cash equivalent' concept of capital for the asset). The problem, in concept, with implicitly focusing on the price at which buyers and sellers meet is that preparers of financial statements are in either or both positions for an asset or liability (for example, an entity that buys goods from wholesalers and sells the goods and related services at a profit in a retail market). For them, entry and exit prices are not the same because they are found in different markets and, depending on the measurement basis, transaction costs are either added to or deducted from the market price. Therefore, in concept, it is necessary to choose between market selling prices and market buying prices for assets and liabilities if an ideal measurement model is to provide a basis for achieving the qualities of desirable measurements referred to in the AASB's comments on Specific Matter for Comment 1.

NZASB feedback May 2021

- Aligning fair value with IFRS 13 is useful, especially for financial instruments.

TRG feedback

- There was support for aligning the fair value requirements in PBE Standards with the for-profit standards.
- The proposals, which explicitly require fair value to be an exit price and be based on market participants' perspective, could affect the fair value measurement of investments in unlisted shares and equity contributions. Some public sector entities currently measure the fair value of such shares or investments based on the company's net asset value (NAV). The current fair value requirements give enough leeway to do so. However, a commercial investor would not buy the shares for this NAV-based amount. Therefore, the shares would need to be impaired under the proposed alignment of the fair value requirements in the financial instrument standards with IFRS 13.
- Some NFP PBEs might be reluctant to provide the proposed additional disclosures on fair value (even though these disclosures are generally not commercially sensitive).

Draft response

We agree with the IPSASB's proposal to include fair value as a measurement basis and to adopt the same definition of fair value as in IFRS 13. We consider that closer alignment with the fair value requirements in IFRS Standards will assist public sector entities that consolidate entities applying IFRS Standards. We also generally agree with most of the proposals to align with IFRS 13, to the extent that fair value is used in IPSAS.

We do have some concerns about the proposed changes to IPSAS 41 *Financial Instruments* and the implications of those changes for unlisted shares and equity contributions to public sector entities. We comment on this further under ED 77.

ED 76 SMC 3: Current operational value as a measurement base

We would appreciate some discussion about the additional comments received since the last meeting. This SMC links with ED 77 SMC 6 on the definition of COV.

SMC 3: Do you agree with the proposed inclusion of current operational value as a measurement basis for assets in the Conceptual Framework?

If not, why not?

Current operational value is the value of an asset used to achieve the entity's service delivery objectives at the measurement date.

The Exposure Draft includes an Alternative View on current operational value.

Background information

- The Board has agreed to comment on SMC 3.
- We propose to agree that if the IPSASB introduces fair value, another current value measurement basis is required.
- Identify concerns with COV as proposed in ED 77 – in ED 77 SMC 6, we propose to disagree with the definition of COV.

NZASB feedback May 2021

Comments from Board members included the following.

- In our response it is important to consider the Alternative View in the ED, and the Board's views on the Alternative View.
- It makes sense to have another current value measurement basis apart from fair value, but there are some concerns about the proposed definition and requirements relating to this additional measurement basis (i.e. COV).
- COV focuses on the service potential of the asset, which is inconsistent with the income approach.
- More consideration is needed around assets held for 'mixed use', i.e. both for their financial capacity and their operational capacity. While most assets held by the Crown are held for their operational capacity, some assets are held for 'mixed use'. This can be the case for medical facilities and social housing buildings.
- The Alternative View proposes to define COV as "*the cost to replace the service potential embodied in an asset at the measurement date*". This notion of replacement cost is clearer than the proposed definition of COV.

Board member feedback (in addition to feedback received at the May meeting)

- A Board member noted the lack of clarity in the definition of COV. The member's comments included the following.
It is not obvious from the definition of COV:
 - That COV is an "entry, entity-specific value" (para 23);

- That COV is based on the asset's "current use rather than highest and best use" (para 25(b));
- That COV applies to "non-financial assets" (B1);
- What "unit of account" should be used when determining COV (B1(a));
- That "key aspects affect the measurement of an asset's COV: location, surplus capacity, restrictions, least costly manner.." (B5);
- That COV "assumes the asset is used to its full capacity, subject to any tests for impairment..." (B11);
- That COV requires "maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs" (B23);
- That COV is measured by applying "measurement techniques... market approach, cost approach and the income approach" (B24), and;
- That when determining COV, "deductions are made for ...obsolescence" (B36).

No definition can capture all aspects. However, the definition could be improved.

One option is to focus on "*the amount an entity would incur to achieve the asset's current service delivery objectives.*"

The Alternative View suggests a definition that is similar to the previous definition of replacement cost (also referred to as optimised depreciated replacement cost):

Current Operational Value is the cost to replace the service potential embodied in an asset at the measurement date.

The question is: what are we trying to measure? Is it the *entity's* service delivery, or the service potential of an *asset* to the entity? ED 77 seems to be focusing more on the entity's service delivery objectives, whereas the proposed definition in the AV focuses more on the asset.

The member queried whether the use of 'cost' in the definition of COV would rule out the market approach and the income approach. Staff think that it would rule only out the income approach (because the market approach in the context of COV refers to the "buying price of a similar asset [...]", i.e. the *cost* of purchasing a similar asset on the market).

- The cover memo for this meeting includes a comparison of DRC versus COV cost approach. That comparison will be most helpful as we think about what to say about the detailed COV proposals. However, it might also help us think about what we are trying to measure. It notes that the proposals about surplus capacity are not clear. Surplus capacity is an important issue because what you are trying to measure will affect how you treat surplus capacity.

Draft response to SMC 3

To be drafted

ED 76 SMC 4: Description of value-in-use

Seeking feedback on whether to respond to SMC 4 and how to respond.

SMC 4: It is proposed to substitute a general description of value in use (VIU) in both cash-generating and non-cash-generating contexts, for the previous broader discussion of VIU. This is because the applicability of VIU is limited to impairments. Do you agree with this proposed change?

If not, why not? How would you approach VIU instead and why?

Background information

- We had previously recommended not commenting on this SMC, but a Board member has suggested that we should.
- VIU can be regarded as a separate measurement basis, but it is true that it is used in a limited number of standards. The IPSASB is planning to delete the current description of VIU *as a measurement basis* and replace that with a general description. It is true that value in use is used in limited circumstances, but that on its own does not preclude it being a measurement basis. As far as we can see, the IPSASB has not said why it isn't a measurement basis, just that its limited use means they are not going to refer to it as such.
- We are seeking feedback on whether the Board wants to comment on SMC 4 and what it would like to say.
- The following extracts show previous text from the Conceptual Framework, proposed new Conceptual Framework text in ED 76 and ED 77 text on value in use.

*Extracts from IPSASB Conceptual Framework***Value in Use**

7.58 *Value in use is:*

The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.

Suitability of Value in Use

- 7.59 Value in use is an entity-specific value that reflects the amount that can be derived from an asset through its operation and its disposal at the end of its useful life. As noted in paragraph 7.42 above, the value that will be derived from an asset is often greater than its replacement cost—it is also usually greater than its historical cost. Where this is the case, reporting an asset at its value in use is of limited usefulness, as by definition, the entity is able to secure equivalent service potential at replacement cost.
- 7.60 Value in use is also not an appropriate measurement basis when net selling price is greater than value in use, as in this case the most resource-efficient use of the asset is to sell it, rather than continue to use it.
- 7.61 Therefore, value in use is appropriate where it is less than replacement cost and greater than net selling price. This occurs where an asset is not worth replacing, but the value of its service potential or ability to generate economic benefits is greater than its net selling price. In such circumstances value in use represents the value of the asset to the entity.
- 7.62 Value in use is an appropriate measurement basis for the assessment of certain impairments, because it is used in the determination of the recoverable amount for an asset or group of assets.

Costs of Services, Operational Capacity, Financial Capacity

- 7.63 Because of its potential complexity¹⁷, its limited applicability and the fact that its operationalisation in a public benefit entity context for non-cash-generating assets involves the use of replacement cost as a

surrogate, value in use is generally inappropriate for determining the cost of services. Its usefulness to assessments of operational capacity is limited, and is only likely to be significant in the atypical circumstances where entities have a large number of assets that are not worth replacing, but their value in use is greater than their net selling price. This may be the case if, for example, an entity will discontinue provision of a service in the future, but the proceeds of immediate sale are less than the service potential embodied in the assets. Value in use does involve an estimate of the net amount that an entity will receive from disposal of the asset. However, its limited applicability reduces its relevance for assessments of financial capacity.

Application of the Qualitative Characteristics

- 7.64 While value in use may be used in assessments of certain impairments its relevance for financial reporting purposes is limited to the circumstances outlined in paragraph 7.61.
- 7.65 The extent to which value in use meets the other qualitative characteristics depends on how it is determined. In some cases, an asset's value in use can be quantified by calculating the value that the entity will derive from the asset assuming its continued use. This may be based on the future cash inflows related to the asset, or on cost savings that will accrue to the entity through its control of the asset. The calculation of value in use takes into account the time value of money and, in principle, the risk of variations in the amount and use takes into account the time value of money and, in principle, the risk of variations in the amount and timing of cash flows
- 7.66 The calculation of value in use can be complex. Assets that are employed in cash-generating activities often provide cash flows jointly with other assets. In such cases value in use can be estimated only by calculating the present value of the cash flows of a group of assets and then making an allocation to individual assets.
- 7.67 Most assets held by public benefit entities are held with the primary objective of contributing to the provision of services, rather than to the generation of a commercial return: such assets are referred to as "non-cash-generating assets." Because value in use is usually derived from expected cash flows, its operationalisation in such a context can be difficult. It may be inappropriate to calculate value in use on the basis of expected cash flows, because such a measure would not be faithfully representative of the value in use of such an asset to the entity. Therefore, it would be necessary to use replacement cost as a surrogate for financial reporting purposes.
- 7.68 The method of determining value in use reduces its representational faithfulness in many cases. It also affects the timeliness, comparability, understandability and verifiability of information prepared on a value in use basis

Extracts from ED 76

7.15 Value in use is discussed in paragraphs 7.57-7.62. It is not included in the above list of measurement bases because its use is limited to impairment.

...

Value in Use

- 7.57 Value in use is applicable for assessments of impairment.
- 7.58 Value in use of a cash-generating asset is the present value of the estimated future cash flows expected to be derived from the continuing use of the asset and from its disposal at the end of its useful life. This requires the discounting of cash flows to a present value. Such requirements and guidance are provided at the standards level.
- 7.59 Value in use of a non-cash-generating asset is the asset's remaining service potential at the measurement date. The estimation of service potential requires the use of techniques, which are dependent on the nature of the asset and, because of its applicability to impairment, the indicator of impairment. Such guidance is provided at the standards level.
- 7.60 Value in use for cash-generating assets is complex and subjective, as it requires the projection of cash flows from an entity perspective. Further complexity arises where assets are deployed in combination with other assets. In such cases, value in use can be estimated only by calculating the present value of the cash flows of a group of assets, rather than discretely, and then making an allocation to individual assets. Such allocations may be arbitrary, which may have an adverse impact on faithful representation.

- 7.61 Value in use for non-cash-generating assets is also complex, as it requires the use of surrogate measurement bases or techniques in order to provide entity-specific estimates of an asset's remaining service potential.
- 7.62 Paragraph 7.35 discusses the situation where an asset is used for service provision and also generates economic benefits, noting that an entity that is using the current value model makes a judgment whether an asset is primarily held for operational capacity or financial capacity, and selects the fair value measurement basis or the current operational value measurement basis. This factor and the complexity and subjectivity discussed above mean that value in use in both a cash-generating and non-cash-generating context is likely to be applicable only to accounting for losses or reversals of losses related to impairment.

Value in Use (from ED 76 Basis for Conclusions)

- BC7.1 The IPSASB considered whether to retain value in use as a current value measurement basis for assets in the Conceptual Framework.
- BC7.2 The IPSASB noted that the definition in the 2014 Conceptual Framework was not fully consistent with that in the IASB's Conceptual Framework, because it is not limited to the cash-generating context and includes a reference to 'service potential'. In its standards development since approval of the Conceptual Framework the IPSASB has placed increased emphasis on the consistent use of terminology and definitions by global standard setters.
- BC7.3 The IPSASB acknowledged the importance of value in use in assessments of impairment gains or losses. The IPSASB also noted that value in use requires complex and subjective projections of cash flows generated by an asset or of the service potential provided by an asset. Complexity increases where assets generate cash flows in combination with other assets.
- BC7.4 The IPSASB acknowledged that some assets both generate cash flows and are used in the delivery of services. In such circumstances the IPSASB reaffirmed that, for financial reporting purposes, preparers of financial statements need to make a professional judgment of the primary purpose for which an asset is held. Under the current value model, where assets are primarily held for operational capacity, current operational value is applied; where assets are primarily held for financial capacity fair value is applied. The continued applicability of value in use is therefore likely to be limited to impairment.
- BC7.5 In light of the above factors the IPSASB decided to replace the definition of value in use with a limited discussion in paragraphs 7.57-7.62 of the updated Chapter.

Extracts ED 77

4. The measurement requirements of this [draft] Standard do not apply to the following:
- (a) Leasing transactions accounted for in accordance with IPSAS 13, *Leases*;
 - (b) Transactions accounted for in accordance with IPSAS 32, *Service Concession Arrangements: Grantor*; and
 - (c) Measurements that have some similarities to the measurement bases in this [draft] Standard but are not those measurement bases, such as net realizable value in IPSAS 12, *Inventories* or value in use in IPSAS 21, *Impairment of Non-Cash-Generating Assets* and IPSAS 26, *Impairment of Cash-Generating Assets* (but this [draft] Standard is applied in measuring fair value as required in IPSAS 21 and 26).

Draft response

We acknowledge that VIU is used in limited circumstances in IPSAS, but the fact that it is used infrequently does not change whether it is or is not a measurement basis. In our view, VIU is a measurement basis.

The discussion of VIU in ED 76 could be quite short, but it should refer to it as a measurement basis.

ED 76 SMC 5: Delete measurement bases – market value and replacement cost

Not seeking feedback at this meeting. Feedback will be sought at a future meeting.

SMC 5: Noting that ED 77, *Measurement*, proposes the use of the cost approach and the market approach as measurement techniques, do you agree with the proposed deletion of the following measurement bases from the Conceptual Framework:

- Market value—for assets and liabilities; and
- Replacement cost—for assets?

If not, which would you retain and why?

- The Board agreed to comment on this SMC.
- We will bring a draft response to a future meeting. In the response, we propose to:
 - Agree with removal of market value on the grounds that the IPSASB is proposing to bring in fair value, and;
 - Express the view that replacement cost is a clearer concept than COV as proposed. At its May meeting, the Board supported this view.

ED 76 SMC 6: Delete measurement bases – net selling price, cost of release, assumption price

Not seeking feedback at this meeting. Feedback will be sought at a future meeting.

SMC 6: The IPSASB considers that the retention of certain measurement bases that were in the 2014 Conceptual Framework is unnecessary. Do you agree with the proposed deletion of the following measurement bases from the Conceptual Framework?

- Net selling price—for assets
- Cost of release—for liabilities
- Assumption price—for liabilities

If not, which would you retain and why?

- The Board agreed to comment on this SMC.
- We will bring a draft response to a future meeting. In the response, we propose to:
 - Agree with deletion of net selling price
 - Disagree with deletion of cost of release and assumption price – staff to identify situations when they think these bases could be relevant and locate previous feedback from constituents about possible need for these bases. For example, we have previously received feedback that the concept of assumption price is important when the government is taking on liabilities a concessional rates (which has been happening recently as a result of COVID-19).
- Further Board discussion required at future meeting – staff acknowledge that cost of release and assumption price are not presently used in standards.

ED 76 SMC 7: Other issues?

The Board agreed not to comment at this stage.

SMC 7: Are there any other issues relating to Chapter 7: *Measurement of Asset and Liabilities in Financial Statements* of the Conceptual Framework that you would like to highlight?

DO NOT propose to comment (subject to comments from constituents or any other issues identified during the process of drafting the letter).

APPENDIX B: Responses on ED 77 Measurement**ED 77 SMC 1—(paragraphs 7–16): Initial measurement**

The Board agreed not to comment on this SMC.

SMC 1: Do you agree an item that qualifies for recognition shall be initially measured at its transaction price, unless:

- That transaction price does not faithfully present relevant information of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes; or
- Otherwise required or permitted by another IPSAS?

If not, please provide your reasons, stating clearly what principles are more appropriate, and why.

DO NOT propose to comment

ED 77 SMC 2—(paragraph 17): Subsequent measurement – historical cost or current value

The Board agreed not to comment on this SMC.

SMC 2: Do you agree after initial measurement, unless otherwise required by the relevant IPSAS, an accounting policy choice is made to measure the item at historical cost or at its current value? This accounting policy choice is reflected through the selection of the measurement model.

If not, please provide your reasons, stating clearly what principles are more appropriate, and why.

DO NOT propose to comment

ED 77 SMC 3—Appendix A (paragraphs A1–A6): Historical cost guidance

The Board agreed not to comment on this SMC.

SMC 3: In response to constituents' comment letters on the Consultation Paper, *Measurement*, guidance on historical cost has been developed that is generic in nature (Appendix A: Historical Cost). Do you agree the guidance is appropriate for application by public sector entities?

If not, please provide your reasons, stating what guidance should be added or removed, and why.

DO NOT propose to comment

- The proposed historical cost guidance is very short and we do not think it is changing any existing requirements.

ED 77 SMC 4—Appendix A (paragraphs A1–A6): Historical cost no measurement technique needed

The Board agreed not to comment on this SMC.

SMC 4: Do you agree no measurement techniques are required when applying the historical cost measurement basis in subsequent measurement?

If not, please provide your reasons, stating which measurement techniques are applicable to the subsequent measurement of an asset or liability measured at historical cost, and why.

DO NOT propose to comment

ED 77 SMC 5—(paragraph 6): Current operational value – principle

We have commented on SMC 5 and SMC 6 together – see SMC 6 below.

SMC 5: Do you agree current operational value is the value of an asset used to achieve the entity’s service delivery objectives at the measurement date?

If not, please provide your reasons, stating clearly what principles [are] more appropriate for the public sector, and why.

We have commented on SMC 5 and SMC 6 together.

ED 77 SMC 6—Appendix B (paragraphs B1–B41): Current operational value – definition and guidance

Seeking feedback on draft response

SMC 6: Do you agree the proposed definition of current operational value and the accompanying guidance is appropriate for public sector entities (Appendix B: Current Operational Value)?

If not, please provide your reasons, stating clearly what definition and guidance is more appropriate, and why.

Background information

- The Board has agreed to comment on this SMC.
- Staff propose that the Board disagrees with the proposed definition of COV, mainly because the proposals are not clear. There may also be particular aspects of the guidance that we disagree with.
- The comparison between DRC and COV cost approach in the cover memo should help in identifying areas where the requirements might differ for entities currently using DRC.
- In discussing the comparison between DRC and COV, the cover memo also notes that the interaction between the proposed requirements on surplus capacity and on external obsolescence is unclear.

Feedback from NZASB May meeting

See comments on ED 76, SMC 3 above. These comments are also relevant to this SMC.

Additional comments on this SMC at the NZASB May meeting included the following.

- Would it still be possible to use DRC as currently defined under the proposals? If DRC cannot be used, this could be an issue for local government. DRC drives depreciation. Depreciation is taken into account when determining rates and charges, and therefore affects a local authority's ability to replace assets.
- To what extent will the proposals lead to change in current practice in New Zealand? There may be cases where, despite the difference between the proposed and current requirements, the accounting outcome would be the same. For example, looking at restricted prison land: Even if the restrictions are legally enforceable, equivalent restricted prison land might not be available on the market. Therefore, under the COV proposals, the prison land would be measured with reference to unrestricted land (for example, with reference to the 'land next door') – which seems consistent with 'highest and best use'. You may end up in a similar position to what happens today in current practice. [However, please also note the Board member's comment below on restricted assets, and the comments from the TRG below, which say that that some entities apply a discount when measuring restricted land].

Feedback from Board members (in addition to discussion at May meeting)

- **What is COV?** See the Board member feedback on ED 76 SMC 1.
- **Land with restrictions:**
 - One current practice for proxy market values for restricted properties differs from the COV proposals. Some entities start with a rural lifestyle block value and then add a location factor, size and type of land and adjust for the restriction to determine the increase in value. They then moderate/check this increase against the average increase in value of residential land value in the specific location.
 - There may be no market value for some restricted land – even in the absence of legal restrictions, a local authority may not be able to sell parks and reserves.
 - **Surplus capacity:** Generally, in local government buildings for operational capacity are not impaired if there is an alternative use.

Feedback from the TRG

- Several TRG members expressed agreement with the Alternative View on COV. They noted the following.
 - The notion of replacement cost is working well in New Zealand.
 - There were some concerns regarding the proposed use of the income approach as a technique for determining COV – see SMC 8 below.

- Other comments from the TRG on the topic of COV included the following.
 - The COV proposals could have a significant impact on some assets. For example, when measuring council reserve land, a discount is currently applied to take into account restrictions on the land. However, under the COV proposals, such restrictions would not be taken into account, unless land with similar restrictions is available on the market. Therefore, the value of such land would generally increase under COV.
 - Several TRG members were interested in our work on understanding the difference between DRC and the cost approach under COV.
 - A TRG member questioned whether a replacement cost approach is appropriate for measuring heritage assets, which are irreplaceable.
 - COV sounds very similar to value in use but uses different terminology.

Still to do

Response to ED 76 SMC 3 is linked to this SMC and is to be completed

- This SMC is linked to ED 76 SMC 3. We are seeking the Board’s feedback at this meeting on the proposed direction of the response to ED 76 SMC 3. That discussion would affect our draft response to this SMC. In the draft response below, we have not gone into detail about our concerns around the definition of COV, but have instead referred to our (yet to be drafted) response to ED 76 SMC 3.

Forthcoming discussion with valuers

- While we intend to speak auditors and valuers about all four EDs, we note that it would be particularly important to discuss with valuers the proposed COV requirements and guidance covered by this SMC. As noted by Board members in May, it would be important to check if valuers understand the COV proposals and the difference between fair value and COV. It is also important to ensure that the COV requirements are aligned as much as possible with how valuers would value assets that are held for their operational capacity. In particular, it would be important to how valuers treat restrictions on an asset, including restrictions that are not legally enforceable or could be removed by the entity.

Draft response

We have some concerns with respect to the definition of COV. We think the definition is not sufficiently clear and could be improved. Please refer to our response to SMC 3 of ED 76. *[Note: That response yet to be drafted]*

We also have the following comments in relation to the proposed guidance on COV.

- We do not consider the income approach to be an appropriate technique for measuring COV. We agree with the Alternative View on this matter. Please see SMC 8 below.
- We agree with the Alternative View that there is a lack of clarity in relation to the proposed treatment of surplus capacity.
 - Paragraph B36(c) of ED 77 says that COV should be reduced for ‘external obsolescence’, which can arise when there is a reduction in demand for the services that the asset can provide. However, such reduction in demand might also be a

potential source of surplus capacity – which the ED says should be *included* (rather than deducted) when determining the asset’s COV (subject to impairment). We think additional guidance should be provided to help entities determine when a reduction in demand is classified as obsolescence and when it is classified as surplus capacity.

- In New Zealand, if a revalued asset has surplus capacity but there is an *alternative use* to that surplus capacity, then the value of the surplus capacity is included in the value of the asset. We agree with the Alternative View that it would be important to clarify the unit of account for situations where the asset has surplus capacity with an alternative use.

- ED 77 requires COV to be measured based on the asset’s current use, rather than its highest and best use. However, the ED also does not allow restrictions on an asset’s use or sale to be taken into account if an equivalent restricted asset is not available for purchase in an orderly market. This is likely to be the case for many restricted land assets. Therefore, such land assets are likely to ultimately be measured based on their highest and best use.
- We have received feedback that in some cases, the COV proposals could have a significant impact on the valuation of entities’ assets – particularly if an entity currently applies a discount when measuring the fair value of restricted land held for its operational capacity. If the restriction is not legally enforceable (and even if the entity would always adhere to those restrictions), it seems that under the proposed requirements the land would need to be valued as if it were unrestricted. This would cause an increase in the value of such land.
- We think additional guidance is needed for determining the COV of assets that are held both for the operational capacity and their financial capacity (as well as additional guidance on determining whether such assets should be measured at COV or fair value – please see our responses to ED 78 below).

ED 77 SMC 7—Appendix B (paragraphs B6–B7): Current operational value – location assumption

Not seeking feedback at this meeting. Feedback will be sought at a future meeting.

SMC 7: Do you agree the asset’s current operational value should assume that the notional replacement will be situated in the same location as the existing asset is situated or used?
If not, please provide your reasons, stating clearly why the asset should be measured at a different value.

Background information

- The Board agreed to comment on this SMC.
- We will seek the Board’s feedback on a draft response at a future meeting.
- Propose to agree that the value of land should be assessed with reference to the current location, but we think that it should be determined having regard to the highest and best use.

Guidance on land in PBE IPSAS 17 (Appendix A, paragraph AG7)

Land

In instances where land is underutilised, the fair value of the land shall be determined by reference to the highest and best use of such land. For example, in a case where specialised facilities are located in a prime central business district site but the operation would be able to be run from a smaller sized and/or less valuable alternative site offering the same service potential, the fair value of the land would be the market value of the entire central business district-located site.

Proposals in ED 77

- Paragraph B4 says that current use may be, but is not necessarily, highest and best use.
- Paragraph B6:
The asset’s current operational value assumes that the entity will continue to meet its service delivery objectives from the same location in which the asset is currently situated or used.
- Paragraph B7:
The current operational value of a building reflects the value of the building in its current location. For example, a hospital operating in a city center that could now be situated in the suburbs, because of the migration of the population, is measured based on the value of the hospital in its current location (e.g., if the cost approach is applied, construction costs, permits, regulations, etc. are based on costs incurred at the current location).

ED 77 SMC 8—(paragraphs B38–B39): Current operational value – use of income approach

Seeking feedback on draft response.

SMC 8: Do you agree the income approach is applicable to estimate the value of an asset measured using the current operational value measurement basis?

If not, please provide your reasons, stating clearly why the income approach is not applicable for measuring current operational value.

The Exposure Draft includes an Alternative View on current operational value.

Background information

- The Board agreed to comment on this SMC.
- Our draft response to SMC 6 already notes our disagreement with IPSASB’s proposal that the income approach is appropriate technique for measuring COV.

Feedback from NZASB May meeting

See the ‘background information’ section of SMC 6 above.

Feedback from the TRG

- It is difficult to see how the income approach can represent the cost to replace an asset.
- For an asset like a building used for social housing, the income approach could result in a range of different values, depending on the size ‘discount’ provided to tenants as compared to market rent – which can change every time Government policy changes.

Still to do

- Staff will consider situations where the use of the income approach might result in useful information and other situations where it might result in assets being reported at amounts much lower than their replacement cost (and/or differing measurements for similar assets). Staff will consider adding such examples to the draft response.

Draft response

We do not consider the income approach to be an appropriate technique for measuring COV. We agree with the Alternative View on this matter.

While the definition of COV as currently proposed does not refer to the cost of replacing an asset, paragraph B9 of ED 77 says that COV is an entry value, which implies that it is the cost of purchasing an equivalent asset. Furthermore, the Alternative View in ED 77 notes that referring to the *cost of replacing the service potential embodied in the asset* would make the definition of COV clearer. We think that the income approach is inconsistent with the notion of an entry value and/or the cost of replacing the service potential embodied in an asset.

Under the income approach to COV, similar assets could be valued very differently, depending on the entity's decision of how much to charge for its services. For example, for a building used for social housing, determining COV using the income approach could result in a range of different values, depending on how much of a 'discount' is provided to tenants as compared to market rent – and this decision could change every time there is a change in government (or a change in government policies).

Additionally, when an entity changes a nominal price for its services or provides services at no charge, an asset measured at COV under the income approach would have a very different carrying amount to an asset measured at COV under the market or cost approach. This could have a negative impact on the comparability and understandability of public sector entities' financial statements.

When an entity charges low or nominal prices for the services it provides using a specific asset, the income approach would result in very low COV amounts, which would not faithfully reflect the remaining service potential embedded in the asset. For example, this could be the case for social housing and infrastructure assets. It may also make it more difficult to know how much it would cost to replace the asset.

[Staff to think of more examples of when the income approach would result in inappropriately low values – and potentially when it could be appropriate]

ED 77 SMC 9—Appendix C (paragraphs C1–C89): Fair value

Seeking feedback on draft response which reflects some comments from the TRG.

SMC 9: In response to constituents' comment letters on the Consultation Paper, *Measurement*, guidance on fair value has been aligned with IFRS 13, *Fair Value Measurement* (Appendix C: Fair Value). Do you agree the guidance is appropriate for application by public sector entities?

If not, please provide your reasons, stating what guidance should be added or removed, and why.

Background information

- The Board has agreed to comment on SMC 9.

TRG feedback

- The proposals, which explicitly require fair value to be an exit price and be based on market participants' perspective, could affect the fair value measurement of investments in unlisted shares and equity contributions. Some public sector entities currently measure the fair value of such shares or investments based on the company's net asset value (NAV). The current fair value requirements give enough leeway to do so. However, a commercial investor would not buy the shares for this NAV-based amount. Therefore, the shares would need to be impaired under the proposed alignment of the fair value requirements in the financial instrument standards with IFRS 13.

Information that is relevant to the TRG feedback above

- When on IPSASB ED 64 *Financial Instruments*, the Board noted the importance of providing guidance on the fair value measurement of unquoted shares and non-cash-generating equity investments. An extract from that comment letter is included below.

Valuation of unquoted equity instruments

We support the development of illustrative examples on the valuation of unquoted equity instruments. However, we think that further guidance to assist entities in determining the fair value of non-cash-generating investments would be helpful.

The guidance and examples in the ED focus more on measuring the fair value of investments in cash-generating entities. In the public sector there can be situations where the investee is carrying out activities that support the investor's public policy objectives. This raises the issue of whether the fair value of such investments should be determined solely by reference to expected cash flows [...] or whether fair value assessments should also take account of other factors, such as the service potential associated with such investments. [An illustrative example in the ED] touches on the possibility that the transaction price may not be representative of fair value at the measurement date, but it does not provide any guidance on estimating the fair value of the non-controlling equity interest.

- IPSAS 41 *Financial Instruments* currently says the following about equity investments in the public sector (these paragraphs would remain in IPSAS 41 under ED 77).

Extract IPSAS 41

Equity Instruments Arising from Non-Exchange Transactions

- AG128. In the public sector, equity investment can be used as a way for an entity to provide financing or subsidized funding to another public sector entity. In such a transaction, there is generally a lack of an active market for such investments (i.e., the equity instrument is unquoted), and there are no or minimal future cash flow expectations from the investment besides a potential redemption by the issuing entity. Cash is provided by the investing entity to the investee generally to further the investee’s economic or social objectives. Examples of such investments could include membership shares in a development bank, or equity investment in another public sector entity that provides certain social programs or services (e.g., shelters, subsidized housing, small business assistance...etc.)
- AG129. At initial recognition of such transactions, an entity shall analyze the substance of the arrangement and assess whether the intention at the outset is the provision or receipt of resources by way of a non-exchange transaction. To the extent that the transaction, or component of the transaction, is a non-exchange transaction, any assets or revenues arising from the transaction are accounted for in accordance with IPSAS 23. The entity providing the resources shall recognize the amount as an expense in surplus or deficit at initial recognition.
- AG130. To the extent an equity instrument arises from the transaction, or component of the transaction, that is within the scope of this Standard, it is to be recognized initially at fair value in accordance with paragraph 57. The equity instrument is to be measured subsequently in accordance with paragraphs 61–63. If the instrument does not have an active market, the entity shall consider valuation techniques and inputs in AG149–AG155) in determining its fair value.
- IPSAS 41 also currently includes requirements on the use of valuation techniques in paragraphs 67–68, and some guidance on determining fair value when there is no active market for the equity instrument, in paragraphs AG149–AG155. ED 77 proposes to replace these paragraphs by a reference to ED 77, which sets out the requirements for fair value measurement, aligned with IFRS 13. The proposed amendment is shown below.

Fair Value Measurement Considerations

66. In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, IPSAS 28 or IPSAS 30, an entity shall apply [draft] IPSAS [X] (ED 77) and paragraphs AG143A–AG143AB AG144–AG155 of Appendix A.
67. ~~The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm’s length exchange motivated by normal operating considerations. Valuation techniques include using recent arm’s length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data. [Deleted]~~
68. ~~The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. [Deleted]~~

- We note that IPSAS 41 contains illustrative examples on determining fair value unquoted equity instruments. See paragraphs IE177 – IE202 of IPSAS 41. These examples demonstrate different valuation techniques for valuing unquoted equity instruments.
- The IPSASB is planning to pick up IFRS 13 virtually unchanged. There does not appear to be any specific discussion of unquoted equity instruments in IFRS 13, but the IASB has published additional education material which explains how commonly used valuation techniques can be applied to unquoted equity instruments. The guidance is entitled [*Illustrative examples to accompany IFRS 13 Fair Value Measurement – Unquoted equity instruments within the scope of IFRS 9 Financial Instruments*](#) (issued December 2012, updated February 2013). However, this guidance is about applying IFRS 13 requirements to unquoted shares, not what to do if you disagree with the outcome.

Draft response

First attempt – feedback welcome

We generally agree with aligning the measurement of fair value when required by IPSAS with the requirements in IFRS 13. We have some concerns about the impact of the proposed changes on financial instruments that are unquoted equity instruments.

Some public sector entities currently measure the fair value of unquoted equity instruments such as equity contributions to other public sector entities based on the net asset value of the entity concerned. In the absence of observable transactions this is a pragmatic approach which gives reasonable information. We are concerned that the changes from fair value as per IPSAS 41 to fair value as per IFRS 13/ED 77 will lead to the impairment of such investments.

We recommend that the IPSASB include explicit guidance on measuring the fair value of unquoted equity instruments. This could involve reviewing the existing Illustrative Examples 24–29 in IPSAS 41, to check that they are consistent with the updated fair value requirements in ED 77.

ED 77 SMC 10—Appendix D (paragraphs D1–D48): Cost of fulfillment

Not seeking feedback at this meeting. Feedback will be sought at a future meeting.

SMC 10: In response to constituents’ comment letters on the Consultation Paper, *Measurement*, guidance on cost of fulfillment has been aligned with existing principles in the Conceptual Framework and throughout IPSAS (Appendix D: Cost of Fulfillment).

Do you agree the guidance is appropriate for application by public sector entities? If not, please provide your reasons, stating what guidance should be added or removed, and why.

- The Board agreed to comment on this SMC.
- Feedback on the proposed response will be sought at a future meeting.
- Propose to generally agree with the proposal, and to note the comments we made on the CP and outline our views on how these have been addressed.

ED 77 SMC 11: Disclosure – Located in individual IPSASs

Not seeking feedback at this meeting. Feedback will be sought at a future meeting.

SMC 11: Do you agree measurement disclosure requirements should be included in the IPSAS to which the asset or liability pertains and not in ED 77?

If not, please provide your reasons, stating clearly where the measurement disclosure requirements should be included, and why.

- The Board agreed to comment on this SMC.
- Feedback on the proposed response will be sought at a future meeting.
- Propose to generally agree.

ED 77 SMC 12: Disclosure – Any that should be located in ED 77?

The Board has agreed not to comment on this SMC.

SMC 12: Are there any measurement disclosure requirements that apply across IPSAS that should be included in ED 77, *Measurement*?

If yes, please provide your reasons, stating clearly what the disclosures are, and why.

We have not commented on this SMC.

ED 77 SMC 13: Disclosure – Consistency across standards

Not seeking feedback at this meeting. Feedback will be sought at a future meeting.

SMC 13: Do you agree current value model disclosure requirements should be applied consistently across IPSAS? For example, the same disclosure requirements should apply to inventory and property, plant, and equipment when measured at fair value.

If not, please provide your reasons, stating clearly which IPSAS require more or fewer measurement disclosures, and why.

- The Board agreed to comment on this SMC.
- Feedback on the proposed response will be sought at a future meeting.
- Propose to generally agree, but note that it may cause confusion in some standards (such as IPSAS 12 *Inventories*, which would include detailed fair value disclosure requirements that would apply to only a few types of inventories)

ED 77 SMC 14: Disclosure – Level of detail for recurring versus non-recurring

Not seeking feedback at this meeting. Feedback will be sought at a future meeting.

SMC 14: Do you agree with the proposal [that] disclosure requirements for items remeasured under the current value model at each reporting date should be more detailed as compared to disclosure requirements for items measured using the current value model at acquisition as proposed in Appendix E: Amendments to Other IPSAS.

If not, please provide your reasons, stating clearly why disclosure requirements should be consistent for recurring items and non-recurring items measured using the current value model.

- The Board agreed to comment on this SMC.
- Feedback on the proposed response will be sought at a future meeting.
- Propose to agree with the proposal – we will seek Board feedback at a future meeting.
- Check against existing disclosure requirements when fair value is used as deemed cost.

ED 77 SMC 15: Disclosure – Inputs to fair value hierarchy

Not seeking feedback at this meeting. Feedback will be sought at a future meeting.

SMC 15: Do you agree fair value disclosure requirements should include requirements to disclose inputs to the fair value hierarchy?

If not, please provide your reasons, stating clearly why disclosure [of] requirements for inputs in the fair value hierarchy are unnecessary.

- The Board agreed to comment on this SMC.
- Feedback on the proposed response will be sought at a future meeting.
- Propose to cover the following in the response.
 - Requiring disclosures about Level 3 inputs could impose considerable costs on PBEs.
 - Consider proposed disclosure requirements for COV as well in this response.
 - The IASB recently issued the ED *Disclosure Requirements in IFRS Standards – A Pilot Approach*. The ED proposes that disclosure requirements in IFRS Standards should focus on *disclosure objectives*, which would be aligned with users' information needs and which would need to be complied with in order to comply with the relevant standard. The proposed overall disclosure objective for IFRS 13 is to provide information that “enables users of financial statements to evaluate the entity’s *exposure to uncertainties associated with fair value measurements*”. In relation to IFRS 13, the Basis for Conclusions of that ED notes the IASB’s conclusion IASB’s conclusion that “detailed information about some Level 2 fair value measurements would be relevant to users of financial statements”, and “detailed information about Level 3 fair value measurements is only relevant to users if those measurements are material”. This could be a useful consideration in commenting to the IPSASB on the proposed fair value disclosures.

APPENDIX C: Responses on ED 78 *Property, Plant and Equipment***ED 78 SMC 1: Relocation and restructuring**

Not seeking feedback at this meeting. Feedback will be sought at a future meeting. No change since the May meeting.

SMC 1: [Draft] IPSAS [X] (ED 78), *Property, Plant, and Equipment* proposes improvements to the existing requirements in IPSAS 17, *Property, Plant, and Equipment* by relocating generic measurement guidance to [draft] IPSAS [X] (ED 77), *Measurement*; relocating guidance that supports the core principles in this Exposure Draft to the application guidance; and adding guidance for accounting for heritage assets and infrastructure assets that are within the scope of the Exposure Draft.

Do you agree with the proposed restructuring of IPSAS 17 within [draft] IPSAS [X] (ED 78)? If not, what changes do you consider to be necessary and why?

- The Board agreed to comment
- We will compare the current and proposed structure of IPSAS 17.
- A final decision on whether to comment on this SMC can be made towards the end of the process when we consider feedback (if any) from constituents.

ED 78 SMC 2—(paragraphs 29-30): Current value model – accounting policy choice

We propose to incorporate TRG feedback in the draft comments. We are seeking Board feedback on whether it agrees all the TRG comments should be incorporated in the response.

SMC 2: Do you agree that when an entity chooses the current value model as its accounting policy for a class of property, plant, and equipment, it should have the option of measuring that class of assets either at current operational value or fair value?

If not, please provide your reasons, stating clearly which current value measurement basis would best address the needs of the users of the financial information, and why.

Background information

- The Board has agreed to comment on this SMC.
- Seek Board views on whether the proposal in ED 78 that COV be *generally* used for assets held for operational capacity is sufficient to guide accounting policy choice.
- Using COV for assets held for operational capacity makes sense in a number of situations.
- However, the EDs mean that some assets such as office buildings which are capable of fair value measurement would need to be measured at COV – and the two bases have different perspectives. Will this lead to similar assets being measured differently?

TRG feedback (May 2021) on the following questions follow

- How will you decide which assets are held for operational capacity?
 - Will some assets (such as land and buildings) be held for both purposes?
 - Does it make sense to require a choice between the two bases for assets (such as office buildings) where the value to the entity and the value to others is likely to be the same?
- In some cases, determining whether an asset is held for its financial or operational capacity would not be a clear-cut decision and would require judgement. The proposed guidance would not be sufficient in such cases. There is a lot of leeway in the guidance as currently drafted. Furthermore, some aspects of the guidance are not clear. For example, it is unclear what would constitute a ‘financial return’. *[Note: At the NZASB May meeting, it was also noted that for assets that are held for both their operating capacity and their financial capacity, it may be difficult to decide under the current proposals whether the asset should be measured at fair value or COV].*
 - Is it appropriate to have two current value measurement bases (i.e. fair value and COV) for ‘standard’ items of property, plant and equipment, such as non-specialised buildings?
 - Some aspects of the proposed guidance appear similar to existing requirements in IPSAS 21 *Impairment of Non-Cash-Generating Assets* and IPSAS 26 *Impairment of Cash-Generating Assets* (which the ED does not change) – but they are not quite the same, which could lead to confusion. For example, the proposed distinction between assets held for their financial capacity and those held for their operational capacity is similar to, but not the same as, the existing distinction between ‘cash generating assets’ and ‘non-cash generating assets’. Furthermore, it is unclear whether the term ‘financial return’ in the proposed guidance means the same as ‘commercial return’ in IPSAS 21 and IPSAS 26.
 - For assets held for their operational capacity, fair value measurement could still be useful, because fair value would reflect the opportunity cost of not using the asset for its ‘highest and best use’. COV would not provide this information.
 - As an entity-specific measurement basis, COV could be subjective and difficult to audit.
 - It would be useful if the proposals clarified the ‘unit of account’ when assessing whether an asset is held for its financial or operational capacity – i.e. whether that assessment is to be made for the entire asset or for portions of the asset. *[Note: The ‘unit of account’ for the purpose of assessing whether an asset should be measured at COV or at fair value was also discussed at the NZASB May meeting; however, that discussion focused on whether the unit of account is the asset or a class of assets].*
 - Some not-for-profit (NFP) PBEs have limited resources and limited financial expertise. They may struggle to understand what is involved in moving from the existing fair value requirements to COV. They would rely on their valuers and their auditors to help them comply with the COV requirements.

Draft response

Yet to draft

ED 78 SMC 3—(paragraph AG3): Characteristics of heritage assets

The Board has agreed not to comment on this SMC.

SMC 3: Are there any additional characteristics of heritage assets (other than those noted in paragraph AG3) that present complexities when applying the principles of [draft] IPSAS [X] (ED 78) in practice?

Please provide your reasons, stating clearly what further characteristics present complexities when accounting for heritage assets, and why.

- The Board agreed not to comment

ED 78 SMC 4—(paragraph AG5): Characteristics of infrastructure assets

Seeking feedback – depends on Board’s views on ED 76 SMC 1.

SMC 4: Are there any additional characteristics of infrastructure assets (other than those noted in paragraph AG5) that present complexities when applying the principles of [draft] IPSAS [X] (ED 78) in practice?

Please provide your reasons, stating clearly what further characteristics present complexities when accounting for infrastructure assets, and why.

Background information

We previously proposed not to comment on this SMC. However, if the Board agrees to include comments about depreciation/amortisation and impairment in ED 76 SMC 1, then we may need to reiterate or note those comments here.

Draft response

Please see our comments on ED 76 SMC 1.

ED 78 SMC 5—(paragraphs 80-81 and AG44-AG45): Disclosure of unrecognised heritage items

Not seeking feedback at this meeting. Feedback will be sought at a future meeting. No change to this SMC since the May meeting

SMC 5: This Exposure Draft proposes to require disclosures in respect of heritage property, plant, and equipment that is not recognized in the financial statements because, at initial measurement, its cost or current value cannot be measured reliably.

Do you agree that such disclosure should be limited to heritage items?

If not, please provide your reasons, stating clearly the most appropriate scope for the disclosure, and why.

- The Board agreed to comment

- Propose to support the proposed disclosure of unrecognised heritage items. There is already such a requirement in PBE IPSAS 17 (see below).

Extract from PBE IPSAS 17

94.1 An entity shall disclose:

- (a) A description of the heritage assets held by the entity that have not been recognised in the financial statements, including the significance and nature of such assets; and
- (b) Where current information is available, an estimate of the value of those unrecognised assets, such as a recent insurance value.

Extract from ED 78

Disclosure of Unrecognized Heritage Property, Plant, and Equipment

80. Where heritage property, plant, and equipment—or class of heritage property, plant, and equipment—is not recognized in the financial statements because, at initial measurement, its cost or current value cannot be measured reliably, the entity shall disclose:
 - (a) The difficulties in obtaining a reliable measurement that prevented recognition; and
 - (b) The significance of the unrecognized asset(s) in relation to delivery of the entity's objectives.
81. Where subsequent expenditures on unrecognized heritage property, plant, and equipment are recognized, the disclosure requirements in paragraphs 72–79 will apply.

ED 78 SMC 6: IG for heritage assets

Not seeking feedback at this meeting. Feedback will be sought at a future meeting. No change to this SMC since the May meeting

SMC 6: Do you agree with the Implementation Guidance developed as part of this Exposure Draft for heritage assets?

If not, please provide your reasons, stating clearly what changes to the Implementation Guidance on heritage assets are required, and why.

The Board agreed to comment on this SMC.

Propose to comment on the following:

- Disagree with SMC and point out that some issues raised by constituents have not been addressed.
- Authoritative versus non-authoritative guidance: The ED contains Implementation Guidance (IG) on Heritage which is non-authoritative. The Board could request the Heritage guidance be instead included as Application Guidance which is authoritative.
- Determination of control of assets (IG6 and IG7): Determination of control is based on indicators, including the timing specified in the agreement. Under IG6 a right to hold heritage items for a defined period under an agreement is assessed as not giving rise to control. Whereas under IG7 a right to hold heritage items for an indefinite period with no legal ownership is assessed as giving rise to control. This implementation guidance could lead to

museums tailoring their agreements to result in whether or not they wish to recognise heritage assets. This practice would not improve comparability across the museum sector.

- Terminology: The Board could note in its submission that it approves of the use of terminology “parties” which includes indigenous groups such as iwi and individuals. Previously it included an entity term.

Do *not* propose to comment on the following:

- Guardianship: The ED does not deal with guardianship. The NZASB has previously suggested that “guardianship” be added as an indicator of control. Staff suggest the Board considers a possible domestic project to provide guidance on guardianship. This would help entities reporting on Māori heritage items.

ED 78 SMC 7: IG for infrastructure assets

We are seeking feedback on this draft response.

SMC 7: Do you agree with the Implementation Guidance developed as part of this Exposure Draft for infrastructure assets?

If not, please provide your reasons, stating clearly what changes to the Implementation Guidance on infrastructure assets are required, and why.

Background information

- The Board has agreed to comment.
- We have suggested that we disagree with the SMC as some issues raised by constituents during the infrastructure and measurement projects have not been addressed.
- We have drafted comments on the following:
 - Costs relating to road infrastructure
 - Valuation of land under or beside infrastructure assets (e.g. land under roads); and
 - Additional guidance on directly attributable costs

Draft response

Costs relating to road infrastructure

For road infrastructure (e.g. state highways) there is no guidance in IPSAS as to how certain costs (e.g. formation costs, brownfield costs etc) should be treated for subsequent valuation purposes. We discuss these two examples below.

Formation is effectively measuring the cost of the earthworks and what has been removed to allow the roading construction to take place. These costs are usually not incurred again and usually treated as a separate component within the roading valuation. There is currently no guidance as to how formation costs should be estimated across an entire network as it is not practicable to

determine this component for each metre of the road and there can be knowledge issues about the pre-existing condition of land prior to construction.

Significant costs can be incurred in constructing a road due to the location of the road being in an already developed area. For example, if a new road is being built in an urban area, this may require the roading authority to purchase and demolish/relocate houses, require compensation payments, and incur significant traffic management/security costs. These are often referred to as brownfield costs. Some of these could be one-off costs that would not be incurred again when the road is replaced, whereas others would be. As with formation costs there can be challenges in reflecting these costs in the valuation, particularly for historical costs. We think it would be useful if the IPSASB developed application guidance regarding these costs.

Land beside and under roads

Some entities in the public sector value land that is under or beside infrastructure assets, such as road and railway corridor land. There is no consensus as to the approach to the valuation of such land. Our understanding is that valuers generally establish a proxy for corridor land based on “across the fence” values. However, there are differing views as to how the across the fence values should then be adjusted for the purposes of establishing the value of the corridor. We begin by noting discussions about this issue under current standards, and then consider the proposals in the EDs.

Arguments for a discount are primarily based on the fact that across the fence values would be unlikely to be realised if the land were to be sold because there would be limited buyers (likely only neighbouring owners). The purchaser's assessment of the added value of securing the strip would also often be lower than the across the fence values. Accordingly, based on an 'exit' price, the infrastructure asset land owner would likely realise less than the across the fence value. This exit price notion would generally suggest some form of discount to the across the fence value. There is also the question of whether the cost of removing assets on the land (e.g. the physical road or rail tracks) and remediating the land should be factored into the valuation as a cost of conversion to the adjacent use.

An alternative approach would be to consider the value of the corridor in terms of 'entry' price. The across the fence value would often represent the starting value, and there could be other development costs and enhanced value to reflect the corridor land “construction” (such as formation costs). Under this entry price approach, the corridor value would likely be greater than the across the fence value.

Current practice in New Zealand varies across different types of corridor land, with some corridor land having a small discount applied and other corridor land being measured with no discount to across the fence values.

We have considered what the proposals in the EDs would mean for such corridor land. If corridor land is subsequently measured using COV, a discount would be permitted only if there is a legal restriction on the land and there is an equivalent restricted asset available as a comparison.

Additional guidance on directly attributable costs

We note that certain directly attributable costs are set out in ED 78 paragraphs 16(a)–(f). However, we think the application guidance could have a fuller description of other directly attributable costs. For example, the previous New Zealand accounting standard FRS 3 *Accounting for Property, Plant and Equipment* contained useful guidance about other types of directly attributable costs in paragraph 5.6 as follows:

“... Examples of directly attributable costs are borrowing costs, survey costs, the cost of obtaining resource consents, site preparation costs including land formation costs, installation costs including architectural and engineering fees, freight, and charges for installation, commissioning and testing...”

APPENDIX D: Responses on ED 79 *Accounting for Non-current Assets Held for Sale and Discontinued Operations*

ED 79 SMC: Additional disclosure

We are seeking feedback on this draft response.

SMC: The IPSASB decided that there was no public sector specific reason to depart from the measurement requirements of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. However, the IPSASB considers that, where materially different, disclosures of the fair value of non-current assets classified as held for sale measured at a lower carrying amount would provide useful information to users of financial statements for accountability purposes.

The additional proposed disclosure is shown at paragraph 52 of this ED.

Do you agree with this disclosure proposal? If not, why not?

Background information

- We have prefaced the comments on this SMC with a general statement of support for developing a standard based on IFRS 5. **Other comments on ED 79** are set out under a separate subheading.
- At the May meeting we indicated that we planned to support the proposed additional disclosure in paragraph 52 (shown below). However, after thinking about the assessments that the disclosure would require and the costs of obtaining additional information we propose to disagree with the proposed additional disclosure.

Extracts from ED 79

52. An entity shall disclose in the notes, the fair value of the non-current asset (or disposal group) classified as held for sale when that non-current asset (or disposal group) is measured at a materially lower carrying amount than fair value.

Disclosure

BC12. The IPSASB decided that in the public sector transparency and accountability are important when an entity decides to sell non-current assets. Therefore, when an asset is classified as held for sale and measured at a carrying amount that is materially lower than fair value, disclosure of the asset's fair value in the notes to the financial statements provides users with information relevant for holding the entity accountable. The IPSASB also noted that this was consistent with advice from members of the IPSASB Consultative Advisory Group that information which allows users to hold the entity accountable for decisions regarding sales of non-current assets is in the public interest.

TRG feedback (May 2021)

- When an entity classifies an asset as held for sale, management should have an idea of approximately how much the entity could receive for selling the asset. In this respect, the requirements should not be onerous. [We have acknowledged this point in the draft response but note information held by management may not be sufficient to support disclosure/non-disclosure].

- However, some PBEs may be reluctant to disclose this fair value information, as it may be commercially sensitive.

Still to do

- Collate any feedback on the proposed additional disclosure in paragraph 52 (feasibility, costs and benefits).

Draft response

New Zealand context

We support the IPSASB developing an IPSAS based on IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. When the IASB decided to develop IFRS 5, it concluded that introducing a classification of assets that are held for sale would substantially improve the information available to users of financial statements about assets to be sold. We have had an equivalent requirements for PBEs in New Zealand since 2004 (with the current standard being PBE IFRS 5). Although there can be some implementation challenges, on the whole we consider that it leads to appropriate measurement and disclosure of non-current assets held for sale and discontinued operations.

Disclosure proposal in paragraph 52

We do not support the proposed disclosure in paragraph 52.

We acknowledge the intention behind the proposed disclosure, as outlined in paragraph BC12. We agree that users would find information about expected inflows useful, particularly if there is a large gap between fair value and carrying amount. We also acknowledge that it would be good practice for an entity proposing to sell assets to obtain information about how much it expects to realise from the sale.

However, we think that the costs of (i) obtaining a fair value and (ii) including that information in an audited set of financial statements would outweigh the benefits to users. We make these comments as a jurisdiction where many public sector entities revalue land and buildings and where depreciated replacement cost is often used to estimate the fair value of infrastructure and specialised assets.

An entity deciding not to make the proposed disclosure on the grounds that it does not think the fair value is materially different to the carrying amount would need to gather sufficient evidence to support its view. Revaluations are generally performed on a rolling three year basis, so an entity will not necessarily have current information available at the end of each year. Specialised items of property, plant and equipment are often revalued using depreciated replacement cost (ie a cost approach) and there may be no other means of obtaining a fair value. If, in the future, assets are measured at current operational value this would not be the same as fair value. In all of these cases additional valuations would be required either for an entity to demonstrate that it did not have to make the proposed disclosure, or to make the disclosure.

The proposed disclosure assumes that there will be cases where fair value is materially more than carrying amount. We note that the gap between fair value and carrying value should be constrained by the measurement requirements for property, plant and equipment. IPSAS 17 requires an entity to review the useful life and residual value of an asset at each annual reporting

date. If fair value is higher than the carrying amount, it is likely that the residual value should be revised upwards. An upwards revision of the residual value would lead to lower depreciation.

We have also thought about the costs and benefits of the proposed disclosure for jurisdictions where the cost model is more commonly used for land and buildings. Under IPSAS 17 (and ED 79.79(d)) entities applying the cost model are encouraged, but not required, to disclose current values when this is materially different from the carrying amount. The proposal in ED 79 would make this disclosure mandatory in respect of assets held for sale. These entities may have larger gaps between the fair value and carrying amounts of assets. The requirements to regularly review the residual value of an asset might reduce the amount of depreciation recognised, but they will not lift the carrying value above the original cost. These entities are less likely to have fair value information available than entities that regularly revalue assets. If they have specialised assets the costs of obtaining valuations could be significant.

Other comments on ED 79

We are seeking feedback on the proposed comments to the IPSASB.

Background information

- We have compared ED 79 to PBE IFRS 5.
 - The recognition and measurement requirements in the two are almost identical. We agree with most of the proposed text in ED 79 and expect that we would align the requirements in PBE IFRS 5 with the resulting IPSAS.
 - There are additional disclosures in ED 79.
 - We have also compared ED 79's proposed amendments to other standards to the equivalent parts of PBE Standards and IFRS Standards. We agree with most of the proposed amendments. There are a few things that we want to bring to the Board's attention, a few that we propose to comment on and a few where we want to do some more work.
- *Initial TRG thoughts (May 2021)*
 - Under PBE IFRS 5 and the proposed ED 79, questions can arise as to whether, when a NFP PBE plans to distribute assets for no consideration to a similar NFP entity, the assets' fair value less costs to sell should be nil.
 - When a public sector PBE transfers an asset to another public sector PBE, the current definition of fair value (less cost to sell) in PBE IFRS 5 seems to work, but the proposed definition as per IFRS 13 could cause issues. The member who raised this point thought the definition of fair value should be broader than what is proposed.
 - Do the proposals make sense for transfers of infrastructure assets within the public sector? Assets could go from COV to 'fair value less costs to sell', and then back to COV once transferred. This has been a bit of an issue under current PBE Standards but the current definition of fair value has meant that it has not been a major problem. Fair value is likely to be less than COV for infrastructure assets.

- Differences for the Board to note – we do not plan to comment on these differences unless we receive feedback to the contrary.
 - ED 79 proposes to require *all the IFRS 13 fair value disclosures*. These are not currently required by PBE IFRS 5 as IFRS 13 does not form part of PBE Standards. We have taken the view that picking up IFRS 13 implies picking up the IFRS 13 disclosures but are open to feedback from the Board.
 - ED 79 paragraphs 13 and 19 uses ‘owners’. PBE IFRS 5, paragraphs 5A and 8, uses ‘shareholders’.
 - ED 79 paragraph 40, which is consistent with IFRS 5, says “A component of an entity comprises **operations and cash flows** that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.” PBE IFRS 5 paragraph 31 says “**operations or cash flows**”.
- Matters that we plan to comment on in relation to the ED itself:

[see draft comments to the IPSASB below]

 - Discuss whether the proposals make sense for transfers of infrastructure assets within public sector. [Based on TRG feedback]
 - Propose to clarify, via illustrative examples, that discontinued operations can be presented on the face of the financial statements (not just in the notes).
- Matters that we plan to comment on in relation to the amendments to other standards:

[see draft comments to the IPSASB below]

 - IPSAS 1 *Presentation of Financial Statements* paragraph 88. The amendment will align IPSAS 1.88 with IAS 1.54 (j) and (k) but it is putting new asset and liability disclosures at the end of the paragraph instead of locating the new asset disclosure with the other asset disclosures and ditto for the liability disclosures. We suggest that the IPSASB presents the list in the same order as IAS 1.
 - IPSAS 14 *Events after the Balance Date* paragraph 31. We think some of the text in 31(d) could be deleted on the grounds that it is now covered by the new wording in (d).
 - IPSAS 14 paragraph 16: The IPSASB should amend paragraph 16 to align with changes introduced by IFRIC 17 *Distributions of Non-cash Assets to Owners*.

Still to do

- Matters where we need to do more work to form a view:
 - Impairment: Consider whether we agree with the IPSASB’s decision to refer to IPSAS 21 and IPSAS 26 in ED 79 paragraph 30(b). PBE IFRS 5 paragraph 22(b) refers only to PBE IPSAS 26.
 - PBE IPSAS 16 *Investment Property* paragraph 13(a) – PBE IPSAS 16 says surplus housing stock held for sale is a non-current asset but IPSAS 16 says it is inventory. Do we recommend that the IPSASB changes IPSAS 16 to say it is a non-current asset?
- Collate any feedback regarding IFRS 5 implementation issues that constituents think we should raise with the IPSASB.

Draft response*Transfers of infrastructure assets*

ED 79 could have a significant impact on the measurement of infrastructure assets to be transferred between entities within the public sector. Infrastructure assets could go from being measured using COV to 'fair value less costs to sell', and then back to COV once transferred. The fair value less costs to sell of infrastructure assets is likely to be less than their COV because fair value is an exit, market-based measurement that reflects the perspective of market participants.

Although public sector entities in New Zealand have been using a standard based on IFRS 5 for many years, this standard included the pre-IFRS 13 definition of fair value. We anticipate that the fair value less costs to sell of infrastructure assets under ED 79 would be less than the fair value less costs to sell under PBE IFRS 5.

Presentation of revenue and expenses on the face of the financial statements

The ED allows entities to disclose the net profit for the discontinued operation, with information on revenue and expenses in the notes. In the public sector the net surplus/deficit for a discontinued operation can be close to zero, despite there being significant gross revenue and expenses. In order to be transparent and ensure that important information is not lost in the notes, some entities in New Zealand have disclosed the revenues and expenses relating to discontinued operations on the face of the statement of financial performance.

We suggest that the illustrative examples be expanded to show how a discontinued operation could be presented on the face of the statement of financial performance.

Note for Board:

An actual example of presentation on the face of the statements is shown below – should we include a generic example along these lines in the comment letter?

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2014

Actual		Notes	Continuing Activities Actual	Discontinued Activities Actual (refer Note 26)	Total Actual	Main Estimates	Supplementary Estimates	Unaudited Forecast ^
2013 \$000			2014 \$000	2014 \$000	2014 \$000	2014 \$000	2014 \$000	2015 \$000
INCOME								
310,938	Crown		275,915	31,537	307,452	338,223	307,452	269,510
3,826	Department		2,709	–	2,709	3,876	4,185	3,001
262,684	Other revenue	2	296,511	1,220	297,731	265,022	270,808	296,144
61	Finance income		89	–	89	335	–	–
577,509	Total income		575,224	32,757	607,981	607,456	582,445	568,655
EXPENDITURE								
304,345	Personnel costs	3	288,760	17,349	306,109	284,558	307,109	301,550
27,802	Depreciation and amortisation	10 11	29,104	785	29,889	39,094	26,098	30,612
11,595	Capital charge	4	11,787	234	12,021	15,887	12,600	14,248
201	Finance costs	5	356	–	356	–	–	–
7,381	Restructuring costs		65	71	136	–	–	–
(302)	(Gains)/losses	6	1,907	–	1,907	–	–	–
208,118	Other operating expenses	7	216,116	12,942	229,058	266,755	241,702	219,180
559,140	Total expenditure		548,095	31,381	579,476	606,294	587,509	565,590
18,369	Net surplus/ (deficit)		27,129	1,376	28,505	1,162	(5,064)	3,065
–	Other comprehensive income		–	–	–	–	–	–
18,369	Total comprehensive income		27,129	1,376	28,505	1,162	(5,064)	3,065

For information on discontinued activities refer to Note 26.

Amendments to IPSAS 1

The proposed amendment to IPSAS 1 *Presentation of Financial Statements* paragraph 88 will align the disclosures required by IPSAS 1 with those required by IAS 1 paragraph 54 (j) and (k) but it would result in the new asset and liability disclosures being located at the end of the paragraph. We think that it would be easier for constituents if the IPSASB located the new asset disclosure immediately following the other asset disclosures and the new liability disclosure immediately following the other liability disclosures.

Amendments to IPSAS 14

We recommend that the IPSASB amend IPSAS 14 *Events after the Reporting Date* paragraph 16 to align with IAS 10 *Events after the Reporting Period* paragraph 13. IAS 10.13 was amended by IFRIC 17 *Distributions of Non-cash Assets to Owners* (2008). The proposed amendment is shown below. We note that the IPSASB is proposing to pick up the other changes to standards made by IFRIC 17 so it would be consistent to pick up this amendment as well.

Dividends or Similar Distributions

..

16. If dividends or similar distributions to owners are declared (~~i.e., the dividends or similar distributions are appropriately authorised and no longer at the discretion of the entity~~) after the reporting date but before the financial statements are authorised for issue, the dividends or similar

distributions are not recognised as a liability at the reporting date because no obligation exists at that time. Such dividends or similar distributions are disclosed in the notes in accordance with IPSAS 1 *Presentation of Financial Statements*. Dividends and similar distributions do not include a return of capital.

We think some of the text in IPSAS 14 paragraph 31(d) could be deleted on the grounds that it is now covered by the proposed new wording in 31(e). The extra examples in IPSAS 14 paragraph 31(d) compared to IAS 10 paragraph 22 would have been useful for constituents in the absence of the IFRS 5 wording. We think the proposed changes to paragraph 31(e) would lead to some duplication (see shaded text).

31 The following are examples of non-adjusting events after the reporting date that would generally result in disclosure:

...

(d) Announcing a plan to discontinue an operation or major program, disposing of assets, or settling liabilities attributable to a discontinued operation or major program, or entering into binding agreements to sell such assets or settle such liabilities;

(e) Major purchases ~~and disposals~~ of assets, classification of assets as held for sale in accordance with [draft] IPSAS X (ED 79), *Non-current Assets Held for Sale and Discontinued Operations*, other disposals of assets, or expropriation of major assets by other public sector entities;



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 11 June 2021

To: NZASB Members

From: Nicola Hankinson

Subject: *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*

Recommendations¹

1. We recommend that the Board:
 - (a) APPROVES for issue *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*, which amends NZ IAS 12 *Income Taxes* (NZ IAS 12); 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.

Introduction

2. On 7 May 2021, the IASB published the final pronouncement *Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)*.
3. The purpose of the amendments is to narrow the scope of the recognition exemption of NZ IAS 12 so that it would not apply to transactions that give rise to equal and offsetting temporary differences (such as right-of-use assets and lease liabilities).
4. In accordance with the Accounting Standards Framework, the XRB Board is committed to adopting international standards in the for-profit sector and ensuring that Tier 1 for-profit entities in New Zealand can assert compliance with IFRS. This means that the Board will seek to adopt all IFRS Standards (including amendments) into our For-Profit Standards as soon as possible after an IASB final pronouncement is issued.

Due process

5. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2019/5 and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB meeting in October 2020.²

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 An update on the IASB meeting in October 2020 is available at:
<https://www.ifrs.org/news-and-events/updates/iasb/2020/iasb-and-joint-iasb-fasb-update-november-2020/#5>

6. The IASB ED *Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Proposed amendments to IAS 12)* was exposed for comment in New Zealand, with no New Zealand submissions made to the Board or directly to the IASB. The Board decided not to comment.
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.

RDR concessions and consistency with Australian Accounting Standards

9. We do not propose any RDR concessions in respect of the disclosure requirements as the amending standard does not create any new disclosure requirements.
10. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard at their next meeting. Therefore, the Tier 1 for-profit reporting requirements will continue to be aligned with those in Australia.

Effective date

11. The amending standard will be applicable for annual reporting periods beginning on or after 1 January 2023 with early application permitted, in line with the effective date established by the IASB.

Draft amending standard and signing memorandum

12. Attached as agenda item 10.2 is the draft for-profit amending standard *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*. A paragraph has been added to limit the application of the amending standard to Tier 1 and Tier 2 for-profit entities only.
13. Attached as agenda item 10.3 is a draft signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

Attachments

- Agenda item 10.2: Draft *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*
- Agenda item 10.3: Draft signing memorandum
- Agenda item 10.4: Application of PBE Policy Approach
- Agenda item 10.5: PBE Policy Approach

DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE
TRANSACTION



Deferred Tax related to Assets and Liabilities arising from a Single Transaction

Issued June 2021

This Standard was issued on 1 July 2021 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 29 July 2021.

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 to IAS 12 *Income Taxes* issued by the International Accounting Standards Board. The amendments to NZ IAS 12 *Income Taxes* narrow the scope of the recognition exemption in paragraphs 15 and 24 of NZ IAS 12 so that it would not apply to transactions that give rise to equal and offsetting temporary differences.

DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE TRANSACTION

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DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE TRANSACTION

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

APPROVAL BY THE IASB OF *DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE TRANSACTION* ISSUED IN MAY 2021

AMENDMENT TO ILLUSTRATIVE EXAMPLES ACCOMPANING IAS 12 *INCOME TAXES*

AMENDMENT TO THE IASB BASIS FOR CONCLUSIONS ON IAS 12 *INCOME TAXES*

DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE
TRANSACTION

Part A – Introduction

This Standard narrows the scope of the recognition exemption in paragraphs 15 and 24 of NZ IAS 12 so that it would not apply to transactions that give rise to equal and offsetting temporary differences. 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

Amendments to NZ IAS 12 *Income Taxes*

Paragraphs 15, 22 and 24 are amended. Paragraphs 22A and 98J–98L are added. Deleted text is struck through and new text is underlined.

Recognition of deferred tax liabilities and deferred tax assets

Taxable temporary differences

- 15 A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:
- (a) the initial recognition of goodwill; or
 - (b) the initial recognition of an asset or liability in a transaction which:
 - (i) is not a business combination; ~~and~~
 - (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); ~~and,~~
 - (iii) at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

...

Initial recognition of an asset or liability

- 22 A temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The method of accounting for such a temporary difference depends on the nature of the transaction that led to the initial recognition of the asset or liability:
- (a) in a business combination, an entity recognises any deferred tax liability or asset and this affects the amount of goodwill or bargain purchase gain it recognises (see paragraph 19);
 - (b) if the transaction affects either accounting profit or taxable profit, or gives rise to equal taxable and deductible temporary differences, an entity recognises any deferred tax liability or asset and recognises the resulting deferred tax expense or income in profit or loss (see paragraph 59);

DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE TRANSACTION

- (c) if the transaction is not a business combination, ~~and~~ affects neither accounting profit nor taxable profit and does not give rise to equal taxable and deductible temporary differences, an entity would, in the absence of the exemption provided by paragraphs 15 and 24, recognise the resulting deferred tax liability or asset and adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent. Therefore, this Standard does not permit an entity to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently (see example below). Furthermore, an entity does not recognise subsequent changes in the unrecognised deferred tax liability or asset as the asset is depreciated.

...

22A A transaction that is not a business combination may lead to the initial recognition of an asset and a liability and, at the time of the transaction, affect neither accounting profit nor taxable profit. For example, at the commencement date of a lease, a lessee typically recognises a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction. The exemption provided by paragraphs 15 and 24 does not apply to such temporary differences and an entity recognises any resulting deferred tax liability and asset.

...

Deductible temporary differences

24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- (a) is not a business combination; ~~and~~
- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); ~~and~~
- (c) at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

...

Effective date

...

98J Deferred Tax related to Assets and Liabilities arising from a Single Transaction, issued in May 2021, amended paragraphs 15, 22 and 24 and added paragraph 22A. An entity shall apply these amendments in accordance with paragraphs 98K–98L for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

98K An entity shall apply *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* to transactions that occur on or after the beginning of the earliest comparative period presented.

98L An entity applying *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* shall also, at the beginning of the earliest comparative period presented:

- (a) recognise a deferred tax asset—to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised—and a deferred tax liability for all deductible and taxable temporary differences associated with:
- (i) right-of-use assets and lease liabilities; and
- (ii) decommissioning, restoration and similar liabilities and the corresponding amounts recognised as part of the cost of the related asset; and
- (b) 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 that date.

DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE TRANSACTION

Amendments to NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards*

Paragraph 39AH is added. In Appendix B, paragraph B1 is amended and paragraph B14 and its heading are added. Deleted text is struck through and new text is underlined.

Effective date

...

39AH *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*, issued in May 2021, amended paragraph B1 and added paragraph B14. An entity shall apply these amendments for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

...

Exceptions to the retrospective application of other NZ IFRSs

This appendix is an integral part of the IFRS.

B1 An entity shall apply the following exceptions:

...

- (g) government loans (paragraphs B10–B12); ~~and~~
- (h) insurance contracts (paragraph B13); ~~and~~
- (i) deferred tax related to leases and decommissioning, restoration and similar liabilities (paragraph B14).

...

Deferred tax related to leases and decommissioning, restoration and similar liabilities

B14 Paragraphs 15 and 24 of NZ IAS 12 *Income Taxes* exempt an entity from recognising a deferred tax asset or liability in particular circumstances. Despite this exemption, at the date of transition to NZ IFRSs, a first-time adopter shall recognise a deferred tax asset—to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised—and a deferred tax liability for all deductible and taxable temporary differences associated with:

- (a) right-of-use assets and lease liabilities; and
- (b) decommissioning, restoration and similar liabilities and the corresponding amounts recognised as part of the cost of the related asset.

Part D – Effective Date

This Standard shall be applied for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted, including financial statements not yet authorised for issue at 23 June 2021.



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 23 June 2021

To: Michele Embling, Chair External Reporting Board

From: Carolyn Cordery, Chair NZASB

Subject: *Deferred Tax related to Assets and Liabilities arising from a Single Transaction – amendments to IAS 12 Income Taxes*

Introduction¹

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* which amends NZ IAS 12 *Income Taxes* (NZ IAS 12).
2. The purpose of the amendments is to narrow the scope of the recognition exemption in NZ IAS 12 so that it would not apply to transactions that give rise to equal and offsetting temporary differences (such as right-of-use assets and lease liabilities arising from the application of NZ IFRS 16 *Leases*).
3. The amendments were issued in response to a recommendation from the IFRS Interpretations Committee (the Committee). Research conducted by the Committee indicated that views differed on whether the recognition exemption applied to transactions, such as leases, that lead to the recognition of an offsetting asset and liability. These differing views resulted in entities accounting for deferred tax on such transactions in different ways, reducing comparability between their financial statements. The IASB expects that the amendments will reduce diversity in financial reporting and align the accounting for deferred tax on such transactions with the general principle in IAS 12.

Due process

4. The International Accounting Standards Board (IASB) issued Exposure Draft *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* (ED/2019/5) in July 2019. Comments were due to the IASB on 14 November 2019.
5. The IASB's ED/2018/5 was exposed for comment in New Zealand, with no New Zealand submissions made to the Board or directly to the IASB. The NZASB decided not to comment. The IASB received 68 comment letters from its world-wide constituents.
6. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2019/5 and concluded that the

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).

applicable due process steps had been completed. This review of due process occurred at the IASB meeting in October 2020.²

7. The IASB issued *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* in May 2021. This amending standard is effective for annual reporting periods beginning on or after 1 January 2023 with early application permitted.
8. The NZASB has approved *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*. 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.
9. 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

10. The amending standard is a standard in its own right. The amending standard is identical to *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* issued by the IASB, except for the New Zealand specific introduction and a scope paragraph explaining that the standard applies to Tier 1 and Tier 2 for-profit entities.
11. The amending standard does not create any new disclosure requirements. Therefore, there are no changes to the RDR concessions in NZ IAS 12.
12. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard at their next meeting.
13. 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 for Tier 1 for-profit entities and is consistent with the New Zealand Accounting Standards Framework.³

Effective date

14. The amending standard will be applicable for annual reporting periods beginning on or after 1 January 2023, with early application permitted.

Other matters

15. 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.

² An update on the IASB meeting in October 2020 is available at: <https://www.ifrs.org/news-and-events/updates/iasb/2020/iasb-and-joint-iasb-fasb-update-november-2020/#5>

³ New Zealand Accounting Standards Framework updated in 2015 available at: [Accounting Standards Framework » XRB](#)

Recommendation

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

Attachments

Deferred Tax related to Assets and Liabilities arising from a Single Transaction

Certificate of determination

Carolyn Cordery
Chair NZASB



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 11 June 2021

To: NZASB Members

From: Nicola Hankinson

Subject: **PBE Policy Approach: *Deferred Tax related to Assets and Liabilities arising from a Single Transaction***

Recommendations¹

1. We recommend that the Board:
 - (a) CONSIDERS the application of the [Policy Approach to the Development of PBE Standards](#) (PBE Policy Approach) to *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*; and
 - (b) AGREES to incorporate the equivalent amendments into PBE IAS 12 *Income Taxes*.

Background

2. *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* amends IAS 12 *Income Taxes* (IAS 12). The purpose of the amendments is to reduce diversity in financial reporting and align the accounting for deferred tax on transactions that give rise to equal and offsetting temporary differences (primarily right-of-use assets and lease liabilities). There is no substantive change to the underlying principles or requirements of IAS 12.
3. The next step is to consider whether the amendments should be incorporated into PBE Standards and, if so, when. In this memo we have applied the relevant parts of the PBE Policy Approach to *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*.

PBE Policy Approach

4. The relevant triggers for considering whether to amend PBE Standards are set out in section 4 *Application of the Development Principle*. In this case, the IASB has issued amendments to an existing IAS Standard which the NZASB has included in the PBE Standards² (subsection 4.2.3). There is no equivalent IPSAS.
5. Paragraphs 36–39 of the PBE Policy Approach set out the matters to be considered. Paragraph 38 highlights the fact that the IPSASB's likely response to the change is less relevant

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² PBE IAS 12 *Income Taxes*.

where there is no equivalent IPSAS on the topic, which will impact on the overall assessment of the costs and benefits of including the amendment in the PBE Standards. Paragraph 39 notes that an implication of this policy is that PBE Standards based on an NZ IFRS may need to be updated or replaced to align with the current equivalent NZ IFRS.

6. The table below set out our thoughts on these matters.

<p>Will the IPSASB consider these issues in an acceptable timeframe?</p> <p>There is no IPSAS equivalent to IAS 12 and IPSAS staff have confirmed that they do not intend to adopt the amendments to IAS 12.</p>
<p>Are the amendments minor?</p> <p>The amendments are not extensive. They clarify the scope of the existing recognition exemption and are not considered to have a significant impact in practice.</p>
<p>Costs and benefits of getting ahead of the IPSASB</p> <p>Costs</p> <p>As noted above, in accordance with paragraph 38 of the PBE Policy Approach, the IPSASB's likely response is less relevant where there is no equivalent IPSAS on the topic.</p> <p>While resources would be required to develop and issue a domestic amending standard, the cost of doing so is not expected to be significant.</p> <p>Who would benefit?</p> <p>Tier 1 and Tier 2 PBEs would benefit from greater clarification about the need to account for deferred tax on transactions that give rise to equal and offsetting temporary differences.</p> <p>While we have not received any feedback that this is a pressing issue, issuing a domestic amending standard would result in continued alignment between NZ IAS 12 and PBE IAS 12 <i>Income Taxes</i>.</p>
<p>RDR</p> <p>There are no new disclosures and therefore no RDR concessions are proposed.</p>

Next steps

7. Staff are of the view that it is appropriate to incorporate the equivalent amendments into PBE IAS 12. If the Board agrees, staff will include the amendments in a future PBE Omnibus Amendments Exposure Draft.

<p>Question for the Board</p> <p>With respect to <i>Deferred Tax related to Assets and Liabilities arising from a Single Transaction</i>, does the Board agree to incorporate the equivalent amendments into PBE IAS 12 <i>Income Taxes</i>?</p>
