

## Board Meeting Agenda

Virtual Meeting — Thursday, 16 December 2021

Est Time	Item	Topic	Objective		Page
<b>NON-PUBLIC SESSION</b>					
<b>PUBLIC SESSION</b>					
10.55 am	<b>3</b>	<b>Amendments to IPSAS 5 Borrowing Costs</b>	(CB)		
	3.1	Application of the PBE Policy Approach	Consider	Paper	3
	3.2	IPSASB Amendments to IPSAS 5 <i>Borrowing Costs – Non-Authoritative Guidance</i>	Consider	Paper	7
11.05 am	<b>4</b>	<b>External Presentation from JBWere — insights into the charitable and broader for-purpose sector</b>			
	4.1	Presentation from Mike Morrow and John McLeod from JBWere	Note	Presentation	–
	4.2	JBWere — 2021 New Zealand Cause Report	Note	<a href="#">Link</a>	–
11.35 am	<b>5</b>	<b>Tier 3 and Tier 4 Post-Implementation Review</b>	(JC/CB)		
	5.1	Cover memo – Project update and next steps	Consider	Paper	21
	5.2	Issues paper – Tier 3 and Tier 4 minimum categories	Consider	Paper	25
12.15 pm	<b>6</b>	<b>Subsidiaries without Public Accountability: Disclosures</b>	(VSF)		
	6.1	Cover memo	Note	Paper	61
	6.2	Draft comment letter	Approve	Paper	67
	6.3	Comment letter from CPA/CA ANZ to Chair of AASB	Note	<a href="#">Link</a>	–
	6.4	IASB ED/2021/7	Note	<a href="#">Link</a>	–
	6.5	IASB ED/2021/7 Basis for Conclusions	Note	<a href="#">Link</a>	–
12.25 pm	<b>7</b>	<b>XRB A1 Definition of Public Accountability</b>	(AH)		
	7.1	Cover memo	Consider	Paper	69
<b>NON-PUBLIC SESSION</b>					

Est Time	Item	Topic	Objective		Page
<b>PUBLIC SESSION</b>					
1.45 pm	<b>9</b>	<b>Public Sector Insurance</b>	(VSF/AT)		
	9.1	Cover memo	Consider	Paper	98
	9.2	Issues paper – Interpretation issue	Consider	Paper	100
	9.3	Draft ED	Consider	Paper	109
	9.4	Draft ITC (in part)	Consider	Paper	162
2.45 pm	<b>10</b>	<b>Auditor Remuneration</b>	(JS/AH)		
	10.1	Cover memo		Paper	179
3.15 pm	<b>11</b>	<b>Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information</b>	(VSF)		
	11.1	Cover memo	Consider	Paper	212
	11.2	Draft amending standard <i>Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information</i>	Approve	Paper	217
	11.3	Draft signing memo	Approve	Paper	223
	11.4	Application of the PBE Policy Approach	Consider	Paper	227
3.25 pm	Afternoon tea break				
3.40 pm	<b>12</b>	<b>Editorial Corrections</b>	(JS)		
	12.1	Cover memo	Consider	Paper	232
	12.2	Editorial corrections to NZ IFRS	Approve	Paper	242
	12.3	Editorial corrections to PBE Standards	Approve	Paper	243
	12.4	Editorial corrections: <i>Financial Reporting (Inflation Adjustments) Regulations 2021</i>	Approve	Paper	246
<b>NON-PUBLIC SESSION</b>					
4.30 pm	<i>Finish</i>				

Next NZASB meeting: 16 February 2022 (location – TBC)

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**Date:** 3 December 2021

**To:** NZASB Members

**From:** Carly Berry

**Subject:** **PBE Policy Approach: *Amendments to IPSAS 5, Borrowing Costs – Non-Authoritative Guidance***

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### Purpose

1. This memo applies the [Policy Approach to the Development of PBE Standards](#) (the PBE Policy Approach) to *Amendments to IPSAS 5, Borrowing Costs – Non-Authoritative Guidance*, which was issued by the IPSASB in November 2021.
2. Application of the PBE Policy Approach to new IPSASB amendments are typically brought to the Board at the first meeting after the IPSASB issues the amendments.

### Recommendations

3. We recommend that the Board:
  - (a) AGREES to propose the incorporation of *Amendments to IPSAS 5, Borrowing Costs – Non-Authoritative Guidance* into PBE Standards as amendments to PBE IPSAS 5 *Borrowing Costs*; and
  - (b) AGREES to include the proposed amendments to PBE IPSAS 5 as part of the Exposure Draft (ED) for *2022 Omnibus Amendments to PBE Standards*. This ED is expected to be submitted to the Board for approval at its meeting in February 2022.

### Background

4. In April 2019, the IPSASB issued the Consultation Paper *Measurement*, which included proposals as to whether it should remove the option to capitalise borrowing costs in IPSAS 5. Feedback on this issue was split between those supporting the proposal to remove the option to capitalise borrowing costs, and those supporting retention of the option. This informed the IPSASB's decision to retain the option to allow entities an accounting policy choice that best reflects the entity's objectives.
5. Some respondents to the Consultation Paper identified practical public sector challenges in capitalising borrowing costs. Therefore, in October 2020 the IPSASB issued Exposure Draft 74 *IPSAS 5, Borrowing Costs – Non-Authoritative Guidance* (ED 74), which added Implementation Guidance and Illustrative Examples to IPSAS 5. The new material illustrates how the existing principles for when borrowing costs can be capitalised should be applied in various regularly encountered public sector contexts. No amendments were proposed to the authoritative material in IPSAS 5.

6. In November 2020 the Board NOTED the proposals in ED 74 and AGREED not to comment on the ED.<sup>1</sup>
7. *Amendments to IPSAS 5, Borrowing Costs – Non-Authoritative Guidance* was issued by the IPSASB in November 2021 (see agenda item 3.2). Apart from a few minor changes, the amendments are the same as those proposed in ED 74.
8. The next step is to consider whether *Amendments to IPSAS 5, Borrowing Costs – Non-Authoritative Guidance* should be incorporated into PBE Standards, and if so, when.

### Application of the PBE Policy Approach

9. The PBE Policy Approach contains a rebuttable presumption that a new IPSAS or changes to an existing IPSAS will be incorporated into PBE Standards (see paragraphs 23 and 24 in the table below). Paragraph 19 of the PBE Policy Approach has also been included, which sets out the ‘development principle’, i.e., the factors that the NZASB considers when deciding whether to introduce or amend a PBE Standard.

#### Extract from the PBE Policy Approach

### 3. The Development Principle

19. In accordance with the *New Zealand Accounting Standards Framework*, the primary purpose of developing the suite of PBE Standards is to better meet the needs of PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:<sup>5</sup>
  - (a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and NFP PBEs, including public sector PBE groups and NFP PBE groups, than would be the case if the development was not made; and
  - (b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:
    - (i) *relevance to the PBE sector as a whole*: for example, where the potential development arises from the issue of a new or amended IFRS Standard, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;
    - (ii) *relevance to the NFP or public sector sub-sectors*: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;
    - (iii) *coherence*: the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);
    - (iv) *the impact on mixed groups*; and
  - (c) In the case of a potential development arising from the issue of a new or amended IFRS Standard that is relevant to PBEs, the IPSASB’s likely response to the change (e.g. whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).

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<sup>1</sup> The analysis of ED 74 was included in agenda item 2.7, November 2020.

#### 4.1 New or Amended IPSAS

##### 22. There is a rebuttable presumption that the NZASB will adopt a new or amended IPSAS.

23. This rebuttable presumption is based on the expectation that the IPSASB's due process has considered the needs of the wide range of users of public sector financial statements in developing and issuing a new or amended IPSAS.<sup>6</sup> Therefore, it is presumed that a new or amended IPSAS will lead to higher quality financial reporting by PBEs in New Zealand in accordance with factors (a) and (b) of the development principle, in the absence of reasons to the contrary (refer to paragraph 25).

##### *Amending a new or amended IPSAS*

24. Depending on the circumstances, it may be appropriate to amend a recently issued new or amended IPSAS in the process of adoption in New Zealand. Examples of possible amendments include:

- (a) improving the quality of the IPSAS in the New Zealand context by, for example, adding guidance or making changes to enhance the clarity and consistency of the requirements to enable public sector PBEs and NFP PBEs to apply the standard consistently;<sup>7</sup>
- (b) adding guidance to assist NFP PBEs in applying the standard, given that the standard has been developed for application by public sector PBEs;
- (c) amending as necessary to reduce any significant costs for mixed groups in the New Zealand context, to the extent that these costs can be reduced while still meeting the needs of users of PBE financial statements (see paragraph 18);<sup>8</sup>
- (d) amending as necessary to maintain the coherence of the suite of PBE Standards;
- (e) excluding options that are not relevant in the New Zealand context; or
- (f) amending the scope of an IPSAS if the IPSAS conflicts with a legislative requirement, or a legislative requirement addresses the same issue for public sector entities. However, in these circumstances, it may be appropriate to adopt the IPSAS for NFP PBEs.

<sup>5</sup> In applying the development principle and rebuttable presumptions in this policy document, the NZASB will consider the costs and benefits of initiating a new development and the relevance of a topic to PBEs based on consultation with constituents.

<sup>6</sup> The rebuttable presumption is also based on the XRB's understanding of the IPSASB's strategic focus – that is, the development of high-quality financial reporting standards and guidance for the public sector.

<sup>7</sup> For example, amendments of this nature may be necessary where the guidance in IPSAS does not fully address certain transactions that are prevalent for New Zealand PBEs.

<sup>8</sup> The significance of any costs to mixed groups will be assessed through constituent outreach activities, and any amendments will be weighed up against other factors in the development principle.

10. Based on an analysis of *Amendments to IPSAS 5, Borrowing Costs – Non-Authoritative Guidance* against the requirements within the table above, staff believe that the amendments will enhance the quality of reporting under PBE IPSAS 5, and that there is no need to rebut the presumption in paragraph 22 of the PBE Policy Approach. Accordingly, staff recommend that these amendments be incorporated into PBE Standards – specifically, into PBE IPSAS 5.

#### 2022 Omnibus Amendments to PBE Standards

11. Staff recommend that the proposed amendments to PBE IPSAS 5 be included as part of the upcoming *2022 Omnibus Amendments to PBE Standards*, as the proposed amendments consist of non-authoritative guidance only and therefore do not warrant a separate ED and Invitation to Comment (ITC) to be issued.

**Next steps**

12. If the Board agrees with our recommendations staff will include the proposed amendments to PBE IPSAS 5 in the ED for the *2022 Omnibus Amendments to PBE Standards*. This ED is expected to be submitted to the Board for approval at its meeting in February 2022.

**Attachments**

Agenda item 3.2: *Amendments to IPSAS 5, Borrowing Costs – Non-Authoritative Guidance*

**Final Pronouncement  
November 2021**

**IPSAS®**

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**Amendments to IPSAS 5, *Borrowing  
Costs – Non-Authoritative Guidance***

**IPSASB**

**International Public  
Sector Accounting  
Standards Board®**

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets International Public Sector Accounting Standards™ (IPSAS™) and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

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# AMENDMENTS TO IPSAS 5, BORROWING COSTS – NON-AUTHORITATIVE GUIDANCE

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## Objective

1. The objective of this pronouncement is to add non-authoritative material to IPSAS 5, *Borrowing Costs*, and to provide guidance for determining the extent to which borrowing costs can be capitalized. There are no amendments to the authoritative material. The amendments add implementation guidance and illustrative examples, which IPSAS 5 does not currently contain. The IPSASB’s decisions to add non-authoritative material to IPSAS 5 are explained in the amended Basis for Conclusions.
2. The IPSASB consulted constituents in its April 2019 Measurement Consultation Paper about whether it should remove the option to capitalize borrowing costs in IPSAS 5. Feedback on this issue was mixed and the IPSASB decided to retain the existing accounting policy option in IPSAS 5. However, the IPSASB has developed additional implementation guidance and examples to illustrate the extent to which borrowing costs can be capitalized.

## Summary of Non-Authoritative Guidance

<b>Section of IPSAS 5, <i>Borrowing Costs</i></b>	<b>Summary of Non-Authoritative Guidance</b>
Basis for Conclusions	Explains the IPSASB decision to <ul style="list-style-type: none"> <li>• Retain the accounting policy choice to capitalize borrowing costs as part of the cost of a qualifying asset when they are directly attributable to the acquisition, construction, or production of a qualifying asset (BC8 – BC14);</li> <li>• Add Implementation Guidance and Illustrative Examples (BC15); and</li> <li>• Distinguish between borrowing costs and transaction costs (BC16 – BC19).</li> </ul>
Implementation Guidance	Guidance added to illustrate the extent to which borrowing costs can be capitalized.
Illustrative Examples	Examples added to illustrate the extent to which borrowing costs can be capitalized.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, IPSAS 5.*

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### **Revision of IPSAS 5 as a result of the IPSASB's Consultation Paper, *Measurement*, issued in April 2019**

- BC8. In April 2019, the IPSASB published the Consultation Paper, *Measurement*. The Consultation Paper proposed a comprehensive framework outlining how measurement bases should be determined when applied in the context of IPSAS. One of the objectives of the Consultation Paper was to seek feedback on whether one of the accounting policy choices in IPSAS 5, *Borrowing Costs* should be removed.
- BC9. IPSAS 5 permits two accounting policy choices for borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset: capitalization or recognition as an expense.
- BC10. The IPSASB proposed eliminating the option to capitalize borrowing costs in order to:
- (a) Address a public sector issue where borrowing is centralized and determined for the economic entity as a whole. Expensing borrowing costs lessens the burden of attributing centralized borrowing costs to specific projects within the public sector;
  - (b) Enhance comparability between the cost of the acquisition, construction, or production of a qualifying asset between public sector entities; and
  - (c) Align more closely with the requirements in the Government Finance Statistics Manual (GFSM) 2014.
- BC11. In developing its preliminary view, the IPSASB acknowledged the complexity of the issue. This complexity, and opposing views on what should be included in cost, resulted in responses to the preliminary view being split with many respondents supporting the Board's proposal, and equally, many respondents disagreeing. Those that disagreed with the proposal to remove the existing accounting policy choice considered that the reasons given for doing so were insufficient. They argued that:
- (a) The difficulties in attributing borrowing costs to specific projects in the public sector were overstated and were an insufficient reason to diverge from private sector accounting treatment. Large conglomerates in the private sector face similar challenges and are able to capitalize borrowing costs;
  - (b) Borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset are part of the cost of that asset. During the period when an asset is under development, the outlays for the resources used must be financed. Financing has a cost. The cost of the asset should include all costs necessarily incurred to get the asset ready for its intended use or sale, including the cost incurred in financing the outlays as a part of the asset's acquisition, construction, or production cost;

- (c) Capitalizing directly attributable borrowing costs enhances accountability and decision making; and
  - (d) Immediate expensing of borrowing costs would be inconsistent with the requirements in other standards to capitalize transaction costs directly attributable to the acquisition, construction, or production of a qualifying asset.
- BC12. Having reviewed the responses, the IPSASB decided to retain the existing accounting policy choice. This approach enables preparers to select the policy that best achieves the measurement objective of the qualifying asset.
- BC13. The IPSASB observed the existing accounting policy choice is consistent with the measurement principles in the Conceptual Framework and allows preparers of public sector financial statements to consider the qualitative characteristics of useful information when selecting an approach that most faithfully represents the cost of the asset.
- BC14. Further supporting its decision to retain the accounting policy choice, the IPSASB noted the following:
- (a) Both capitalizing borrowing costs and expensing borrowing costs have technical merits. In some cases, respondents took opposite views: for example, on whether borrowing costs are an attribute of the cost of an asset;
  - (b) The goal of the approach when accounting for borrowing costs is to assist financial statement users in obtaining the most appropriate reflection of acquisition, construction, or production costs of a qualifying asset, which may in some cases include borrowing costs;
  - (c) While at certain levels of government the allocation of borrowing costs is challenging, at other levels, such as at the local government levels, it can be relatively straightforward;
  - (d) Capitalization of borrowing costs would align with IFRS where that is an economic entity's preferred approach, whereas the expensing of borrowing costs would demonstrate alignment with GFS if that is an economic entity's preferred approach; and
  - (e) There would need to be a clear benefit to expensing all borrowing costs before the IPSASB would remove the existing accounting policy choice to capitalize borrowing costs. Because there are unavoidable costs in eliminating an accounting policy choice, the IPSASB carefully considered the costs and benefits of any new pronouncement. In this case, the IPSASB had not been informed that preparers who elected to capitalize borrowing costs under IPSAS 5 found doing so unnecessarily burdensome.
- BC15. Some respondents to the Consultation Paper identified practical public sector challenges in capitalizing borrowing costs. The IPSASB therefore developed Implementation Guidance and Illustrative Examples to assist entities in determining the extent to which borrowing costs can be capitalized.

**Distinction between borrowing costs and transaction costs**

- BC16. In reaching the conclusion to retain the accounting policy choice, the IPSASB noted that accounting for borrowing costs may not be consistent with accounting for transaction costs. Some respondents proposed that the accounting treatment of borrowing costs and transaction costs should be consistent because they considered either:
- (a) Borrowing costs to be a type of transaction costs. Borrowing costs are directly attributable to the borrowing (for example, the issuance of a government financial instrument). Therefore, they meet the criteria of a transaction cost; or
  - (b) Transaction costs to be a type of borrowing costs. Some respondents proposed this view based on the methodology applied in calculating the effective interest rate of a financial instrument. This is because some transaction costs are added to, or subtracted from, the principal amount of a financial instrument when determining the gross proceeds of a borrowing in order to determine the effective interest rate.
- BC17. The IPSASB considered these views, but decided that borrowing costs and transaction costs are different economic phenomena. The IPSASB concluded it is appropriate for the accounting principles to differ for each type of “cost” depending on the facts and circumstances.
- BC18. In reaching this view, the IPSASB noted that borrowing costs comprise interest and other expenses incurred by an entity in connection with borrowing funds. Borrowing costs are often contractually linked to the underlying borrowing. Should the borrowing be transferred, the borrowing costs would either be transferred to the new counterparty or separated contractually.
- BC19. Transaction costs are incremental costs directly attributable to the transaction. However, transaction costs are independent of the contractual terms of the debt instrument. Should the debt instrument be transferred, the entity transferring the instrument is generally not compensated for the transaction costs because they are not transferred to the counterparty assuming the instrument.

## **Implementation Guidance**

*This guidance accompanies, but is not part of, IPSAS 5.*

### *A.1 Period of Borrowing Cost Capitalization*

**When applying the allowed alternative treatment, as described in paragraphs 17–18, when can an entity begin to include borrowing costs in the cost of the qualifying asset?**

Where outlays and borrowings have been incurred specifically to fund a qualifying asset's acquisition, construction, or production, the costs of those borrowings should be capitalized when the activities necessary to prepare the asset for its intended use or sale begin. The activities necessary to get the asset ready for use encompass more than the asset's physical acquisition, construction, or production. The activities include technical and administrative work prior to the commencement of physical acquisition, construction, or production, but exclude holding the asset when no development that changes the asset's condition is being undertaken.

The activities (i.e., technical and administrative work) undertaken prior to commencement of the physical acquisition, construction, or production of a qualifying asset should contribute to the actual development or construction of that asset.

### *A.2 Limit on Capitalization*

**When applying the allowed alternative treatment, as described in paragraphs 17–18, to specific borrowings, are borrowing costs included in the cost of the qualifying asset in that period limited to the borrowing costs incurred in that period?**

Yes. If a borrowing can be specifically associated with outlays on acquisition, construction, or production of a qualifying asset, the amount of borrowing costs capitalized during that period is limited to the borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

### *A.3 Asset Funded through Transfers*

**In many jurisdictions, the acquisition, construction, or production of a qualifying asset is funded through a transfer from another public sector entity. Does the entity acquiring, constructing, or producing the qualifying asset consider the transferor's underlying source of the funds, i.e., whether the funds are generated by tax revenues, general cash holdings or borrowings, when it determines the amount that can be included in the cost of the qualifying asset when applying the allowed alternative treatment, as described in paragraphs 17–18?**

No. When the acquisition, construction, or production of a qualifying asset is fully funded through a transfer, there will be no directly attributable borrowing costs to capitalize. The entity may include in the cost of the qualifying asset only those borrowing costs which it has incurred.

### *A.4 Asset Funded through a Centralized Lending Program – Interest Rates*

**A centralized lending agency may fund its activities by borrowings through several separate loan instruments. Each instrument may have a different interest rate. An entity may borrow funds from the centralized lending agency and use these funds for the acquisition, construction, or production of a qualifying asset. If the entity is using the allowed alternative treatment, as described in paragraphs 17–18, does the entity apply the weighted average interest rate incurred**

**by the centralized lending agency when including borrowing costs in the cost of the qualifying asset?**

No. The weighted average interest rate incurred by the centralized lending agency is not relevant in the preparation of the financial statements of the entity acquiring, constructing, or producing the qualifying asset. The entity can include in the cost of the qualifying asset only those borrowing costs which it itself has incurred.

The entity must consider all facts and circumstances when determining the borrowing costs incurred in its arrangement with the centralized lending agency. In some cases, the interest rate stated in the terms of the arrangement may not reflect the true borrowing costs associated with the funds received. When the entity identifies concessionary terms, the entity should apply the requirements in IPSAS 41, *Financial Instruments*, paragraphs AG118–AG127<sup>1</sup> and capitalize borrowing costs based on a market related interest rate that the entity would have incurred on a similar loan (see IPSAS 41, IE153-IE172 for examples illustrating how to determine the interest rate in a concessionary loan). Interest expense calculated using the effective interest rate method is eligible for inclusion in the cost of the qualifying asset in accordance with this Standard.

If the centralized lending agency and the entity to which it lends funds are part of the same economic entity, in the financial statements of the consolidated entity, the borrowing costs incurred by the centralized lending agency can be capitalized to the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalized by the controlled entity.

**A.5 Asset Funded through an Entity's Own General Borrowing – Borrowings are not Specific to Qualifying Asset**

**When an entity acquiring, constructing, or producing a qualifying asset manages its own borrowing program, but borrowings are not specific to the qualifying asset, how does the entity determine the borrowing costs directly attributable to the qualifying asset? This may occur when an entity uses cash on hand to fund the cost of a qualifying asset. This cash on hand is funded from general borrowings, tax revenue and other fees and transfers.**

The amount of borrowing costs eligible for inclusion in the cost of the qualifying asset is determined using the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period. The weighted average of borrowing costs is then applied to the outlays on the qualifying asset incurred during the period in determining the amount eligible for capitalization.

The entity shall exclude from the weighted average calculation, those borrowings that are made specifically for the purpose of obtaining another qualifying asset until substantially all the activities necessary to prepare that asset for its intended use are complete. The amount of borrowing costs capitalized during a period shall not exceed the amount of borrowing costs incurred during that period.

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<sup>1</sup> Where an entity has not yet adopted IPSAS 41, the requirements in IPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraphs AG84-AG90 are applied. Similar to the IPSAS 41 requirements, an entity should capitalize borrowing costs based on a market related interest rate that the constructing entity would have incurred on a similar loan.

*A.6 Asset Funded through General Borrowings – Range of Debt Instruments*

**Does an entity apply a weighted average of borrowing costs when multiple debt instruments are used to fund the cost of a qualifying asset?**

Yes. An entity may not be able to fund the cost of a qualifying asset with a single debt instrument. When multiple debt instruments are used, the cost of borrowing is determined by calculating the weighted average of the borrowing costs applicable to all the debt instruments outstanding during the period, excluding borrowings that are made specifically for the purpose of obtaining another qualifying asset (until substantially all the activities necessary to prepare that asset for its intended use are complete).

**Illustrative Examples**

*These examples accompany, but are not part of, IPSAS 5.*

**Qualifying Asset Constructed Over a Period of Time**

- IE1. On March 31, 20X1, Municipality XYZ begins construction of a tunnel to accommodate transit between two commercial hubs. The construction period is 5 years and the project is budgeted to cost CU100 million (CU20 million is paid to the construction company on the date the construction begins and on March 31 of each subsequent year during the construction period). Municipality XYZ issues a 25-year CU100 million bond on March 31, 20X1 that yields a fixed coupon of 5 per cent per annum. This bond was issued specifically to finance the construction of this project. The Municipality has a December 31 year end and earns a rate of interest of 3 percent on the temporary investment of any excess borrowings.
- IE2. On December 31, 20X1, the Municipality has accrued borrowing costs of CU3.75 million (CU100 million x 5 percent x 9/12 months).
- IE3. In determining the borrowing costs that can be included in the cost of the tunnel, the Municipality is limited to capitalizing the borrowing costs incurred during the period less any investment income on the temporary investment of those borrowings.
- IE4. At December 31, 20X1, Municipality XYZ recognizes its tunnel asset as a work in progress. The amount capitalized is CU21.95 million (CU20 million + [CU100 million x 5 percent x 9/12 months] – [CU80 million x 3 percent x 9/12 months]). This represents the funds transferred to the construction company and the borrowing costs incurred during the period less the investment income earned on the CU80 million invested.

**Centralized Borrowing Program – Eligible Borrowing Costs**

- IE5. The Department of Infrastructure begins construction of a new road network on June 15, 20X1. The project costs are budgeted to be CU500 million. All financing required by the Department of Infrastructure, and all other government departments, is secured centrally by the Department of Finance.
- IE6. The Department of Finance estimates its cash flow needs on an annual basis in order to determine the most appropriate source of funding to meet its internal lending needs. These sources include tax revenue, fee revenue, bonds issuances and loans.



IE7. The Department of Infrastructure negotiates a 10-year loan from the Department of Finance. The Department of Finance requires the Department of Infrastructure to pay borrowing costs of 3 percent per annum. This is consistent with the market rate of interest the Department of Infrastructure would incur if the arrangement was negotiated at arm’s length.

IE8. When the Department of Infrastructure secures financing from the Department of Finance, the Department of Infrastructure is aware borrowings comprise various sources, but has no visibility of how the Department of Finance sources the funds, nor of the weighted average borrowing costs the Department of Finance incurs.

IE9. In determining the borrowing costs eligible for inclusion in the cost of the road network, the Department of Infrastructure includes only those borrowing costs which it itself has incurred. Because the loan is at market terms, the Department of Infrastructure concludes there are no concessionary elements and determines borrowing costs eligible for inclusion in the cost of the road network are based on the interest rate of 3 percent stated in the contract.

**General Borrowing – Weighted Average Cost of Borrowing**

IE10. State Government T has begun construction of a new airport. The cost of this airport is budgeted to be CU500 million. State Government T manages its own borrowings; however, it does not borrow for specific projects. In determining its borrowing needs, State Government T budgets its cash shortfall over a given period and ensures borrowings will cover its liquidity needs.

IE11. Over the construction period, State Government T held three instruments that were open for the entire construction period:

- State Bonds – CU1 billion, yielding an annual rate of 5 percent;
- Loan with Financial Institution A – CU300 million, with an annual interest rate of 7 percent; and
- Loan with Financial Institution B – CU600 million, with an annual interest rate of 9 percent.

IE12. In determining the amount of borrowing costs eligible for inclusion in the cost of the airport, State Government T calculates the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period.

	<b><u>A</u></b> <b><u>Principal</u></b>	<b><u>B</u></b> <b><u>Interest Rate</u></b>	<b><u>C</u></b> <b><u>Proportion of Debt</u></b>	<b><u>D = B x C</u></b> <b><u>Weighted Average</u></b>
<u>State Bonds</u>	<u>CU1,000 million</u>	<u>5 percent</u>	<u>1,000 / 1,900</u>	<u>2.63</u>
<u>Loan A</u>	<u>CU300 million</u>	<u>7 percent</u>	<u>300 / 1,900</u>	<u>1.11</u>
<u>Loan B</u>	<u>CU600 million</u>	<u>9 percent</u>	<u>600 / 1,900</u>	<u>2.84</u>
<b><u>Weighted Average Interest Rate</u></b>				<b><u>6.58 percent</u></b>

IE13. State Government T calculates the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period to be 6.58 percent.

**Specific Borrowing – Borrowing for Part of Qualifying Asset’s Amount**

IE14. State Government C began construction of a new road network on January 1, 20X1. The cost of this road network is budgeted to be CU750 million. State Government C funds this project with amounts received on January 1, 20X1 from two sources:

- Federal grant in the amount of CU500 million; and
- Loan from a financial institution of CU250 million, with an annual interest rate of 5 percent.

In order to receive the federal grant, State Government C was required to show it was able to secure financing. It is State Government C’s policy to allocate borrowed funds to the construction of the qualifying asset first. State Government C earns a rate of interest of 3 percent on the temporary investment of any excess borrowings.

IE15. As at December 31, 20X1, State Government C has incurred outlays of CU200 million as part of the construction of the asset. These outlays were transferred in one lump sum payment to the construction company at the commencement of construction on January 1, 20X1. In addition to the outlays of CU200 million, State Government C capitalizes CU11 million ( $[\text{CU}250 \text{ million} \times 5 \text{ percent}] - [\text{CU}50 \text{ million} \times 3 \text{ percent}]$ ) in borrowing costs, against the qualifying asset.

IE16. Because State Government C borrowed CU250 million for the purposes of obtaining the road network, but has only incurred outlays related to that qualifying asset in the amount of CU200 million, State Government C was able to earn interest revenue on the excess funds borrowed. State Government C capitalized borrowing costs incurred during the period of CU12.5 million less the investment income of CU1.5 million on the temporary investment of those borrowings.

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**Date:** 3 December 2021

**To:** NZASB Members

**From:** Jamie Cattell

**Subject:** **Update on Tier 3 and 4 Standard Post-implementation Review**

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### **Purpose and introduction<sup>1</sup>**

1. The purpose of this session is to provide the Board with an update on progress in responding to the feedback obtained in the Tier 3 and 4 Post-implementation Review.

### **Recommendations**

2. The Board is asked to NOTE the status of the issues identified as requiring standard-setting activity.

### **Background**

3. At its June meeting the Board considered the feedback received on the Post-implementation Review and agreed whether each topic required standard-setting activity, education and awareness raising activity, or a combination of both.
4. Between August and December 2021 the Board considered each of these issues and made in-principle decisions about how they should be addressed. We are gradually working through the issues requiring standard-setting activity and will then develop exposure drafts proposing amendments to the Tier 3 and Tier 4 Standards.

### **Update on issues identified as requiring further action**

5. Table 1 below summarises those issues on which the Board has agreed to consider standard-setting activity and the decisions made to date.
6. At this meeting we are focusing on the minimum categories of revenue/receipts, expenditure, assets, and liabilities in the Tier 3 and Tier 4 Standards – refer to agenda item 5.2.

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<sup>1</sup> 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).

<b>Table 1 Update on issues identified as requiring standard-setting activity</b>		
<b>Issues</b>	<b>Comment</b>	<b>Progress</b>
Asset valuation	Consider options to address issues raised concerning the ability to revalue in the Tier 3 Standard, including introduction of a new revaluation option for certain asset classes and/or additional guidance on how to apply the opt-up option.	Discussed at August 2021 NZASB meeting.  The Board agreed to consider drafting for including simple revaluation requirements in the Tier 3 Standard for PPE, investment property, and financial investments (which are actively traded).
Tier 4 Standard simplification (including the requirement to report on resources and commitments)	The Board agreed to undertake a holistic review of the Tier 4 standard to re-express the existing requirements in simpler language.	At its September 2021 meeting, the Board considered simplifications to the Tier 4 Standard. Staff have conducted some targeted consultations with key stakeholders.
Improvements to help Tier 3 and Tier 4 Standards work better for Māori entities, through an increased Kaupapa Māori focus	Consider options to incorporate te ao Māori concepts and initiatives to support the use Te Reo in Tier 3 and Tier 4 performance reports.	<i>Paused pending the development of an XRB Māori engagement strategy.</i>
Difficulty understanding the objectives and requirements related to service performance reporting	Consider options for simplifying the requirements and terminology used.	At its September 2021 meeting the Board considered simplifications to the Tier 4 Standard including those related to service performance reporting.  At its October 2021 meeting the Board considered amendments to align the Tier 3 and Tier 4 terminology with that used in PBE FRS 48.
Revenue recognition in the Tier 3 Standard	Consider options for improving revenue recognition requirements in the Tier 3 Standard to address issues raised with the current “use or return condition” requirements.	Discussed at September and October 2021 NZASB meetings.  At its September 2021 meeting, the Board agreed to broaden the scope of arrangements for which revenue may be deferred.  In October 2021 the Board considered drafting for how this might look in practice. There were mixed views about the most appropriate solution. The Board agreed to seek feedback on both options in the Exposure Draft.
Illustrative examples for revenue in the Tier 3 Standard	Consider options to update the illustrative examples to reflect any change in the revenue recognition requirements.	<i>To be considered following final decision on revenue recognition.</i>

Table 1 Update on issues identified as requiring standard-setting activity		
Issues	Comment	Progress
Minimum categories	Consider options for amending the minimum categories in the Tier 3 and 4 Standards to better reflect the terminology used by entities and to ensure the minimum categories address the information needs of users and to respond to application challenges.	Discuss at December 2021 NZASB meeting – refer agenda item 5.2.
Definition of “cash” in the Tier 3 Standard and “receipts” in the Tier 4 Standard.	Consider options for clarifying the definition of cash and receipts in the Tier 3 and Tier 4 Standard.	<i>Will be addressed during development of the exposure draft of the Tier 3 and Tier 4 Standards.</i>
Accumulated funds and reserves	Consider options for amending the Tier 3 Standard to improve disclosures and simplify the terminology relating to accumulated funds and other reserves.	At its October 2021 meeting the Board agreed to require additional narrative disclosures in the Tier 3 Standard about an entity’s general approach managing its accumulated funds.  The Board also agreed to include additional guidance in Tier 3 standard on the circumstances in which an entity may choose to create separate reserves.
Statement of cash flows	Agreed to aligning the format of the statement of cash flows in the Tier 3 Standard with the statement of receipts and payments in the Tier 4 Standard.	<i>Will be addressed during development of the exposure draft of the Tier 3 Standard.</i>
Additional guidance on the requirements for opting up	Consider options for clarifying the requirements in the Tier 3 Standard relating to opting up to the Tier 2 PBE Standards for certain transactions. Feedback received suggested that the most common cases in which entities elect to opt up relate to revaluation of assets and investments.	Discussed at October 2021 meeting. The Board agreed to include additional guidance on opting up in the Tier 3 Standard.  The additional guidance is expected to take the form of an appendix which specifies the relevant standard(s) for common situations in which an entity may opt up.
Determining whether an entity has exceeded the size threshold	Consider options to include simple guidance on determining the tier size thresholds within the Tier 3 and Tier 4 Standards (rather than requiring a small entity to work through the detail of XRB A1).	At its September 2021 meeting the Board considered simplifications to the Tier 4 Standard including paragraphs highlighting the entities to which the Tier 4 Standard applies.  <i>Similar paragraphs will be included during the development of the exposure draft of the Tier 3 Standard.</i>

Table 1 Update on issues identified as requiring standard-setting activity		
Issues	Comment	Progress
Entity information	Consider options to refine (and possibly reduce) the disclosures required in relation to entity information.	At its September 2021 meeting the Board considered simplifications to the Tier 4 Standard including paragraphs highlighting the entities to which the Tier 4 Standard applies.  <i>Similar paragraphs will be included during the development of the exposure draft of the Tier 3 Standard.</i>

**Next steps**

7. We intend to develop exposure drafts of the Tier 3 and Tier 4 Standards based on the decisions made by the Board, for consideration during Q1 2022.

**Attachments**

Agenda item 5.2: Minimum categories in the Tier 3 and Tier 4 Standards



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**Date:** 3 December 2021

**To:** NZASB Members

**From:** Jamie Cattell

**Subject:** **Minimum categories in the Tier 3 and Tier 4 Standards**

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## Introduction

1. At its June 2021 meeting the Board agreed on its high-level approach to issues raised in the Simple Format Reporting Standards Post-implementation Review (PIR). This included a review of the minimum categories of income, expenditure, assets, and liabilities<sup>1</sup> in the Tier 3 and Tier 4 Standards.<sup>2</sup>
2. Many preparers, especially Tier 4 preparers, have highlighted difficulties in applying the minimum categories. Respondents have highlighted that the current categories are causing significant application issues at times, resulting in transactions of the same source or nature being allocated to different minimum categories. This is leading to inconsistencies in the data recorded in the Charities Services register concerning how the charities sector is funded and the nature of expenditure.
3. The most common area of diversity and confusion is whether grants received should be allocated to the *donations revenue* category or *revenue from providing goods or services* category. Many respondents have requested a *grant* category be added to the Tier 3 and Tier 4 Standards to simplify the reporting of grants received.

## Recommendations

4. The Board is asked to:
  - (a) NOTE the PIR feedback concerning the minimum categories in the Tier 3 and Tier 4 Standards;
  - (b) CONSIDER staff recommendations in response to issues raised; and
  - (c) provide DIRECTION on the development of proposed amendments to the Tier 3 and Tier 4 Standards in response to the issues raised.

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<sup>1</sup> Hereafter referred to as the “minimum categories”.

<sup>2</sup> The Tier 3 Standards consist of:

- *Public Benefit Entity Simple Format Reporting – Accrual (Public Sector)*
- *Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)*

The Tier 4 Standards consist of:

- *Public Benefit Entity Simple Format Reporting – Cash (Public Sector)*
- *Public Benefit Entity Simple Format Reporting – Cash (Not-For-Profit)*

Hereafter referred to as “the Tier 3 and Tier 4 Standards”.

### Structure of this memo

5. The remaining sections in this memo are:
  - (a) Current requirements in the Tier 3 and Tier 4 Standards;
  - (b) PIR feedback;
  - (c) Analysis of PIR feedback;
  - (d) Staff recommendations to amend the minimum categories; and
  - (e) Next steps.

### Current requirements in the Tier 3 and Tier 4 Standards

6. The minimum categories required by the public sector and not-for-profit versions of the Tier 3 and Tier 4 Standards are similar. However, there are some differences in the categories each version uses to reflect the public sector and not-for-profit contexts.
7. The general principles for applying the minimum categories in the Tier 3 and Tier 4 Standards are also similar between all versions and have been summarised below. This is followed by the specific minimum categories in each of the standards. Extracts of the relevant sections from each of the standards (including associated guidance material) have been included in the [Appendices A-D](#).

### General principles

8. To improve the understandability, consistency and comparability of the performance reports, the Tier 3 and Tier 4 Standards require minimum categories to be reported.
9. An entity is required to report using the minimum category only where the category is applicable and significant to the entity.
10. The standards give the preparer flexibility to relabel the categories (i.e. use different descriptions) to reflect terminology more appropriate for the entity, provided that the separate categories are still maintained.<sup>3</sup>
11. The standards also allow an entity to disaggregate the categories or present additional categories where doing so will enhance users' understanding of the entity's financial performance.<sup>4</sup>

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<sup>3</sup> Refer to paragraphs:

- A57, A74, A100 and A126 of PBE SFR-A (NFP);
- A60, A76, A102 and A128 of PBE SFR-A (PS);
- A48, A60, A78 and A92 of PBE SFR-C (NFP); and
- A51 and A63 of PBE SFR-C (PS).

<sup>4</sup> Refer to paragraphs:

- A59, A77, A103 and A129 of PBE SFR-A (NFP)
- A62, A79, A105 and A131 of PBE SFR-A (PS);
- A50, A63, A86 and A98 of PBE SFR-C (NFP); and
- A53 and A66 of PBE SFR-C (PS).

12. The standards seek to achieve a balance between comparability and understandability on the one hand, and flexibility for entities to reflect their own circumstances on the other.
13. The standards provide a note of caution, that having too many categories can make it difficult for users to understand the overall picture of the entity. Therefore, the number of disaggregated or additional categories should be limited to those that are really necessary.

Minimum categories of revenue/receipts

14. The Tier 3 and Tier 4 Standards require as a minimum (when applicable and significant to the entity), the following aggregated revenue categories to be reported separately:

<b>Table 1 – Minimum categories of revenue</b>	
<b>Not-for-profit</b>	<b>Public sector</b>
Donations, fundraising and other similar revenue/receipts.	Donations, fundraising and other similar revenue/receipts
Fees, subscriptions and other revenue/receipts from members.	Funding from central or local government.
Revenue/Receipts from providing goods or services.	Revenue/Receipts from non-governmental sources for providing goods or services.
Interest, dividends and other investment revenue/ income receipts.	Interest, dividends and other investment revenue/ income receipts.

15. In addition to these mandatory minimum categories, the Tier 3 and Tier 4 Standards list other categories of revenue/receipts an entity might wish to present.

<b>Table 2 – Suggested additional categories of revenue</b>	
<b>Not-for-profit</b>	<b>Public sector</b>
Donations or koha from the public	Grants, donations or koha from the public or non-governmental organisations (Tier 3) Donations or koha from the public (Tier 4)
Fundraising revenue/receipts	Fundraising revenue
Grants not directly related to service delivery	General funding from central or local government
Fees and subscriptions from members	
Donations, koha or offerings from members	
Revenue/Receipts from grants of contracts for service with central or local government	Funding from central or local government for the delivery of goods services
Revenue/Receipts from grants or contracts for service with non-governmental agencies	Other revenue from the provision of goods and services (Tier 3)
Revenue/Receipts from sales to the public	Receipts from the sale of goods or services to the public (Tier 4)
Revenue/Receipts from sales to members	
Revenue/Receipts from commercial activities	Receipts from commercial activities (Tier 4)

<b>Table 2 – Suggested additional categories of revenue</b>	
<b>Not-for-profit</b>	<b>Public sector</b>
Lease or rental revenue/receipts	Lease or rental revenue/receipts
Interest or dividend revenue/receipts	Interest or dividend revenue/receipts
	Fees and charges

Minimum categories of expenditure

16. The Tier 3 and Tier 4 Standards require as a minimum (when applicable and significant to the entity), the following aggregated expenditure categories to be reported separately:

<b>Table 3 – Minimum categories of expenditure</b>	
<b>Not-for-profit</b>	<b>Public sector</b>
Expenses/Payments related to public fundraising	Expenses related to fundraising
Volunteer and employee related costs/payments	Employee related costs (Tier 3)
Costs/Payments related to providing goods and services	Costs/Payments related to providing goods or services.
Grants and donations made/paid	Grants paid (Tier 4)

17. In addition to these minimum categories, the Tier 3 and Tier 4 Standards list other categories an entity might wish to present.

<b>Table 4 – Suggested additional categories of expenditure</b>	
<b>Not-for-profit</b>	<b>Public sector</b>
Administration and overhead costs/payments	Administration and overhead costs/payments
Lease and rental expense/payments	Lease and rental expense/payments
Affiliation fees	
Interest expense/payments	Interest expense/payments
Bad debts (Tier 3)	Bad debts (Tier 3)
Depreciation (Tier 3)	Depreciation (Tier 3)
Impairment charges (Tier 3)	Impairment charges (Tier 3)
	Fees paid to members of the governing body (Tier 3)
	Repairs and maintenance (Tier 4)

Assets in the Tier 3 Standard

18. The following aggregated categories of assets are required to be reported separately at a minimum in the Tier 3 Standard (when applicable and significant to the entity).

<b>Table 5 – Minimum categories of assets</b>	
<b>Not-for-profit</b>	<b>Public sector</b>
Bank accounts and cash	Bank accounts and cash
Debtors and prepayments	Debtors and prepayments
Inventory	Inventory
Property, plant and equipment	Property, plant and equipment
Investments	Investments

Liabilities in the Tier 3 Standard

19. The following aggregated categories of liabilities are required to be reported separately at a minimum in the Tier 3 Standard (when applicable and significant to the entity).

<b>Table 6 – Minimum categories of liabilities</b>	
<b>Not-for-profit</b>	<b>Public sector</b>
Bank overdraft	Bank overdraft
Creditors and accrued expenses	Creditors and accrued expenses
Employee costs payable	Employee costs payable
Unused donations and grants with conditions	Unused donations and grants with conditions
Loans	Loans

Resources in the Tier 4 Standard

20. Only the not-for-profit version of the Tier 4 Standard requires an entity to present a statement of resources and commitments. The following aggregated categories of resources are required to be reported separately at a minimum (when applicable and significant to the entity).

<b>Table 7 – Minimum categories of resources</b>	
<b>Not-for-profit</b>	
Bank accounts and cash	
Money held on behalf of others	
Money owed to the entity	

21. In addition to these minimum categories, the Tier 4 Standard lists other categories an entity might wish to present.

<b>Table 8 – Suggested additional categories of resources</b>	
<b>Not-for-profit</b>	
Grants to the entity that have been approved by the grantor, but not yet received	Computers (including software)
Subscriptions owed by members	Furniture and fittings

<b>Table 8 – Suggested additional categories of resources</b>	
<b>Not-for-profit</b>	
Receipts due as a result of providing goods or services	Office equipment
Interest or dividends receivable	Investments (including shares)
GST receivable	Inventory on hand
Land and buildings	Other resources used in the entity’s activities
Motor vehicles	Resources held on behalf of others

Commitments in the Tier 4 Standard

22. The following aggregated categories of commitments are required to be reported separately at a minimum (when applicable and significant to the entity).

<b>Table 9 – Minimum categories of commitments</b>
<b>Not-for-profit</b>
Money payable by the entity
Other commitments
Guarantees

23. In addition to these minimum categories, the Tier 4 Standard lists other categories of commitments an entity might wish to present

<b>Table 10 – Suggested additional categories of commitments</b>
<b>Not-for-profit</b>
Unpaid invoices relating to the provision of goods or services
Unpaid invoices relating to capital activities
Wages and salaries due and payable, including bonuses and honoraria
Cash owing to third parties relating to employees (for example, ACC levies, PAYE, and superannuation contributions such as Kiwisaver)
GST payable
Interest payable
Loans payable
Grants payable by the entity that have been approved, but not yet paid
Commitments to make future payments under a lease
Commitments to purchase property, plant and equipment
Loans or grants the entity is legally committed to making
Cash received that relates to activities to be undertaken in a future period

24. Rather than requiring presentation of a statement of resources and commitments, the public sector version of the Tier 4 Standard requires any significant resources and commitments to

be disclosed in the notes to the performance report. As part of the planned amendments to Tier 4 Standard, we are expecting to propose a similar approach in the NFP version.

**PIR Feedback**

25. Many respondents to the PIR commented on the minimum categories and generally raised concerns about application and interpretation challenges when applying them.
26. The views expressed in relation to the minimum categories of revenue and expenditure included the following.
  - (a) That the minimum categories as defined are inconsistent with how charities think about themselves and how users of their performance reports generally think about charities.
  - (b) The minimum categories do not allow charities to provide the basic information about how its funded and how it spends the funds received. For example, the ‘story’ about whether the entity is a business that raises funds for charitable purposes, or how much revenue has been received from fundraising activities is lost when reporting against the minimum categories.
  - (c) The minimum categories when applied strictly, result in some useful information being obscured in comparison to the information that was disclosed prior to the implementation of the Tier 3 and Tier 4 Standards. A particularly important area to which this related was the aggregation of all general grant and donation revenue into a single category.
  - (d) In practice entities are finding it difficult to distinguish between ‘pure grants’ and grants which should be classified as revenue from providing goods and services.
  - (e) Separating revenue/receipts into amounts received from members and non-members introduces unnecessary complexity into the standard without providing useful information. It was also highlighted that attempting to make this distinction presents specific challenges within a te ao Māori or religious context.
  - (f) Many charities struggle to understand how to fit their transactions into the minimum categories which results in many transactions being reported as "other".
  - (g) Salaries and wages should be separately reported from other employee and volunteer costs as it is a key area of interest to users of performance reports.
27. Some comments were also received in relation to the minimum categories of resources and commitments in the Tier 4 Standard. These comments included the following.
  - (a) Reporting of significant accounts payable and accounts receivable should be required, if practicable to obtain.
  - (b) The statement of resources and commitments should be renamed to “the statement of assets and liabilities”. It was considered this would result in less confusion for Tier 4 entities.
  - (c) The statement of resources and commitments does not currently provide a complete snapshot of all the resources and commitments of the entity. When assessing funding

applications, funders are often asking for more information about the assets and liabilities held by Tier 4 entities.

- (d) The statement of resources and commitments should explicitly require reporting of annual leave accruals and accrued interest.
  - (e) Unexpected grants should be reported as a commitment rather than in the schedule of other information.
28. It is important to highlight that despite the concerns noted above no respondents considered that there should be no minimum categories at all. Some respondents specifically expressed support for having minimum categories in principle and considered that they, if appropriately set up, would make performance reports more understandable and comparable.
29. Following the conclusion of the PIR consultation period, staff have held further meetings with Charities Services, IRD, and JBWere to better understand the difficulties arising from the use of the current minimum categories. In addition, staff presented options for amending the minimum categories. The feedback received has helped inform our thinking on the staff recommendations proposed in the next section of this memo.
30. Several consistent themes emerged from these meetings which have been summarised below.
- (a) It was considered that the aggregation of revenue/receipts from donations with income from grants and other fundraising revenue/receipts together with general grants is not appropriate as it resulted in transactions of a different nature being presented together. Revenue from general grants should be reported separately.
  - (b) It was considered that the aggregation of revenue/receipts from commercial activities (sale of goods or services) together with revenue/receipts from service contracts/grants was not appropriate. Revenue from service contracts/grants should be reported separately.
  - (c) It was considered that many users of NFP financial statements are interested in information on how much support the NFP sector receives from the government. Therefore, it was considered that it would be useful to require revenue/receipts from central and local government to be presented separately from other sources of income.
  - (d) While separation of revenue/receipts between members and non-members is not considered critical in many circumstances, there are some entities where the users consider this split important and useful.
  - (e) It was generally considered that retaining interest, dividends, and other investment revenue/receipts as a separate category was appropriate – even if this category is often not significant. It was noted that this income has a different nature than other income and was not an area which entities find difficult to allocate transactions.
  - (f) While additional categories may be useful, the number of additional categories required will need to be carefully considered to avoid the application of the standard appearing to be more onerous or complex.



- (g) It was considered that disclosing salary and wages as a separate category from other costs would be useful. It was noted that many users are interested in how much the charitable sector spends on employment.
- (h) The individual categories of expenditure did not present many difficulties on application but it is important to ensure they are sensibly aligned with the categories of income to the extent possible (this comment came from users who have a desire to match revenue with associated expenditure – fund accounting).
- (i) The minimum categories of income and expenditure in the public sector version of the Tier 3 and Tier 4 Standards are too prescriptive and more flexibility should be provided.
- (j) The public sector version of the Tier 3 and Tier 4 Standards appear to be asking preparers to split their income based on its source when it would be more appropriate to split it by nature.

### Analysis of PIR feedback

- 31. The PIR feedback indicates that while there is general support for retaining the minimum categories in some form, the minimum categories of income and expenditure could be improved by requiring additional disaggregation and refinement.
- 32. Feedback also indicates that the minimum categories of resources and commitments do not currently provide sufficient detail for users of Tier 4 performance reports to have a clear understanding of the significant assets and liabilities held.
- 33. Based on the feedback received, the main issues to consider are as follows.

**Issue 1:** Should the minimum categories of revenue and expenditure in the Tier 3 and Tier 4 Standards be:

- (a) further disaggregated based on the nature of the related transactions?  
If so, to what extent?
- (b) further disaggregated based on the source of the related transactions?  
If so, to what extent?

**Issue 2:** Should the minimum categories of resources and commitments be amended to provide a clearer understanding of significant assets and liabilities held by Tier 4 entities?

- 34. For issue 1 we agree that requiring additional disaggregation of the minimum categories of income and expenditure would make them more useful for both preparers and users of PBE performance reports. We also consider that making some additional categories mandatory, within reason, will also make the Tier 3 and Tier 4 Standards easier to apply.
- 35. For issue 2, we agree that requiring additional information on specific categories of assets and liabilities would make Tier 4 performance reports more useful. Insofar as the additional categories required are limited to those which are significant and meaningful to Tier 4 entities, we consider that requiring these additional categories is not likely to significantly increase the complexity of the Tier 4 Standard.

**Staff recommendations to amend the minimum categories**

**Issue 1: Minimum categories of revenue/receipts and expenditure**

36. As noted above, the Tier 3 and Tier 4 Standards already suggest additional categories an entity could choose to use in its performance report when reporting on revenue/receipts and expenditure. The suggested additional categories include options based both on the nature of the transaction and on the source of the transaction.
37. We consider that these categories provide an appropriate basis from which the Board can determine whether and to what extent the minimum categories of revenue/receipts and expenditure in the Tier 3 and Tier 4 Standards should be disaggregated further and amended in response to feedback received.

Not-for-profit minimum income categories (Tier 3 and Tier 4)

38. Table 11 on the next page explores different approaches for amending the Tier 3 and Tier 4 minimum revenue categories and contrasts these against the existing requirements. Changes to the current categories are marked in **red font**.

<b>Table 11 – Options for amending minimum revenue categories —Tier 3 and Tier 4 (not-for-profit)</b>				
<b>Current categories (status quo)</b>	<b>Option A – Based on nature</b>	<b>Option B – Based on source</b>	<b>Option C – Mixture of nature and source (comprehensive)</b>	<b>Option D – Mixture of nature and source (simple)</b>
Donations, fundraising and other similar receipts.	Donations, <b>bequests</b> and fundraising	Donations, koha, <b>bequests</b> and other fundraising <b>from public</b>	Donations, koha, <b>bequests</b> , and other <b>general</b> fundraising <b>activities</b>	Donations, koha, <b>bequests</b> , and other <b>general</b> fundraising <b>activities</b>
	<b>Grants</b> [Not directly related to delivery of specific goods or services]	<b>Government grants</b> [General operating <b>and</b> delivery of specific goods or services]	<b>Government grants</b> [Excluding service delivery grants/contracts]	<b>Grants</b> [Excluding service delivery grants/contracts]
		<b>Non-government grants</b> [General operating <b>and</b> delivery of specific goods or services]	<b>Non-government grants</b> [Excluding grants/contracts to delivery of specific goods or services]	
Revenue from providing goods or services.	<b>Revenue from service delivery contracts/contracts</b> [Delivery of specific goods or services that supports the entity's NFP objectives]		<b>Funding from service delivery grants/contracts (Government)</b>	<b>Funding from service delivery grants/contracts (Government)</b>
			<b>Funding from service delivery grants/contracts (non-Government)</b>	<b>Funding from service delivery grants/contracts (non-Government)</b>
	<b>Revenue from commercial activities</b> [Sale of goods or services]	<b>Revenue from commercial activities</b> [Sale of goods or services]	<b>Revenue from commercial activities</b> [Sale of goods or services]	<b>Revenue from commercial activities</b> [Sale of goods or services]
Fees, subscriptions and other revenue/receipts from members.	Membership fees and subscriptions	Fees, subscriptions and other revenue from members	Membership fees and subscriptions	Membership fees and subscriptions
Interest, dividends and other investment revenue/receipts	Interest, dividends and other investment revenue	Interest, dividends and other investment revenue	Interest, dividends and other investment revenue	Interest, dividends and other investment revenue
	<b>Other revenue</b>	<b>Other revenue</b>	<b>Other revenue</b>	<b>Other revenue</b>

- 39. The staff view is that **Option D** most appropriately addresses the concerns raised by PIR respondents and feedback received from subsequent discussions with key stakeholders.
- 40. The increase in the number of the minimum revenue categories is expected to assist preparers in identifying the appropriate category for different types of revenue transactions. The amended Tier 3 and Tier 4 Standards will emphasise that only applicable revenue categories will need to be reported against.

**Question for the Board**

Q1. Does the Board agree with the staff recommendation to draft amendments regarding the minimum Tier 3 and Tier NFP revenue categories based on Option D in Table 11? If not, what other option (or combination of options) would the Board prefer?

Not-for-profit minimum expenditure categories (Tier 3 and Tier 4)

- 41. Based on the feedback received, we recommend the following amendments to the minimum expense categories in the Tier 3 and Tier 4 Standards.

<b>Table 12 – Recommended minimum expenditure categories (not-for-profit)</b>	
<b>Current Categories</b>	<b>Staff recommendation</b>
Expenses/Payments related to public fundraising	Costs related to fundraising
Volunteer and employee related costs/payments	<b>Employee remuneration</b>
	Other employee and volunteer costs
Costs/Payments related to providing goods and services	<b>Costs related to delivery of NFP activities</b> (Excluding expenses related to the categories above)
	<b>Costs related to commercial trading activities</b>
Grants and donations made/paid	Grants and donations made
	<b>Other costs</b>

- 42. The increase in the number of the minimum expense categories is expected to assist preparers in identifying the appropriate category for expense transactions. The amended Tier 3 and Tier 4 Standards will emphasise that only applicable expense categories will need to be reported against.

**Question for the Board**

Q2. Does the Board agree with the staff recommendations to draft amendments regarding the minimum Tier 3 and Tier NFP expense categories, based on staff recommendation in Table 12? If not, what other amendments would you suggest?

Public sector minimum revenue/receipts categories (Tier 3 and Tier 4)

43. Based on the feedback received, we recommend the following amendments to the minimum revenue/receipts categories in the Tier 3 and Tier 4 Standards (Public Sector). These amendments are aligned with the proposed not-for-profit amendments to the extent appropriate for the public sector.

<b>Table 13 – Recommended minimum revenue categories (public sector)</b>	
<b>Current categories</b>	<b>Staff recommendation</b>
Donations, fundraising and other similar revenue/receipts	Donations, koha, bequests and other fundraising revenue received/receipts from the public
	Grants from non-governmental organisations
Funding from central or local government	General funding received from central or local government
	Funding from service delivery grants/contracts (central or local government)
Revenue/Receipts from non-governmental sources for providing goods or services	Funding from service delivery grants/contracts (non- government)
	Revenue/receipts from commercial activities
Interest, dividends and other investment revenue/ income receipts	Interest, dividends and other investment revenue/receipts
	Other revenue/receipts

**Question for the Board**

- Q3. Does the Board agree with the staff recommendation to draft amendments regarding the minimum Tier 3 and Tier 4 (public sector) revenue categories, based on Table 13? If not, what other amendments would you suggest?

Public sector expenditure categories

44. Based on the feedback received, we recommend the following amendments to the minimum expense categories in the Tier 3 and Tier 4 Standards (Public Sector). These amendments are aligned with the proposed not-for-profit amendments to the extent appropriate for the public sector.

Table 14 – Recommended expenditure categories (public sector)	
Current Categories	Staff recommendation
Expenses related to fundraising	Costs related to fundraising
Employee related costs	Employee remuneration
	Other employee costs
Costs/Payments related to providing goods and services	Costs related to providing goods and services
	Costs related to commercial activities
Grants paid	Grants and donations
	Other costs

**Question for the Board**

Q4. Does the Board agree with the staff recommendation to draft amendments regarding the minimum Tier 3 and Tier 4 (public sector) expenditure categories, based on Table 14? If not, what other amendments would you suggest?

**Issue 2: Minimum categories of assets and liabilities**

- 45. The Board has previously agreed remove the requirement to present a Statement of Resources and Commitments from the Tier 4 (NFP) Standard and instead require the disclosure of significant asset and liabilities in the notes to the performance report. This is consistent with the existing approach taken in the Tier 4 (Public Sector) Standard.
- 46. The Board has also previously agreed to no longer use the term “resources” (described as significant assets instead) and “commitments” (described as significant assets instead) in the Tier 4 Standard.
- 47. We have considered whether the minimum categories of significant assets and liabilities that will disclosed in the notes of Tier 4 entities require amendment.

Minimum Tier 4 asset categories

- 48. The Tier 4 Standard currently provides additional categories of resources that an entity may choose to disclose. We have reviewed these additional categories to consider whether any should be included as a minimum category in the Tier 4 Standard under the significant asset note disclosure.

Table 15 – Consideration of additional asset minimum categories	
<p>Debtors and other receivables:</p> <ul style="list-style-type: none"> <li>• Grants receivable</li> <li>• Member subscriptions receivable</li> <li>• Receivables from of goods or services</li> <li>• Interest or dividends receivable</li> <li>• GST receivable</li> </ul>	<p><b>Recommend <u>not</u> including as a minimum category in the significant assets note</b></p> <p>As the Tier 4 Standard is cash-based we do not consider it is appropriate to require accrual-based balances unless they are frequently significant for the relevant entities. We do not expect Tier 4 entities in general to have significant receivable balances.</p> <p>There will be an overriding requirement to disclose any significant asset balances.</p>
<p>Inventory on hand (goods held for sale or distribution)</p> <p>Other resources used in the entity’s activities.</p>	<p><b>Recommend <u>not</u> including as a minimum category in the significant assets note</b></p> <p>This category is only relevant for those entities which carry on a commercial activity selling goods, or which retain significant inventories used in fulfilling their purposes.</p> <p>We do not expect Tier 4 entities in general to have significant inventory balances. In addition, under the cash standard, purchases of this nature will be expensed when purchased.</p>
<p>Property, plant and equipment (PP&amp;E):</p> <ul style="list-style-type: none"> <li>• Land and buildings</li> <li>• Motor vehicles</li> <li>• Computers (including software)</li> <li>• Furniture and fittings</li> <li>• Office equipment</li> <li>• Inventory on hand (goods held for sale or distribution)</li> </ul>	<p><b>Recommend land and buildings be included as a minimum asset category in the significant asset note</b></p> <p>Many Tier 4 entities own land and/or buildings which can be very significant to the entity. We consider it would be useful to explicitly require these to be reported in the notes.</p> <p>However, we do not consider that other PP&amp;E classes should be included in the minimum categories of significant assets disclosed in the notes.</p>
<p>Investments</p>	<p><b>Recommend investments be included as a minimum category in the significant assets note</b></p> <p>Many Tier 4 entities have significant investments. We consider it would be useful to explicitly require these to be reported in the Tier 4 note disclosure.</p>

49. Based on the above analysis and feedback received, we recommend the Tier 4 Standard require that the following minimum categories of significant assets be disclosed in the notes.

Table 16 – Recommendations for minimum asset categories (note disclosure)	
Current category	Suggested categories
Bank accounts and cash	Bank accounts and cash (including term deposits)
Money owed to the entity	Significant amounts owed from external parties
	Land and buildings
	Investments (excluding term deposits)
Other resources	Other significant assets

**Question for the Board**

Q5. Does the Board agree with the staff recommendation to draft amendments regarding the minimum asset categories in the Tier 4 Standard, based on Table 16?

Any amendments will be replicated across both the not-for-profit and public sector versions of the Tier 4 Standard.

Minimum Tier 4 liability categories

50. The Tier 4 Standard currently provides additional categories of commitments that an entity may choose to disclose. We have reviewed these additional categories to consider whether any should be included as a minimum category in the Tier 4 Standard under the significant liability note disclosure.

Table 17 – Consideration of additional liability minimum categories	
<p>Creditors</p> <ul style="list-style-type: none"> <li>• Money payable by the entity</li> <li>• Unpaid invoices relating to the provision of goods or services</li> <li>• Unpaid invoices relating to capital activities</li> <li>• GST Payable</li> </ul>	<p>Recommend <u>not</u> including as a minimum category in the significant liabilities note</p> <p>As the Tier 4 Standard is cash-based we do not consider it is appropriate to require the disclosure of accrual-based balances. We do not expect Tier 4 entities in general to have significant amounts payable or accrued expenditure.</p> <p>There will be an overriding requirement to disclose any significant liability balances.</p>
<p>Other payables</p> <ul style="list-style-type: none"> <li>• Wages and salaries payable</li> <li>• Annual leave</li> </ul>	<p>Recommend <u>not</u> including as a minimum category in the significant liabilities note</p> <p>As the Tier 4 Standard is cash-based we do not consider it is appropriate to require accrual-based balances of this nature</p> <p>We do not expect Tier 4 entities in general to have significant unpaid employee costs.</p>
<p>Loans and other advances</p>	<p>Recommend loans and other advances be included as a minimum category in the significant liabilities note</p> <p>As loans can often represent significant balances, we consider it is appropriate to specifically require them to be reported in the significant liabilities note.</p> <p>We also consider this disclosure will be important when Tier 4 entities has significant assets such as land and buildings which are financed by borrowings.</p>
<p>Grants payable by the entity that have been approved, but not yet paid.</p>	<p>Recommend <u>not</u> including as a minimum category in the significant liabilities note</p> <p>As the Tier 4 Standard is cash-based we do not consider it is appropriate to require accrual-based balances.</p> <p>We do not expect Tier 4 entities in general to have significant unpaid grants.</p> <p>There will be an overriding requirement to disclose information about any significant liabilities.</p>



51. Based on the above analysis and feedback received, we recommend the Tier 4 Standard require the following minimum categories of significant liabilities be disclosed in the notes.

Table 18 – Recommendations for minimum liability categories (note disclosure)	
Current category	Suggested categories
Money payable by the entity	
	Bank overdraft
	Loans
Other commitments	Other significant amounts owed to external parties
	Money held on behalf of others

**Question for the Board**

- Q6. Does the Board agree with the staff recommendation to draft amendments regarding the minimum liability categories in the Tier 4 Standard, based on Table 18?  
Any amendments will be replicated across both the not-for-profit and public sector versions of the Tier 4 Standard.

Minimum Tier 3 asset and liability categories

52. Based on the feedback received, no changes were considered necessary to the Tier 3 minimum asset and liability categories, other than some terminology changes.

**Next steps**

53. Based on Board FEEDBACK and DIRECTION staff will prepare an exposure draft proposing amendments to the Tier 3 and Tier 4 Standards for consideration at a future meeting.

*Appendices A to D contain extracts from the standards, for ease of reference.*

## Appendix A — Extracts from PBE SFR-A (NFP)

### Revenue

...

- A54. In order to make information understandable to users, revenue shall be aggregated and separately presented in categories. As a **minimum**, the following aggregated categories shall be reported separately:
- (a) Donations, fundraising and other similar revenue;
  - (b) Fees, subscriptions and other revenue from members;
  - (c) Revenue from providing goods or services; and
  - (d) Interest, dividends and other investment revenue.
- A55. Category (a) above includes grants and donations/koha received from the public and other organisations, for example, central or local government, charitable trusts, foundations and other philanthropic agencies. It also includes any revenue from fundraising activities. Grants received from the government or other agencies that are in substance a contract for delivery of goods or services would be included in category (c) above. Any revenue from members, including donations, would be included in category (b).
- A56. Entities need report only the minimum categories specified in paragraph A54 separately when the category is applicable and significant to the entity.
- A57. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A54, provided that the separate categories are still maintained.
- A58. 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.

### *Optional Information*

- A59. The minimum categories specified in paragraph A54 may be disaggregated, or additional categories may be presented in the statement of financial performance, when such presentation will enhance users' understanding of the entity's financial performance. Possible disaggregated or additional categories are listed below.
- (a) Donations or koha from the public;
  - (b) Fundraising revenue;
  - (c) Grants not directly related to service delivery;
  - (d) Fees and subscriptions from members;
  - (e) Donations, koha or offerings from members;
  - (f) Revenue from grants or contracts for service with central or local government;
  - (g) Revenue from grants or contracts for service with non-governmental agencies;
  - (h) Revenue from sales to the public;
  - (i) Revenue from sales to members;
  - (j) Revenue from commercial activities;
  - (k) Lease or rental revenue;
  - (l) Interest or dividend revenue; and
  - (m) Other revenue.
- A60. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main revenue sources of the entity. Too many categories can make it difficult for

users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.

- A61. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report. For example, fundraising from the public may be further disaggregated by fundraising campaign or type, such as by street collection, postal appeal, raffles or charity auction. The entity may also elect to include in the notes to the performance report a list of donors or grant providers, together with a summary of their contributions, if it considers that this is useful information. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

...

### **Expenses**

...

- A72. In order to make information understandable to users, expenses shall be aggregated and separately presented in categories. As a **minimum**, the following aggregated categories shall be reported separately:

- (a) Expenses related to public fundraising;
- (b) Volunteer and employee related costs;
- (c) Costs related to providing goods or services; and
- (d) Grants and donations made.

- A73. Entities need report only the minimum categories specified in paragraph A72 separately when the category is applicable and significant to the entity.

- A74. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A72, provided that the separate categories are still maintained.

- A75. 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.

- A76. Reimbursements for expenses incurred by employees on behalf of the organisation are not classified as employee expenses. For example, reimbursing an airfare for an employee to attend a conference. This is recorded in the appropriate category of expenses (for example, expenses relating to providing goods or services if that was the reason the travel took place).

### **Optional Information**

- A77. The minimum categories specified in paragraph A72 may be disaggregated, or additional categories may be presented in the statement of financial performance, when such presentation will enhance users' understanding of the entity's financial performance. Possible disaggregated or additional categories are listed below.

- (a) Administration and overhead costs;
- (b) Lease and rental expense;
- (c) Affiliation fees;
- (d) Interest expense;
- (e) Bad debts;
- (f) Depreciation;
- (g) Impairment charges; and
- (h) Other expenses.

- A78. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main expenses of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.

A79. Breakdowns of the minimum categories or the disaggregated or additional categories may be provided in the notes to the performance report. For example, employee related payments could be disaggregated into salaries and wages, employer superannuation contributions (for example, KiwiSaver) and other costs relating to employees (for example, ACC levies). The objective is to provide a breakdown that gives the most useful information to users of the performance report.

...

#### **Assets**

...

A92. In order to make information understandable to users, assets shall be aggregated and presented separately in categories. As a **minimum**, the following aggregated categories shall be reported separately and split between current and non-current (see paragraph A102):

- (a) Bank accounts and cash;
- (b) Debtors and prepayments;
- (c) Inventory;
- (d) Property, plant and equipment; and
- (e) Investments.

A93. Bank Accounts and cash comprise petty cash, cheque or savings accounts, and deposits held at call with banks.

A94. Debtors (sometimes called accounts receivable) comprise amounts owed to the entity by customers or others. This includes any GST receivable from Inland Revenue.

A95. Prepayments are expenses paid in advance of a good or service being received by the entity (such as rent, insurance or salaries and wages).

A96. Inventories are materials or supplies that are to be consumed in producing goods or services, held for sale or distribution in the ordinary course of operations, or are in the process of production for sale or distribution. Inventories include food, clothing or goods held for distribution, stocks held in opportunity and charity shops, information brochures printed for the entity but not yet distributed, goods purchased for resale, consumable stores, maintenance materials, spare parts for plant and equipment, and work-in-progress, such as educational/training course materials under development.

A97. Property, plant, and equipment (sometimes called fixed assets) are tangible items that are used in the production or supply of goods or services, or for administrative purposes, and are expected to be used during more than one financial year.

A98. Investments are shares, term deposits, bonds, units in unit trusts, or similar instruments held by the entity.

A99. Entities need report only the minimum categories specified in paragraph A92 separately when the category is applicable and significant to the entity.

A100. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A92, provided that the separate categories are still maintained.

A101. 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.

A102. In presenting the statement of financial position the entity shall identify those assets which are intended to be converted to cash within 12 months of the balance date, for example, debtors that are expected to be collected within a few months of balance date, or inventories that are expected to be sold or used within the next year. These shall then be classified as "current assets". The remaining assets shall then be classified as "non-current assets".

***Optional Information***

- A103. The minimum categories specified in paragraph A92 may be disaggregated, or additional categories may be presented in the statement of financial position, when such presentation will enhance users' understanding of the entity's financial position.
- A104. The main asset category where this is likely to be useful is property, plant, and equipment. A class of property, plant, and equipment is a grouping of assets of a similar nature or function in an entity's operations. Possible classes of property, plant and equipment that could be reported separately (either in the statement of financial position or in the notes to the performance report) are:
- (a) Land;
  - (b) Buildings;
  - (c) Motor vehicles;
  - (d) Furniture and fixtures;
  - (e) Office equipment;
  - (f) Computers (including software); and
  - (g) Machinery.
- A105. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main assets of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.
- A106. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report, for example, classes of property, plant and equipment, or different types of inventory (such as inventories held for consumption versus inventories held for sale). The objective is to provide a breakdown that gives the most useful information to users of the performance report.

...

**Liabilities**

...

- A119. In order to make information understandable to users, liabilities shall be aggregated and presented separately in categories. As a **minimum**, the following aggregated categories shall be reported separately and split between current and non-current (see paragraph A128):
- (a) Bank overdraft;
  - (b) Creditors and accrued expenses;
  - (c) Employee costs payable;
  - (d) Unused donations and grants with conditions; and
  - (e) Loans.
- A120. Creditors (sometimes called accounts payable) are amounts owing to suppliers to pay for goods or services that have been acquired in the course of the entity's operations. GST payable to Inland Revenue is also part of creditors.
- A121. Accrued expenses are costs incurred but not yet paid. This includes electricity, gas, telephone services used but not yet paid, water and local authority rates payable but not yet paid, and rent for the use of premises not yet paid.
- A122. Employee costs payable are amounts owing to, but not yet paid to employees. This category includes wages and salaries earned but not yet paid, holidays earned but not yet taken (holiday pay accrual), ACC contributions owing, PAYE withheld from employees' remuneration but not yet paid over to Inland Revenue, and contributions to superannuation schemes (such as KiwiSaver) or other post-employment benefit schemes collected but not paid over.

- A123. Unused donations and grants with conditions attached are donations or grants that have a “use or return” condition attached to them. This creates a binding obligation on the entity that is recorded as a liability (see paragraphs A63–A67 for a further discussion on revenue with conditions). This category includes unused revenue for service delivery contracts that have a “use or return” condition attached.
- A124. Loans are amounts borrowed by the entity.
- A125. Entities need report only the minimum categories specified in paragraph A119 separately when the category is applicable and significant to the entity.
- A126. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A119, provided that the separate categories are still maintained.
- A127. 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.
- A128. In presenting the statement of financial position the entity shall identify those liabilities which are due to be paid within 12 months of the balance date, which shall then be classified as “current liabilities”. The remaining liabilities shall then be classified as “non-current liabilities”.

***Optional Information***

- A129. The minimum categories specified in paragraph A119 may be disaggregated, or additional categories may be presented in the statement of financial position, when such presentation will enhance users’ understanding of the entity’s financial position.
- A130. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main liabilities of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.
- A131. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report, for example, a breakdown of loans. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

## Appendix B — Extracts from PBE SFR-A (PS)

### Revenue

...

- A57. In order to make information understandable to users, revenue shall be aggregated and presented separately in categories. As a **minimum**, the following aggregated categories shall be reported separately:
- (a) Funding from central or local government;
  - (b) Revenue from non-governmental sources for providing goods or services;
  - (c) Donations, fundraising and other similar revenue; and
  - (d) Interest, dividends and other investment revenue.
- A58. Category (a) above includes all funding received from central or local government, including both general funding and funding that is linked to the delivery of specific goods or services. Category (b) includes fees, charges and other revenue from other organisations and individuals that are (in substance) a contract for the delivery of goods or services (including student fees, registration fees, licensing fees and examination fees). Category (c) includes grants and donations/koha received from the public and non-governmental organisations (such as charitable trusts, foundations and other philanthropic agencies).
- A59. Entities need report only the minimum categories specified in paragraph A56 separately when the category is applicable and significant to the entity.
- A60. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A56, provided that the separate categories are still maintained.
- A61. 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.

### *Optional Information*

- A62. The minimum categories specified in paragraph A56 may be disaggregated, or additional categories may be presented in the statement of financial performance, when such presentation will enhance users' understanding of the entity's financial performance. Possible disaggregated or additional categories are listed below.
- (a) General funding from central or local government;
  - (b) Funding from central or local government for the delivery of goods or services;
  - (c) Fees and charges;
  - (d) Other revenue from the provision of goods or services;
  - (e) Grants, donations or koha from the public or non-governmental organisations;
  - (f) Fundraising revenue;
  - (g) Lease or rental revenue;
  - (h) Interest or dividend revenue; and
  - (i) Other revenue.
- A63. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main revenue sources of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.
- A64. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report, for example, fees and charges may be disaggregated by type of fees (for example, school fees, examination fees, activity fees). Where the entity receives significant donations and grants, the entity may also elect to include in the notes to the performance report a list of donors or grant

providers, together with a summary of their contributions, if it considers that this is useful information. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

...

### **Expenses**

...

- A74. In order to make information understandable to users, expenses shall be aggregated and presented separately in categories. As a **minimum**, the following aggregated categories shall be reported separately:
- (a) Employee related costs;
  - (b) Costs related to providing goods or services; and
  - (c) Expenses related to fundraising.
- A75. Entities need report only the minimum categories specified in paragraph A74 separately when the category is applicable and significant to the entity.
- A76. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A74, provided that the separate categories are still maintained.
- A77. 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.
- A78. Reimbursements for expenses incurred by employees on behalf of the organisation are not classified as employee expenses but are recorded in the appropriate category of expenses, for example, as an expense relating to providing goods or services.

### ***Optional Information***

- A79. The minimum categories specified in paragraph A74 may be disaggregated, or additional categories may be presented in the statement of financial performance, when such presentation will enhance users' understanding of the entity's financial performance. Possible disaggregated or additional categories are listed below.
- (a) Administration and overhead costs;
  - (b) Fees paid to members of the governing body;
  - (c) Lease and rental expense;
  - (d) Interest expense;
  - (e) Bad debts;
  - (f) Depreciation;
  - (g) Impairment charges; and
  - (h) Other expenses.
- A80. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main expenses of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.
- A81. Breakdowns of the minimum categories or the disaggregated or additional categories may be provided in the notes to the performance report. For example, employee related payments could be disaggregated into salaries and wages, employer superannuation contributions (for example, KiwiSaver) and other costs relating to employees (for example, ACC levies). The objective is to provide a breakdown that gives the most useful information to users of the performance report.

...



## Assets

...

- A94. In order to make information understandable to users, assets shall be aggregated and presented separately in categories. As a **minimum**, the following aggregated categories shall be reported separately and split between current and non-current (see paragraph A104):
- (a) Bank accounts and cash;
  - (b) Debtors and prepayments;
  - (c) Inventory;
  - (d) Property, plant and equipment; and
  - (e) Investments.
- A95. Bank Accounts and cash comprise petty cash, cheque or savings accounts, and deposits held at call with banks.
- A96. Debtors (sometimes called accounts receivable) comprise amounts owed to the entity by customers or others. This includes any GST receivable from Inland Revenue.
- A97. Prepayments are expenses paid in advance of a good or service being received by the entity (such as rent, insurance or salaries and wages).
- A98. Inventories are materials or supplies that are to be consumed in producing goods or services, held for sale or distribution in the ordinary course of operations, or are in the process of production for sale or distribution. Inventories include information brochures printed for the entity but not yet distributed, consumable stores, maintenance materials, spare parts for plant and equipment, and work-in-progress, such as educational/training course materials under development.
- A99. Property, plant, and equipment (sometimes called fixed assets) are tangible items that are used in the production or supply of goods or services, or for administrative purposes, and are expected to be used during more than one financial year.
- A100. Investments are shares, term deposits, bonds, units in unit trusts, or similar instruments held by the entity.
- A101. Entities need report only the minimum categories specified in paragraph A94 separately when the category is applicable and significant to the entity.
- A102. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A94, provided that the separate categories are still maintained.
- A103. 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.
- A104. In presenting the statement of financial position the entity shall identify those assets which are intended to be converted to cash within 12 months of the balance date, for example, debtors that are expected to be collected within a few months of balance date, or inventories that are expected to be sold or used within the next year. These shall then be classified as “current assets”. The remaining assets shall then be classified as “non-current assets”.

### *Optional Information*

- A105. The minimum categories specified in paragraph A94 may be disaggregated, or additional categories may be presented in the statement of financial position, when such presentation will enhance users’ understanding of the entity’s financial position.
- A106. The main asset category where this is likely to be useful is property, plant, and equipment. A class of property, plant, and equipment is a grouping of assets of a similar nature or function in an entity’s operations. Possible classes of property, plant and equipment that could be reported separately (either in the statement of financial position or in the notes to the performance report) are:

- (a) Land;
- (b) Buildings;
- (c) Motor vehicles;
- (d) Furniture and fixtures;
- (e) Office equipment;
- (f) Computers (including software); and
- (g) Machinery.

A107. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main assets of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.

A108. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report, for example, classes of property, plant and equipment, or different types of inventory (such as inventories held for consumption versus inventories held for sale). The objective is to provide a breakdown that gives the most useful information to users of the performance report.

...

### Liabilities

...

A121. In order to make information understandable to users, liabilities shall be aggregated and presented separately in categories. As a **minimum**, the following aggregated categories shall be reported separately and split between current and non-current (see paragraph A130):

- (a) Bank overdraft;
- (b) Creditors and accrued expenses;
- (c) Employee costs payable;
- (d) Unused donations, grants and government funding with conditions; and
- (e) Loans.

A122. Creditors (sometimes called accounts payable) are amounts owing to suppliers to pay for goods or services that have been acquired in the course of the entity's operations. GST payable to Inland Revenue is also part of creditors.

A123. Accrued expenses are costs incurred but not yet paid. This includes electricity, gas, telephone services used but not yet paid; water and local authority rates payable but not yet paid, and rent for the use of premises not yet paid.

A124. Employee costs payable are amounts owing to, but not yet paid to employees. This category includes wages and salaries earned but not yet paid, holidays earned but not yet taken (holiday pay accrual), ACC contributions owing, PAYE withheld from employees' remuneration but not yet paid over to Inland Revenue, and contributions to superannuation schemes (such as KiwiSaver) or other post-employment benefit schemes collected but not paid over.

A125. Unused donations, grants and government funding with conditions are donations, grants or government funding that have a "use or return" condition attached to them. This creates a binding obligation on the entity that is recorded as a liability (see paragraphs A65–A69 for a further discussion on revenue with conditions). This category includes unused revenue for service delivery contracts that have a "use or return" condition attached.

A126. Loans are amounts borrowed by the entity. These are likely to be relatively uncommon amongst entities applying this Standard.

A127. Entities need report only the minimum categories specified in paragraph A121 separately when the category is applicable and significant to the entity.

- A128. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A121, provided that the separate categories are still maintained.
- A129. 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.
- A130. In presenting the statement of financial position the entity shall identify those liabilities which are due to be paid within 12 months of the balance date, which shall then be classified as “current liabilities”. The remaining liabilities shall then be classified as “non-current liabilities”.

***Optional Information***

- A131. The minimum categories specified in paragraph A121 may be disaggregated, or additional categories may be presented in the statement of financial position, when such presentation will enhance users’ understanding of the entity’s financial position.
- A132. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main liabilities of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.
- A133. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report, for example, a breakdown of loans. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

## Appendix C — Extracts from PBE SFR-C (NFP)

### *Required Information*

#### **Receipts**

- A39. Receipts comprise all money received during the financial year. This includes notes and coins, cheques and other funds deposited into the entity's bank accounts.
- A40. Receipts can come from various sources, for example, public donations, grants from philanthropic trusts, donations and fees from members, funding for the provision of goods or services (including government contracts) and sales of goods or services (including trading receipts from commercial activities).
- A41. Receipts can also vary in their nature. Most receipts will relate to the normal operating activities of the entity (for example, receipts from a fundraising event). However, some receipts might result from transactions of a capital nature (for example, receipts from the sale of a computer or from borrowings). In order to provide useful information to users, receipts are therefore categorised either as operating receipts or capital receipts
- A42. Receipts shall be recorded on the receipt of cash, either in a bank account or as physical money received by the entity. For example, a donation shall be recorded on the date it is received, even if it is banked on a later date. Where cash received relates to a future period, relevant disclosures shall be included in the statement of resources and commitments (see example 5 in section 8).
- A43. Transfers of principal amounts between the bank accounts of the entity, or from the maturity of term deposits, shall not be recorded as receipts as they involve only the movement of cash within the entity, not the generation of a receipt. However, any interest received shall be recorded as a receipt.
- A44. In order to make information understandable to users, receipts shall be aggregated and presented separately in categories. As a **minimum**, the following aggregated categories shall be reported separately:
- Operating receipts:
- (a) Donations, fundraising and other similar receipts;
  - (b) Fees, subscriptions and other receipts from members;
  - (c) Receipts from providing goods or services; and
  - (d) Interest, dividends and other investment income receipts.
- Capital receipts:
- (e) Receipts from the sale of resources; and
  - (f) Receipts from borrowings.
- A45. Category (a) above includes grants and donations/koha received from the public and various other organisations, for example, central or local government, charitable trusts, foundations and other philanthropic agencies. It also includes any receipts from fundraising activities. Grants received from the government or other agencies that are in substance a contract for the delivery of goods or services would be included in category (c) above, any receipts from members, including donations, would be included in category (b).
- A46. Category (e) above (the sale of resources) includes the sale of physical assets, and the sale of any investments such as shares or bonds.
- A47. Entities need report only the minimum categories specified in paragraph A44 separately when the category is applicable and significant to the entity.
- A48. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A44, provided that the separate categories are still maintained.
- A49. 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.

***Optional Information***

A50. The minimum categories specified in paragraph A44 may be disaggregated, or additional categories may be presented, in the statement of receipts and payments when such presentation will enhance the user's understanding of the entity's financial performance. Possible disaggregated or additional categories are listed below.

Operating receipts:

- (a) Donations or koha from the public;
- (b) Fundraising receipts;
- (c) Grants not directly related to service delivery;
- (d) Fees and subscriptions from members;
- (e) Donations, koha or offerings from members;
- (f) Receipts from grants or contracts for service with central or local government;
- (g) Receipts from grants or contracts for service with non-governmental agencies;
- (h) Receipts from sales to the public;
- (i) Receipts from sales to members;
- (j) Receipts from commercial activities;
- (k) Lease or rental receipts;
- (l) Interest and dividend income receipts; and
- (m) Other operating receipts.

A51. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main sources of receipts by the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.

A52. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report. For example, fundraising from the public may be further disaggregated by fundraising campaign or type, such as by street collection, postal appeal, raffles or charity auction. The entity may also elect to include in the notes to the performance report a list of donors and grant providers, together with a summary of their contributions, if this is considered useful information. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

**Payments**

A53. Payments comprise all money paid during the financial year by cash, cheque, bank transfer or other method.

A54. Payments can be either operating payments (relating to day-to-day activities) or capital payments (relating to the purchase of resources or the repayment of borrowings).

***Required Information***

A55. Payments shall be recorded on the date that the payment is made. For example, a payment shall be recorded when a cheque is passed to the recipient (such as by posting), rather than the later date when the cheque is presented and the money withdrawn from the bank account.

A56. Transfers of principal amounts from one bank account to another, or for investment in term deposits, shall not be recorded as payments as they involve only the movement of cash not the disbursement of cash.

A57. In order to make information understandable to users, payments shall be aggregated and presented in categories. As a **minimum**, the following aggregated categories shall be reported separately:

Operating payments:

- (a) Payments related to public fundraising;

- (b) Volunteer and employee related payments;
- (c) Payments related to providing goods or services; and
- (d) Grants and donations paid.

Capital Payments:

- (e) Purchase of resources; and
  - (f) Repayment of borrowings.
- A58. Category (e) above (the purchase of resources) includes the purchase of physical assets, and the purchase of any investments such as shares or bonds.
- A59. Entities need report only the minimum categories specified in paragraph A57 separately when the category is applicable and significant to the entity.
- A60. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A57, provided that the separate categories are still maintained.
- A61. 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.
- A62. Reimbursements for expenses incurred by employees on behalf of the entity (for example, reimbursing an airfare for an employee) shall not be classified as employee payments but in the appropriate category of payments (for example, payments relating to providing goods or services if that was the reason the travel took place).

***Optional Information***

- A63. The minimum categories specified in paragraph A57 may be disaggregated, or additional categories may be presented, in the statement of receipts and payments when such presentation will enhance users' understanding of the entity's financial performance. Possible disaggregated or additional categories are listed below:

Operating payments:

- (a) Administration and overhead payments;
  - (b) Lease and rental payments;
  - (c) Affiliation fees;
  - (d) Interest payments; and
  - (e) Other operating payments.
- A64. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main payment types of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.
- A65. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report. For example, employee related payments could be disaggregated into salaries and wages, and other costs relating to employees, including superannuation contributions (for example, Kiwisaver) and ACC levies. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

...

**Schedule of Resources**

- A75. Resources comprise items owned by the entity and available for the entity to use in the future (commonly referred to as assets). They may have been purchased or donated. They can take the form of bank accounts and cash, money owing to the entity, or physical assets such as buildings or computers.

***Required Information***

- A76. In order to make information understandable to users, resources shall be aggregated and presented in categories. As a **minimum**, the following aggregated categories shall be separately reported:
- (a) Bank accounts and cash;
  - (b) Money held on behalf of others;
  - (c) Money owed to the entity; and
  - (d) Other resources.
- A77. Entities need report only the minimum categories specified in paragraph A76 separately when the category is applicable and significant to the entity.
- A78. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A76, provided that the separate categories are still maintained.
- A79. If there is difficulty in determining the category that should be used for a particular balance, 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.

***Bank Accounts and Cash***

- A80. This category shall comprise the total cash at the end of the financial year as disclosed in the statement of receipts and payments (see paragraph A35).

***Money Held on Behalf of Others***

- A81. If an entity is holding any cash on behalf of others it shall be reported separately.

***Money Owed to the Entity***

- A82. This category shall comprise amounts owed to the entity by third parties. The nature and amount of the money owed to the entity shall also be described (for example, invoices issued for which money has not yet been received).

***Other Resources***

- A83. This category shall comprise the non-cash resources owned by the entity and available to use in the future.
- A84. For each significant purchased resource, the entity shall report (either in the schedule of resources or in the notes to the performance report) either the cost or current value of the resource. This requirement applies only where the cost is available or it is practicable to obtain a current value - for example, using the latest rates valuation as a current value for land and buildings. Where a current value is reported the source and date of that value shall be disclosed.
- A85. For each significant donated resource, the entity shall report (either in the schedule of resources or in the notes to the performance report) a current value, where such a value can be practicably obtained. Where a current value is reported the source of that value shall be disclosed.

***Optional Information***

- A86. The minimum categories specified in paragraph A76 may be disaggregated, or additional categories may be presented, in the schedule of resources when such presentation will enhance the user's understanding of the entity's financial position. Possible disaggregated or additional categories are listed below:

Money Owed to the Entity:

- (a) Grants to the entity that have been approved by the grantor, but not yet received;
- (b) Subscriptions owed by members;
- (c) Receipts due as a result of providing goods or services;
- (d) Interest or dividends receivable; and

- (e) GST receivable (if the entity is registered for GST and a refund is due from Inland Revenue).

Other Resources:

- (a) Land and buildings;
- (b) Motor vehicles;
- (c) Computers (including software);
- (d) Furniture and fittings;
- (e) Office equipment;
- (f) Investments (including shares);
- (g) Inventory on hand (goods held for sale or distribution);
- (h) Other resources used in the entity's activities; and
- (i) Resources held on behalf of others.

A87. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main resources of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.

A88. Breakdowns of the minimum categories or the disaggregated or additional categories may be provided in the notes to the performance report. For example, a more detailed breakdown of physical resources. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

**Schedule of Commitments**

A89. Commitments comprise amounts owed by the entity (commonly referred to as liabilities) and legal obligations to make payments at a future date.

**Required Information**

A90. In order to make information understandable to users, resources shall be aggregated and presented in categories. As a **minimum**, the following aggregated categories shall be separately reported:

- (a) Money payable by the entity;
- (b) Other commitments; and
- (c) Guarantees.

A91. Entities need report only the minimum categories specified in paragraph A90 separately when the category is applicable and significant to the entity.

A92. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A90, provided that the separate categories are still maintained.

A93. 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.

*Money Payable by the Entity*

A94. This category shall comprise the money owed by the entity to third parties. The reason that the money is owed and the amounts to be paid shall also be described (for example, unpaid invoices).

*Other Commitments*

A95. This category shall comprise any significant contractual commitments (both operating and capital). The nature of the commitment and the amounts to be paid shall also be described. For example, where the entity leases an office, the entity shall disclose the total amount of the lease payments payable until the lease ends, and the date the lease ends.



A96. This category shall also include any amounts received that relate to activities to be undertaken in a future period and which would need to be repaid should those activities not occur.

*Guarantees*

A97. This category shall comprise any contractual guarantees given by the entity. In relation to each guarantee the following shall be reported:

- (a) The nature of the guarantee;
- (b) The reason why the guarantee was provided; and
- (c) The maximum amount that could be paid under the guarantee.

***Optional Information***

A98. The minimum categories specified in paragraph A90 may be disaggregated, or additional categories may be presented, in the schedule of commitments when such presentation enhances the user's understanding of the entity's financial position. Possible disaggregated or additional categories are listed below:

Money Payable by the Entity:

- (a) Unpaid invoices (whether paid by cash or electronically such as through direct debit) relating to the provision of goods or services (for example, rent payable, rates payable and utilities accounts payable, such as, telephone, electricity and gas);
- (b) Unpaid invoices (whether paid by cash or electronically) relating to capital activities;
- (c) Wages and salaries due and payable, including bonuses and honoraria;
- (d) Cash owing to third parties relating to employees (for example, ACC levies, PAYE, and superannuation contributions such as Kiwisaver);
- (e) GST payable (if the entity is registered for GST and GST is payable to Inland Revenue);
- (f) Interest payable;
- (g) Loans payable; and
- (h) Grants payable by the entity that have been approved, but not yet paid.

Other commitments:

- (a) Commitments to make future payments under a lease;
- (b) Commitments to purchase property, plant and equipment;
- (c) Loans or grants the entity is legally committed to making; and
- (d) Cash received that relates to activities to be undertaken in a future period.

A99. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main commitments of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.

A100. Breakdowns of the minimum categories or the disaggregated or additional categories may be provided in the notes to the performance report. For example, a more detailed breakdown of guarantees. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

## Appendix D — Extracts from PBE SFR-C (PS)

### Receipts

- A42. Receipts comprise all money received during the financial year. This includes notes and coins, cheques and other funds deposited into the entity's bank accounts.
- A43. Receipts can come from various sources, for example, funding from government (either as general funding or for the provision of goods or services), fees and charges (such as burial fees), and sales of goods or services (including trading receipts from commercial activities).
- A44. Receipts can also vary in their nature. Most receipts will relate to the normal operating activities of the entity (for example, receipts from the provision of goods or services). However, some receipts might result from transactions of a capital nature (for example, receipts from the sale of a computer or from borrowings). In order to provide useful information to users, receipts are therefore categorised either as operating receipts or capital receipts.

### Required Information

- A45. Receipts shall be recorded on the receipt of cash, either in a bank account or as physical money received by the entity. For example, a fee or charge shall be recorded on the date it is received, even if it is banked on a later date. Where cash received relates to a future period, relevant disclosures shall be included in the notes to the performance report if the amount is significant.
- A46. Transfers of principal amounts between the bank accounts of the entity, or from the maturity of term deposits, shall not be recorded as receipts as they involve only the movement of cash within the entity, not the generation of a receipt. However, any interest received shall be recorded as a receipt.
- A47. In order to make information understandable to users, receipts shall be aggregated and presented separately in categories. As a **minimum**, the following aggregated categories shall be reported separately:

#### Operating receipts:

- (a) Funding from central or local government;
- (b) Receipts from non-governmental sources for providing goods or services;
- (c) Donations and other similar receipts; and
- (d) Interest, dividends and other investment income receipts.

#### Capital receipts:

- (e) Receipts from the sale of resources; and
- (f) Receipts from borrowings.

- A48. Category (a) above includes all funding received from central or local government including both general funding and funding that is linked to the delivery of specific goods or services. Category (b) includes fees, charges and other receipts from other organisations and individuals that are (in substance) for the delivery of goods or services.
- A49. Category (e) above (the sale of resources) includes the sale of physical assets, and the sale of any investments such as shares or bonds.
- A50. Entities need report only the minimum categories specified in paragraph A47 separately when the category is applicable and significant to the entity.
- A51. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A47, provided that the separate categories are still maintained.
- A52. 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.

***Optional Information***

A53. The minimum categories specified in paragraph A47 may be disaggregated or additional categories may be presented in the statement of receipts and payments when such presentation will enhance users' understanding of the entity's financial performance. Possible disaggregated or additional categories are listed below.

Operating receipts:

- (a) Donations or koha from the public;
- (b) General funding from central or local government;
- (c) Funding from central or local government for the delivery of goods or services;
- (d) Receipts from the sale of goods or services to the public;
- (e) Receipts from commercial activities;
- (f) Lease or rental receipts;
- (g) Interest and dividend income receipts; and
- (h) Other operating receipts.

A54. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main sources of receipts by the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.

A55. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report. For example, receipts from the sale of goods or services to the public may be further disaggregated by type of good or service. Where the entity receives significant donations and grants, the entity may also elect to include in the notes to the performance report a list of donors and grant providers, together with a summary of their contributions, if this is considered useful information. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

**Payments**

A56. Payments comprise all money paid during the financial year by cash, cheque, bank transfer or other method.

A57. Payments can be either operating payments (relating to day-to-day activities) or capital payments (relating to the purchase of resources or the repayment of borrowings).

***Required Information***

A58. Payments shall be recorded on the date that the payment is made. For example, a payment shall be recorded when a cheque is passed to the recipient (such as by posting), rather than the later date when the cheque is presented and the money withdrawn from the bank account.

A59. Transfers of principal amounts from one bank account to another, or for investment in term deposits, shall not be recorded as payments as they involve only the movement of cash not the disbursement of cash.

A60. In order to make information understandable to users, payments shall be aggregated and presented in categories. As a **minimum**, the following aggregated categories shall be reported separately:

Operating payments:

- (a) Employee related payments;
- (b) Payments related to providing goods or services; and
- (c) Grants paid.

Capital Payments:

- (d) Purchase of resources; and
- (e) Repayment of borrowings.

- A61. Category (d) above (the purchase of resources) includes the purchase of physical assets, and the purchase of any investments such as shares or bonds.
- A62. Entities need report only the minimum categories specified in paragraph A60 separately when the category is applicable and significant to the entity.
- A63. The minimum categories may be described using terminology appropriate for the entity and need not use the titles used in paragraph A60, provided that the separate categories are still maintained.
- A64. 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.
- A65. Reimbursements for expenses incurred by employees on behalf of the entity (for example, reimbursing an airfare for an employee) shall not be classified as employee payments but in the appropriate category of payments (for example, payments relating to providing goods or services if that was the reason the travel took place).

***Optional Information***

- A66. The minimum categories specified in paragraph A60 may be disaggregated or additional categories may be presented in the statement of receipts and payments when such presentation will enhance users' understanding of the entity's financial performance. Possible disaggregated or additional categories are listed below:

Operating payments:

- (a) Administration and overhead payments;
  - (b) Repairs and maintenance;
  - (c) Interest payments; and
  - (d) Other operating payments.
- A67. Disaggregated or additional categories should be used only where doing so is necessary to provide users with an understanding of the main payment types of the entity. Too many categories can make it difficult for users to understand the overall picture. The number of disaggregated or additional categories used should therefore be limited to those that are really necessary.
  - A68. Breakdowns of the minimum categories, or the disaggregated or additional categories, may be provided in the notes to the performance report. For example, employee related payments could be disaggregated into salaries and wages, and other costs relating to employees, including superannuation contributions (for example, Kiwisaver) and ACC levies. The objective is to provide a breakdown that gives the most useful information to users of the performance report.

...

***Significant Resources and Commitments***

- A79. The notes to the performance report shall disclose the nature and amount of:
  - (a) Any significant resources owned by the entity; and
  - (b) Any significant commitments of the entity.
- A80. Resources comprise items owned by the entity and available for the entity to use in the future (commonly referred to as assets). They may have been purchased or donated. They can take the form of bank accounts and cash, money owing to the entity, or physical assets such as buildings or computers.
- A81. Commitments comprise amounts owed by the entity (commonly referred to as liabilities) and legal obligations to make payments at a future date.

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**Date:** 3 December 2021  
**To:** NZASB Members  
**From:** Vanessa Sealy-Fisher  
**Subject:** **Subsidiaries without Public Accountability: Disclosures**

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### Recommendation<sup>1</sup>

1. We recommend that the Board approves the draft comment letter to the IASB on IASB ED/2021/7 *Subsidiaries without Public Accountability: Disclosures* (the ED) (agenda item 6.2).

### Background

2. The International Accounting Standards Board (IASB) began work on the *Disclosure Initiative—Subsidiaries that are SMEs* project following suggestions that the IASB should look at permitting subsidiaries to apply IFRS Standards with reduced disclosure requirements. The IASB issued the ED in July 2021. Comments are due to the IASB by 31 January 2022.
3. Staff issued the ED for comment in New Zealand (with a comment due date of 12 November). To support constituent feedback, staff also prepared a comparison of the proposals in the ED with the current disclosure requirements for Tier 2 for-profit entities. This comparison is available on the [XRB website](#).
4. The NZASB has been monitoring this project for some time, as it could offer an alternative way of establishing Tier 2 disclosure requirements in New Zealand.
5. The XRB Board in July 2020 agreed to put a temporary hold on the harmonisation of disclosure requirements with Australia for Tier 2 for-profit entities. In March 2020 the AASB issued a new Tier 2 disclosure standard – AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*. As a result of AASB 1060, Tier 2 disclosures in Australian Accounting Standards and NZ IFRS are no longer fully aligned. The XRB will reconsider the need for harmonisation of Tier 2 disclosure requirements at some point in the future, pending further work by the IASB on introducing reduced disclosure requirements for certain entities.
6. At its August 2021 meeting, the Board agreed to write a short comment letter to the IASB in support of the proposals. Comment letters are due to the IASB by 31 January 2022. The draft comment letter expresses general support for the proposals but recommends that the scope of the ED be expanded to all entities without public accountability (rather than only subsidiaries without public accountability). This recommendation is consistent with the alternative view included in the ED.

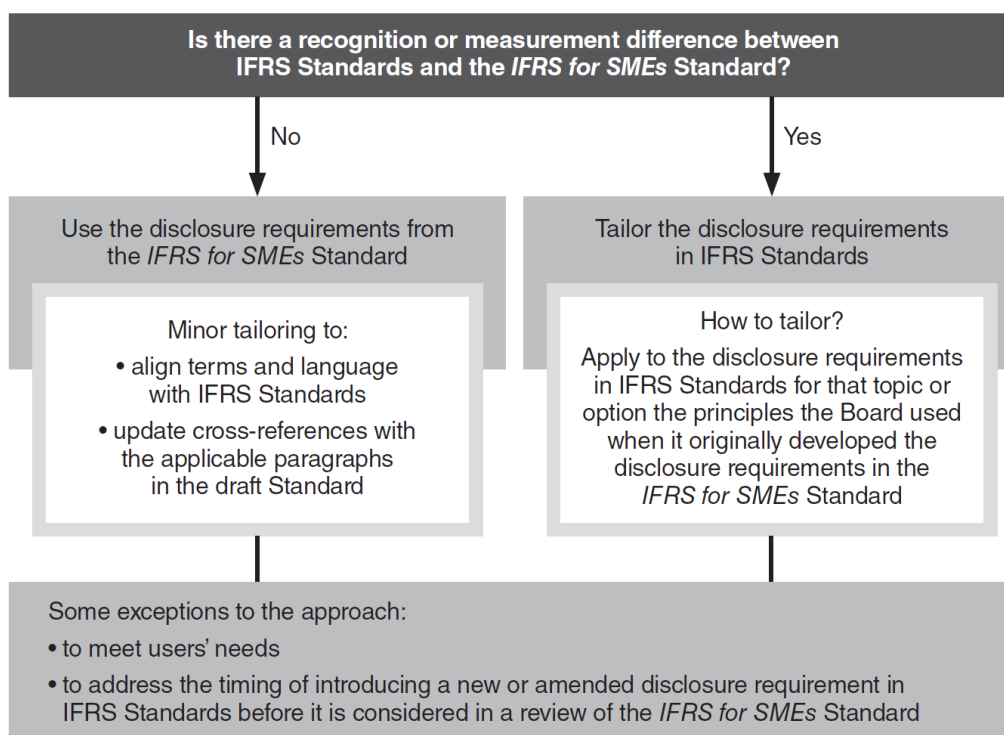
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<sup>1</sup> This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

ED/2021/7

7. The ED sets out proposals for a new, optional, IFRS® Standard that would specify the disclosure requirements for an entity if, and only if, at the end of its reporting period the entity:
  - (a) is a subsidiary (as defined in Appendix A of IFRS 10 *Consolidated Financial Statements*);
  - (b) does not have public accountability (as defined in the ED). The proposed definition of public accountability is the same as that in the *IFRS for SMEs® Standard*, and the same as that used in paragraph 8 of XRB A1 *Application of the Accounting Standards Framework*; and
  - (c) has an ultimate or intermediate parent that produces consolidated financial statements available for public use that comply with IFRS Standards.
  
8. The objective of the proposals is to permit eligible subsidiaries to apply the reduced disclosures in the ED while applying the recognition, measurement and presentation requirements in IFRS Standards. An entity that applies the reduced disclosures would be required to disclose that fact and would also be able to assert compliance with IFRS (see paragraph 22 of the ED).
  
9. The reduced disclosure requirements in the ED have been developed with reference to the *IFRS for SMEs Standard*. The diagram below explains the approach taken to determining the disclosure requirements in the ED.

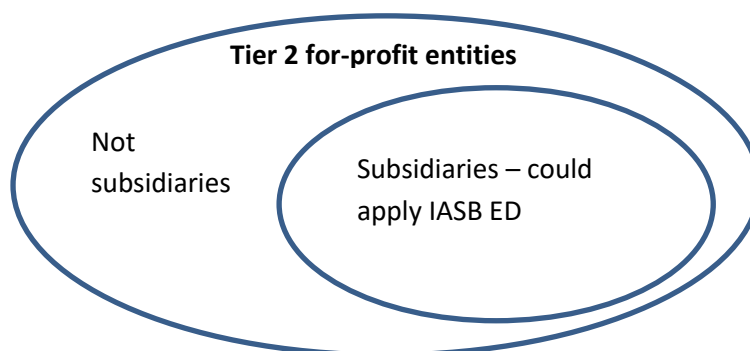
**Diagram 1**



### High-level comparison of proposals in the ED with RDR

10. Points to note when considering the differences between the disclosure requirements for Tier 2 for-profit entities and the proposed disclosures in the ED are listed below.
- (a) There is a scope difference (see Diagram 2). Tier 2 is available to a for-profit entity that does not have public accountability and is not a large public sector for-profit entity. As mentioned earlier in this memo, the scope of the ED is limited to subsidiaries that do not have public accountability.
  - (b) Some of the paragraphs in IFRS Standards which have been excluded from the ED are guidance rather than disclosure requirements (for example, paragraphs 37–39 of NZ IAS 2 *Inventories*, paragraphs 14–16 of NZ IAS 24 *Related Party Disclosures*).
  - (c) Some of the disclosure requirements in IFRS Standards have been simplified in the ED. Many of these simplifications are the same as, or substantively similar to, current RDR paragraphs that contain disclosure requirements for Tier 2 for-profit entities.

**Diagram 2**



11. Appendix A to this memo contains a high-level comparison of the proposed disclosure requirements in the ED with the current disclosure requirements for Tier 2 for-profit entities. This comparison lists NZ IFRSs where:
- (a) the RDR disclosures and the ED substantively the same;
  - (b) there are fewer disclosures in the ED compared with RDR; and
  - (c) there are more disclosures in the ED compared with RDR.

### Matters for future consideration

12. The following Accounting Standards Framework matters will require further consideration as this IASB project progresses. We want to raise awareness of the above issues at the December meeting. We do not plan to discuss them.
- (a) *Adoption of the final IASB pronouncement in New Zealand.* Under the Accounting Standards Framework, all IFRS Standards are incorporated within NZ IFRS so that Tier 1 for-profit entities applying NZ IFRS can also assert compliance with IFRS. The ED indicates that the new disclosure standard would be issued as an IFRS Standard and that entities that apply the new Standard would be able to assert compliance with IFRS.

- (b) *Tier 2 for-profit disclosure requirements.* If and how we use a final IASB pronouncement in New Zealand for setting reduced disclosure requirements for Tier 2 for-profit entities, if the IASB continues to restrict the scope of the proposed standard to eligible subsidiaries. Currently the Tier 2 reduced disclosure regime is available to any for-profit entity that does not have public accountability and is not a large for-profit public sector entity. An entity does not have to be a subsidiary to qualify for Tier 2.
- (c) *Harmonisation with Australia for Tier 2 for-profit.* Under the *Joint Statement of Intent: Single Economic Market Outcomes Framework*, for-profit entities operating in both jurisdictions should be able to prepare only one set of financial statements.<sup>2</sup> In the future we will need to consider if the outcomes of this IASB project will allow for a framework that both Australia and New Zealand could use to develop its Tier 2 disclosure exemptions.

### AASB meeting<sup>3</sup>

- 13. At its meeting on 10 November, the AASB agreed to comment on the ED and recommend that the IASB:
  - (a) broaden the scope of the Standard to apply to all entities without public accountability;
  - (b) reconsider the evidence supporting the cost versus benefit analysis and accordingly further reduce the proposed disclosure requirements;
  - (c) consider including all disclosure requirements, including those related to presentation, and guidance in the Standard; and
  - (d) document thoroughly the decision-making process in the Basis for conclusions to explain the reasons for adding the required disclosures.
- 14. The AASB also noted staff's initial considerations of the potential implications of any final IFRS Standard for AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (AASB 1060). Those considerations are whether to:
  - (a) replace AASB 1060 with the new IFRS Standard;
  - (b) amend AASB 1060 to add any additional disclosures to achieve compliance with IFRS Standards;
  - (c) keep AASB 1060 unchanged; and
  - (d) adopt the new IFRS Standard as an alternative to AASB 1060.
- 15. AASB staff will conduct targeted outreach to seek feedback on the implications of the IASB's proposals.

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<sup>2</sup> Signed by Prime Ministers Rudd and Keys in August 2009.

<sup>3</sup> [AASB Action Alert](#) issue No; 211 15 November 2021



**Question for the Board**

Does the Board APPROVE the draft comment letter on IASB ED/2021/7 *Subsidiaries without Public Accountability: Disclosures*?

**Next steps**

16. We will amend the comment letter for any changes requested by the Board, seek final sign-off from the Chair and submit the comment letter in January 2022.

**Attachments**

- Agenda item 6.2: Draft comment letter to the IASB
- Agenda item 6.3: Comment letter from CPA/CA ANZ to Chair of AASB (in supporting papers)
- Agenda item 6.4: IASB ED/2021/7 *Subsidiaries without Public Accountability: Disclosures* (in supporting papers)
- Agenda item 6.5: IASB Basis for Conclusions on ED/2021/7 (in supporting papers)

**Appendix A**

High-level comparison of the proposed disclosure requirements in IASB ED/2021/7 with the disclosure requirements for Tier 2 for-profit entities (RDR)

<p>RDR disclosures and the ED substantively the same</p>	<ul style="list-style-type: none"> <li>• NZ IFRS 2 <i>Share-based Payment</i></li> <li>• NZ IAS 1 <i>Presentation of Financial Statements</i></li> <li>• NZ IAS 2 <i>Inventories</i></li> <li>• NZ IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i></li> <li>• NZ IAS 21 <i>The Effects of Changes in Foreign Exchange Rates</i></li> <li>• NZ IAS 24 <i>Related Party Disclosures</i></li> <li>• NZ IAS 29 <i>Financial Reporting in Hyperinflationary Economies</i></li> <li>• NZ IAS 34 <i>Interim Financial Reporting</i></li> <li>• NZ IAS 40 <i>Investment Property</i></li> <li>• NZ IAS 41 <i>Agriculture</i></li> <li>• NZ IFRIC 2 <i>Members' Shares in Co-operative Entities and Similar Instruments</i></li> <li>• NZ IFRS 17 <i>Distribution of Non-cash Assets to Owners</i></li> <li>• NZ SIC-29 <i>Service Concession Arrangements: Disclosures</i></li> </ul>
<p>Fewer disclosures in the ED compared with RDR</p>	<ul style="list-style-type: none"> <li>• NZ IFRS 3 <i>Business Combinations</i> (some disclosures simplified)</li> <li>• NZ IFRS 5 <i>Non-Current Assets Held for Sale and Discontinued Operations</i></li> <li>• NZ IFRS 6 <i>Exploration for and Evaluation of Mineral Resources</i></li> <li>• NZ IFRS 7 <i>Financial Instruments: Disclosures</i> (many for first-time adoption of NZ IFRS 9)</li> <li>• NZ IFRS 12 <i>Disclosure of Investment in Other Entities</i></li> <li>• NZ IFRS 14 <i>Regulatory Deferral Accounts</i>)</li> <li>• NZ IFRS 15 <i>Revenue from Contracts with Customers</i> (generally fewer but some additional)</li> <li>• NZ IFRS 16 <i>Leases</i></li> <li>• NZ IAS 7 <i>Statement of Cash Flows</i></li> <li>• NZ IAS 12 <i>Income Taxes</i></li> <li>• NZ IAS 16 <i>Property, Plant and Equipment</i></li> <li>• NZ IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i></li> <li>• NZ IAS 38 <i>Intangible Assets</i></li> <li>• NZ IFRIC 5 <i>Rights to Interests arising from Decommission, Restoration and Environmental Rehabilitation Funds</i></li> <li>• NZ IFRIC 19 <i>Extinguishing Financial Liabilities with Equity Instruments</i></li> <li>• NZ IFRIC 23 <i>Uncertainty over Income Tax Treatments</i></li> </ul>
<p>More disclosures in the ED compared with RDR</p>	<ul style="list-style-type: none"> <li>• NZ IFRS 1 <i>First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards</i> (a couple)</li> <li>• NZ IFRS 13 <i>Fair Value Measurement</i> (a couple)</li> <li>• NZ IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> (all disclosures required)</li> <li>• NZ IAS 10 <i>Events after the Reporting Period</i></li> <li>• NZ IAS 19 <i>Employee Benefits</i>. (mainly for defined benefit plans)</li> <li>• NZ IAS 23 <i>Borrowing Costs</i></li> <li>• NZ IAS 27 <i>Separate Financial Statements</i> (disclosures about investment entity status)</li> <li>• NZ IAS 32 <i>Financial Instruments: Presentation</i> (offsetting)</li> <li>• NZ IAS 36 <i>Impairment of Assets</i></li> </ul>

[date 2022]

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](http://www.ifrs.org)

Dear Andreas

**ED/2021/7 *Subsidiaries without Public Accountability: Disclosures***

Thank you for the opportunity to comment on ED/2021/7 *Subsidiaries without Public Accountability: Disclosures* (the ED). The ED has been exposed for comment in New Zealand and some New Zealand constituents may comment directly to you.

The purpose of this comment letter to express our general support for this project. We welcome the development of an IFRS Standard which will simplify and reduce the cost of financial reporting for certain entities by providing for reduced disclosure requirements. However, we recommend that the IASB reconsiders the scope of the proposals and broadens it to all entities without public accountability.

In New Zealand, legislation specifies which entities are required to prepare financial statements that comply with generally accepted accounting practice (GAAP). GAAP for for-profit entities comprises New Zealand equivalents to IFRS® Standards (NZ IFRS) and some domestic standards to cater for the New Zealand regulatory environment. Entities that do not have public accountability apply the recognition and measurement requirements in NZ IFRS but are permitted to make fewer disclosures for cost:benefit reasons. This is because the recognition and measurement requirements in NZ IFRS are considered to be more appropriate for these entities than the requirements in the *IFRS for SMEs* Standard. These entities comprise entities that are not subsidiaries, as well as entities that are subsidiaries of a parent entity that prepares financial statements that comply with IFRS Standards and are available for public use.

We have not answered the questions in the Invitation to Comment, nor have we considered the proposed disclosures in detail.

If you have any queries or require clarification of any matters in this letter, please contact staff ([Vanessa.Sealy-Fisher@xrb.govt.nz](mailto:Vanessa.Sealy-Fisher@xrb.govt.nz) or me.

Yours sincerely

Carolyn Cordery  
**Chair – New Zealand Accounting Standards Board**

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**Date:** 3 December 2021  
**To:** NZASB Members  
**From:** Anthony Heffernan  
**Subject:** **XRBA1 Definition of Public Accountability**

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### Purpose and introduction<sup>1</sup>

1. The purpose of this memo is to receive Board DIRECTION on how we should respond to issues identified concerning the definition of *public accountability* in XRBA1 *Application of the Accounting Standards Framework* (XRBA1).
2. The definition of public accountability as used in XRBA1 is a key element in determining an entity's reporting tier when preparing general purpose financial reports in accordance with GAAP<sup>2</sup>. All for-profit and PBE reporting entities are required to apply Tier 1 reporting requirements if they have public accountability (as defined) at any time during the reporting period – regardless of any other considerations, including size.<sup>3</sup>
3. The definition of public accountability is also important for determining when a reporting entity is classified as a Public Interest Entity (PIE) for audit and assurance purposes. A PIE in New Zealand is defined as any entity that meets the Tier 1 reporting criteria in XRBA1.<sup>4</sup> Auditors of PIEs have additional independence requirements.
4. We have received feedback that applying the XRBA1 definition of public accountability is causing some application issues in practice. We have also received feedback from NZAuASB staff that an increasing number of audit practitioners are expressing concerns that the current definition of public accountability is too broad (i.e. concerns that too many entities are being classified as PIEs).
5. Through subsequent discussions with the XRBA's Accounting Technical Reference Group (TRG) and other practitioners, we have received feedback that the application issues are not considered pervasive. However, we continue to receive feedback from individual practitioners that the XRBA1 definition of public accountability is causing application issues for certain types of entities – specifically securities brokers/dealers and fund managers.
6. The memo provides background information on the XRBA1 definition of public accountability, explains the application issues arising in practice and other related concerns, and explores possible standard-setting responses.

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<sup>1</sup> 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).

<sup>2</sup> Generally accepted accounting practice (GAAP) comprises of accounting standards issues by the XRBA, and authoritative notices issued by the XRBA.

<sup>3</sup> XRBA1, paragraph 17 and 37.

<sup>4</sup> Professional and Ethical Standards 1 (PES 1).

## Recommendations

7. The recommendations below are supported and explained within the content of this memo.
8. The Board is asked to provide DIRECTION on the possible standard-setting response to the interpretation issues and other related concerns arising from the application of the XRB A1 definition of public accountability.
9. Based on the feedback received, concerns about the XRB A1 definition of public accountability can be broadly summarised into two issues.<sup>5</sup>

Issue 1: Concerns (mainly from audit practitioners) that the current definition of public accountability in XRB A1 is too broad – too many entities in New Zealand are required to apply the highest level of reporting (Tier 1) and as a result, too many entities are being classified as PIEs for assurance purpose (and therefore required to comply additional independence requirements).

Issue 2: Concerns that it is not clear whether certain types of entities have public accountability as defined by XRB A1 — specifically, security brokers/dealers and fund managers. This issue centres around concerns that the current definition is difficult to understand and apply, therefore amendments to reduce the diversity of application outcomes in practice would be welcomed.

### Issue 1

10. In response to issue 1, we recommend no standard-setting action be taken at this time. Instead, staff will continue to monitor the discussion on the PIE definition for assurance purposes by the international Boards<sup>6</sup> and the NZAuASB.
11. We will also work together with NZAuASB staff to develop a paper to advance a broader discussion of this issue at the next joint NZASB/NZAuASB meeting planned for the first quarter of next year.<sup>7</sup>

### Issue 2

12. In response to issue 2, staff have developed possible options to amend the definition of public accountability in XRB A1, to help reduce the extent of interpretation issues arising in practice. We request Board direction on whether we should commence a project to develop any of these options further into an amending standard. Any proposed amendments to XRB A1 will require XRB Board approval.

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<sup>5</sup> We have discussed the application of the XRB A1 definition of public accountability with key stakeholder groups, but we have not conducted broad public outreach activities.

<sup>6</sup> The International Ethics Standards Board for Accountants (IESBA) is expected to finalise the PIE definition in December 2021 and the International Auditing and Assurance Standards Board (IAASB) is accelerating a project to consider the implications for the auditing standards.

<sup>7</sup> This could include a discussion by the NZAuASB on whether the PIE definition for assurance purposes should continue to be aligned to Tier 1 as defined for financial reporting purposes.

## Structure of the memo

13. The remaining sections of this memo are:
- [Background information](#)
    - Tier 1 reporting criteria in XRB A1
    - Definition of public accountability in XRB A1
    - AASB Tier 1 reporting criteria
    - Definition of PIE for assurance purposes
  - [Application issues and other feedback received](#)
  - [Staff recommendations —responding to issues identified](#)
14. The memo also includes the following appendices with further background information (which Board members can choose to read).
- [Appendix A](#) — XRB A1 definition of public accountability
  - [Appendix B](#) — EG A1 guidance on determining whether an entity has public accountability
  - [Appendix C](#) — AASB Tier 1 reporting criteria
  - [Appendix D](#) — Flowchart of current Tier 1 reporting criteria

## Background information

### Tier 1 reporting criteria in XRB A1

15. XRB A1 sets out the tiers of financial reporting for all entities that have a statutory obligation to prepare general purpose financial reports in accordance with standards issued by the XRB (or that opts under any enactment to prepare such reports). This includes setting out the criteria for each tier and the accounting standards that apply to each tier.<sup>8</sup>
16. In general, XRB A1 requires all reporting entities with public accountability (as defined) to report in accordance with Tier 1 reporting requirements. The full Tier 1 reporting criteria for for-profit and PBE entities are outlined below.

### *For-profit entities*

17. A for-profit entity is required to report in accordance with Tier 1 For-Profit Accounting Requirements (i.e. full NZ IFRS) if it:
- (a) (i) has public accountability at any time during the reporting period; or
  - (ii) is a large (total expenses over \$30 million) for-profit public sector entity; or

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<sup>8</sup> The reporting tier structure set out in XRB A1 applies to entities that have a statutory obligation to prepare general purpose financial reports in accordance with GAAP or a non-GAAP standard issued by the XRB (and entities that opt under any enactment to prepare such reports). For the sake of brevity, in this memo we have omitted the reference to 'non-GAAP standard issued by the XRB' when referring to the reporting tier requirements in XRB A1.

- (b) is eligible to report in accordance with the accounting requirements of Tier 2 but does not elect to report in accordance with that tier.<sup>9</sup>

*Public benefit entities (PBE)*

- 18. A public benefit entity (PBE) is required to report in accordance with Tier 1 PBE Accounting Requirements (i.e. full PBE Standards) if it:
  - (a) (i) has public accountability at any time during the reporting period;<sup>10</sup> or
  - (ii) is large (total expenses over \$30 million); or
  - (b) is eligible to report in accordance with the accounting requirements of another tier but does not elect to report in accordance with that other tier.<sup>11</sup>

Definition of public accountability in XRB A1

- 19. Any New Zealand entity that has a statutory requirement to prepare general purpose financial reports in accordance with XRB Standards (or that opts under any enactment to prepare such reports) that has public accountability (as defined) at any time during the reporting period is required to apply Tier 1 reporting requirements.
- 20. XRB A1 defines an entity as having public accountability if:
  - (a) it meets the IASB definition of public accountability; or
  - (b) it is deemed to have public accountability in New Zealand based on whether it is an FMC reporting entity that has a “higher level of public accountability” than other FMC reporting entities, in accordance with the Financial Markets Conduct Act 2013 (FMC Act) or other notice issued by the FMA.<sup>12</sup>
- 21. The two legs of the XRB definition of public accountability are discussed in the separate sections below. The second leg is described by this paper as the “deeming approach”.
- 22. The full definition of public accountability and the accompanying guidance paragraphs as provided in XRB A1 are set out in [Appendix A](#).
- 23. Further guidance on applying the definition of public accountability is provided in the XRB’s Explanatory Guide EG A1 *Guide to Application of Accounting Standards Framework* — refer to [Appendix B](#).

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<sup>9</sup> XRB A1, paragraph 17.

<sup>10</sup> XRB A1 emphasises that definition of public accountability for determining Tier 1 reporting requirements has a specific technical meaning and is narrower than the generic term of public accountability that generally used to describe the nature of all PBEs.

<sup>11</sup> XRB A1, paragraph 37.

<sup>12</sup> XRB A1, paragraph 7.



*First leg — The IASB definition of public accountability*

24. The IASB definition of public accountability in XRB A1 is used by the IASB to define the intended scope of the *IFRS for SMEs Standard*. This definition is replicated word-for-word in paragraph 8 of XRB A1.

In accordance with the IFRS for SMEs Standard, an entity has public accountability if:

- (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
- (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

25. The same definition of public accountability has been recently used by the IASB in the *ED/2021/7 Subsidiaries without Public Accountability: Disclosures* issued in July 2021.<sup>13</sup>
26. The original rationale for using the IASB definition of public accountability in XRB A1 was to ensure that for-profit entities that should be applying full NZ IFRS (from a public interest perspective) are generally aligned with those that the IASB considers should be applying full IFRS Standards (to reflect generally accepted international best practice).<sup>14</sup>

*Second leg — Entities deemed to have public accountability*

27. When first developing the [New Zealand Accounting Standards Framework](#), the XRB recognised the need to deem certain entities as having public accountability for financial reporting purposes – and therefore requiring them to apply Tier 1 reporting requirements. Most of these entities are caught by the IASB’s principles-based definition of public accountability, but to remove any doubt certain entities were ‘deemed’ to have public accountability by paragraph 9 of XRB A1.

9 An entity is deemed to have public accountability in New Zealand if:

- (a) it is an FMC reporting entity or a class of FMC reporting entities that is considered to have a “higher level of public accountability” than other FMC reporting entities under section 461K of the Financial Markets Conduct Act 2013; or
- (b) it is an FMC reporting entity or a class of FMC reporting entities that is considered to have a “higher level of public accountability” by a notice issued by the Financial Markets Authority (FMA) under section 461L(1)(a) of the Financial Markets Conduct Act 2013.

28. FMC reporting entities with a “higher level of public accountability” under the FMC Act or through a notice issued under the FMC Act include:
- (a) all issuers of equity securities or debt securities;
  - (b) listed issuers;
  - (c) licensed derivatives issuers;

<sup>13</sup> This is a proposed new IFRS Standard that would permit eligible subsidiaries to apply IFRS Standards with a reduced set of disclosure requirements.

<sup>14</sup> Paragraph 11 of the New Zealand Accounting Standards Framework.

- (d) recipients of money from a conduit issuer;
  - (e) licensed managed investment schemes (MIS) (in respect of the investment fund financial statements);
  - (f) registered banks;
  - (g) credit unions;
  - (h) licensed insurers;
  - (i) building societies; and
  - (j) any other entity designated as having a higher level of public accountability by the FMA.
29. FMC reporting entities with 'lower levels of public accountability' include:<sup>15</sup>
- (a) licensed MIS managers (in respect of the manager's own financial statements);
  - (b) licensed providers of discretionary investment management services (DIMMS);<sup>16</sup>
  - (c) licensed peer-to-peer lending service providers;
  - (d) licensed crowd funding service providers;
  - (e) licensed supervisors;<sup>17</sup> and
  - (f) licensed market operators (domestic).<sup>18</sup>
30. Section 461(J)(2) of the FMC Act provides that the XRB, when setting its financial reporting tier strategy, "*must have regard to which FMC reporting entities are considered to have a higher level of public accountability*".
31. The FMC Act does not require the XRB to include any particular class of FMC reporting entity (including those classified as having higher levels of public accountability) within a particular tier of financial reporting. It is the responsibility of the XRB to decide the reporting tier for different types of entities.<sup>19</sup>
32. The *New Zealand Accounting Standards Framework* sets out the XRB's view that any entity designated under law as having a "higher level of public accountability" by the FMA is deemed to have public accountability and is therefore required to report under Tier 1. The deeming approach in XRB A1 ensures that the definition of public accountability reflects current legislation, most notably the FMC Act.<sup>20</sup>

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<sup>15</sup> These FMC reporting entities are required to apply Tier 2 reporting requirements.

<sup>16</sup> A DIMS is an arrangement whereby the investor gives a financial advisor authority to make buy-sell decisions on its behalf and authority to manage some or all of the investors holdings of financial products.

<sup>17</sup> Supervisors are appointed to look after investors' interests for some types of financial products (debts securities, specified managed funds, superannuation schemes (including KiwiSaver), and the interests of residents of retirement villages.

<sup>18</sup> Anyone operating a financial product market needs to be licenced unless the market is exempt. A financial product market is a facility where financial products are bought or sold, or where offers or invitations to buy or sell financial products are made.

<sup>19</sup> Section 461(J)(3) of the FMC Act.

<sup>20</sup> Paragraph 13 of the New Zealand Accounting Standards Framework.

AASB Tier 1 reporting criteria

33. AASB 1053 *Application of Tiers of Australian Accounting Standards* sets out the criteria for different reporting tiers in Australia. The Tier 1 reporting criteria include the IASB definition of public accountability, and the accompanying integral guidance includes deeming provisions similar to the approach taken in XRB A1.
34. Except for some differences in the specific entities described by the deeming provisions (to take into account Australian securities law and regulations), the Tier 1 reporting criteria approach in Australia is consistent with XRB A1. The AASB approach uses the same IASB definition of public accountability and also includes a deeming approach in Appendix B of AASB 1053.
35. In developing its Tier 1 reporting criteria, the AASB concluded that for-profit entities that have public accountability (as defined in *IFRS for SMEs*) should be required to apply full IFRSs as adopted in Australia. The AASB noted that, since Australia has adopted full IFRSs, it would be logical to use the same public accountability notion used by the IASB in determining which entities in the for-profit sector should apply Australian Accounting Standards in full.<sup>21</sup>
36. The AASB acknowledged constituents' comments that the application of the IASB definition of public accountability in some cases may involve increased judgement. Some constituents noted it would be helpful for the AASB to clarify certain terms used in the IASB definition of public accountability. These include the term 'public market' referred to in the first leg of the definition, and the terms 'fiduciary', 'broad', 'outsiders', and 'primary business' referred to in the second leg of the definition. However, the AASB noted it is not a policy of the Board to further interpret the IASB's terms and definitions. Accordingly, the AASB decided that, instead of interpreting the terms in the definition, AASB 1053 should identify entities that the Board deems to have public accountability in the Australian context, to supplement the IASB's definition of public accountability (see Appendix B of AASB 1053).<sup>22</sup>
37. For further details on the AASB's Tier 1 reporting criteria (including Appendix B of AASB 1053), please refer to [Appendix C](#).

Definition of public interest entity (PIE) for assurance purposes

38. The definition of public accountability as defined by XRB A1 is important from an audit engagement perspective, because it is a key factor in determining when a reporting entity is classified as a PIE. Auditors of PIEs have additional independence requirements when performing audit engagements.

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<sup>21</sup> BC 25 of AASB 1058

<sup>22</sup> BC 26 of AASB 1058

*Definition of PIE in New Zealand*

39. A PIE in New Zealand is defined as:

Any entity that meets the Tier 1 reporting criteria in XRB A1 and is not eligible to report in accordance with the accounting requirements of another tier.<sup>23</sup>

40. Whether an entity has public accountability for reporting purposes as defined by XRB A1 will also determine whether an entity is a PIE for audit engagement purposes. NZAuASB staff have provided feedback that audit practitioners do not feel that the definition of public accountability in XRB A1 is clear in certain circumstances, which leads to issues when determining whether the entity should be treated as a PIE for assurance purposes.

*Definition of PIE in International Code of Ethics for Professional Accountants*

41. In the glossary to the International Code of Ethics for Professional Accountants (including International Independence Standards) (the Code), a PIE is defined as follows.

(a) A listed entity; or  
 (b) An entity:  
     (i) Defined by regulation or legislation as a public interest entity; or  
     (ii) For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation might be promulgated by any relevant regulator, including an audit regulator.

Other entities might also be considered to be public interest entities, as set out in paragraph 400.8 of the Code.

400.8 Some of the requirements and application material set out in this Part reflect the extent of public interest in certain entities which are defined to be public interest entities. Firms are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:

(a) The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples might include financial institutions, such as banks and insurance companies, and pension funds.  
 (b) Size.  
 (c) Number of employees.

42. The definition of a PIE in the Code includes no direct reference to the IASB definition of public accountability, but it does include many similar concepts and principles. It is interesting to note the other PIE considerations in paragraph 400.8 of the Code – range of stakeholders, size, and number of employees – which are not considered as part of the IASB definition of public accountability.
43. IESBA in coordination with the IAASB is currently reviewing the definitions of the terms “listed entity” and “PIE” in the Code, to revise them as necessary so that they remain relevant and fit

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<sup>23</sup> Professional and Ethical Standards 1 (PES 1)

for purpose. An Exposure Draft *Proposed Revisions to the Definitions of Listed Entities and Public Interest Entity in the Code* (ED) was issued by IESBA in May 2021.

44. The ED proposes to broaden the definition of a PIE to include additional categories of entity, including:
  - a publicly traded entity;
  - an entity one of whose main functions is to take deposits from the public;
  - an entity one of whose main functions is to provide insurance to the public;
  - an entity whose function is to provide post-employment benefits; and
  - an entity whose function is to act as a collective investment vehicle.
45. An area of contention is whether pension funds and mutual funds available to the public should be included in the PIE categories. It is generally agreed that large managed investment funds should be included in the definition of a PIE because they attract significant public interest, but not all investment schemes of this nature should be caught (such as smaller investments schemes and those that are closely held).
46. The ED recognises that the local standard setter and regulator have a role in refining the PIE categories to give regard to national conditions and legal frameworks for financial products provided to the public. It is expected that local jurisdictions will add additional categories of entities to the international definition of a PIE.
47. The IESBA intends to finalise the amended PIE definition at its December 2021 meeting.
48. The NZAuASB has agreed that once the IESBA PIE definition is updated, it will be necessary to re-evaluate whether the New Zealand PIE definition (currently based on the Tier 1 reporting criteria in XRB A1) remains fit for purpose.

#### **Application issues and other feedback received**

49. On a sporadic basis, we have received feedback from individual practitioners that applying the definition of public accountability as used for determining Tier 1 reporting requirements in XRB A1 is considered overly complex and difficult to apply in certain circumstances.
50. Some difficulties in applying the XRB A1 definition of public accountability are to be expected, given the IASB definition of public accountability is principles-based, and applying the deeming approach requires consideration of specified terms in the FMC Act and other notices issued by FMA. The application of a degree of professional judgement is considered necessary and appropriate for certain entities.
51. To better understand the extent and nature of these application issues, staff have completed some targeted outreach activities over the May–July 2021 period. This included discussions with the TRG, FMA, NZAuASB staff, AASB staff, and individual practitioners who have previously raised concerns with us. We also reached out to Lay Wee Ng, who was involved in the development of the tier structure in XRB A1 when it was first introduced.

52. The objective of the outreach was to consider whether amendments to the XRB A1 definition of public accountability (and/or associated guidance material) should be considered, to make it clearer and more straightforward to apply.

#### TRG

53. At the TRG July 2021 meeting, members were asked for feedback on whether there was a need to amend the definition of public accountability in XRB A1 and whether the Tier 1 reporting criteria were causing any other concerns in practice.
54. TRG comments included the following.
- Application issues in applying the XRB A1 definition of public accountability have arisen in the past, but these have been largely worked through and resolved by the accounting firms.
  - The application issues that have arisen in practice mainly relate to the deeming approach used in the XRB A1 definition of public accountability. Determining whether an entity has “higher levels of public accountability” as defined the by FMC Act or other FMA notices is not always straightforward. The resolution of these issues has often required the support of professional legal advice as issues have centred around the interpretation of the law.
  - The use of the IASB definition of public accountability as part of the XRB A1 definition of public accountability was not considered to be causing significant interpretation issues in practice. Most entities caught by the IASB definition of public accountability are also FMC reporting entities – therefore whether an FMC entity is considered to have public accountability is often being driven by whether the entity is classified as having “higher levels of public accountability” by FMC Act.
  - Rather than amending the definition of public accountability in XRB A1, TRG members suggested there could be benefits in issuing some additional guidance to assist entities applying the definition, for certain types of entities where there is some diversity in practice – for example, sharebrokers.
  - Overall, TRG members considered that the application issues arising in practice from applying the XRB A1 definition of public accountability are not considered “pervasive”.

#### FMA

55. The Tier 1 reporting criteria and the definition of public accountability in XRB A1 were discussed with Jacco Moison (Head of Audit and Financial Reporting) and Sanja Sesto (Financial Reporting Manager) on 22 July 2021.
56. They did not highlight any significant concerns about the application of the current definition of public accountability in XRB A1. They acknowledged that there was a level of professional judgement required by certain FMC reporting entities when determining whether they have “higher levels of accountability” as defined by the FMC Act and other FMA notices.

57. They noted that when XRB A1 was last exposed for comment, the FMA had recommended that the IASB definition of public accountability be removed from the Tier 1 reporting criteria. They would support an outcome whereby only those for-profit entities classified as having “higher levels of public accountability” under FMC regulations should be required to apply Tier 1 reporting requirements.

Audit practitioners

58. Comments received from audit practitioners from major accounting firms included the following.<sup>24</sup>
- There is a diversity of views across the accounting firms about how the Tier 1 reporting criteria should be applied in practice. Some are concluding that only entities that are considered to have “higher levels of accountability” as defined by the FMC Act are required to apply Tier 1 reporting requirements.
  - When there is uncertainty about whether an entity meets the Tier 1 reporting criteria, there is a tendency to elect to report under Tier 1. This decision is based on the desire to avoid the risk of a decision to report under a lower tier being subject to regulatory scrutiny. Simply opting up to Tier 1 in circumstances where there is doubt does not resolve the issue concerning whether the entity should be treated as a PIE for assurance purposes. A PIE is defined as an entity that is required to report using Tier 1 reporting requirements and excludes entities that could choose to opt down.

*Uncertainty about whether ‘securities brokers/dealers’ have public accountability*

59. Follow-up discussions with the audit partner (to better understand the comment above about the diversity of views) confirmed that the key area of difficulty arises from applying the second part of the IASB definition of public accountability as it relates to “*securities brokers/dealers*”. Specifically, it is not clear whether entities broadly described as securities brokers/dealers “*hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses*”.
60. When these entities are not classified under FMC regulations as having “higher levels of public accountability”, it is not clear when the broader IASB definition of public accountability applies to entities that are broadly described as “securities brokers/dealers”.
61. The bracketed text in paragraph 8(b) of XRB A1 provides the impression that “most” securities brokers/dealers are caught by the IASB definition of public accountability. The audit partner considered that this does not appropriately reflect the diverse nature of services now provided by different types of securities brokers/dealers in New Zealand.

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<sup>24</sup> Comments were received from 1 audit partner which included comments the audit partner had received from other audit practitioners across different firms.

**Extract from XRB A1**

- 8 In accordance with the IASB definition, an entity has public accountability if:
- (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
  - (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

62. The term ‘broker’ under the FMC Act and other FMA regulations is generally considered to be a financial service provider who holds or deals with client money or property on behalf of clients. This can include stockbrokers, providers of investment portfolio services, and financial advisors who receive money from clients. However, some financial service providers who are known as “brokers” do not hold any client money or property, such as some insurance brokers and mortgage brokers.<sup>25</sup>
63. When applying the IASB definition of public accountability, it is not clear when securities brokers/dealers are considered to *hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses*. In most cases, the primary business of securities brokers/dealers is to buy/sell securities on behalf of clients and/or provide investment advisory and portfolio administration services. Under the FMC Act, some securities brokers/dealers are classified as having “higher levels of accountability” than other FMC entities based on the nature of the service provided, and others are not.

*Uncertainty about whether ‘fund managers’ have public accountability*

64. In practice, we understand there is also some uncertainty over whether fund managers are caught by the IASB definition of public accountability and are required to apply Tier 1 reporting requirements. The FMC Act and other FMA regulations generally classify fund managers who provide discretionary investment management services (DIMS) as having a lower level of public accountability.
65. The diversity in views arises from applying the IASB definition of public accountability, specifically whether fund managers are considered to *“hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses”*.
66. Fund Managers, as described by FMA regulations, provide administration services associated with operating managed investment schemes (for example KiwiSaver schemes). Most fund managers are FMA authorised financial advisors who are licensed to provide DIMS. Fund Managers who provide DIMS are authorised to make buy/sell decisions on behalf of clients in respect of a portfolio of investments, often without the need to refer to the client for every transaction or investment decision.<sup>26</sup>

<sup>25</sup> *Guidance Note: Broker Obligations*, issued by the FMA February 2014.

<sup>26</sup> *Guidance Note: Discretionary Investment Management Services*, issued by the FMA June 2014.



*Uncertainty about the application of paragraph 10 of XRB A1*

67. Practitioners have also noted that paragraph 10 of XRB A1 adds unnecessary complexity to the application of the definition of public accountability when applying the Tier 1 reporting criteria.

<b>Extract from XRB A1</b>	
<b>Public accountability</b>	
7	For the purpose of applying the Tier 1 criteria, an entity has public accountability if: <ul style="list-style-type: none"> <li>(a) it meets the IASB definition of public accountability as specified in paragraph 8 (subject to paragraph 10); or</li> <li>(b) it is deemed to have public accountability in New Zealand in accordance with paragraph 9.</li> </ul>
8	In accordance with the IASB definition, an entity has public accountability if: <ul style="list-style-type: none"> <li>(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or</li> <li>(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).</li> </ul>
9	An entity is deemed to have public accountability in New Zealand if: <ul style="list-style-type: none"> <li>(a) it is an FMC reporting entity or a class of FMC reporting entities that is considered to have a “higher level of public accountability” than other FMC reporting entities under section 461K of the Financial Markets Conduct Act 2013; or</li> <li>(b) it is an FMC reporting entity or a class of FMC reporting entities that is considered to have a “higher level of public accountability” by a notice issued by the Financial Markets Authority (FMA) under section 461L(1)(a) of the Financial Markets Conduct Act 2013.</li> </ul>
10	Notwithstanding paragraph 8(b), an FMC reporting entity is not considered to have public accountability unless it is considered to have a “higher level of public accountability” than other FMC reporting entities in accordance with paragraph 9(a) or 9(b).

68. The impact of applying paragraph 10 of XRB A1 is:
- (a) an FMC reporting entity<sup>27</sup> that holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses does not have public accountability unless it is considered to have a “higher level of public accountability” as defined by the FMC Act; and
  - (b) any other entity that has a statutory obligation (or opts under any enactment) to prepare financial statements in accordance with GAAP has public accountability if it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.
69. Practitioners have highlighted difficulties interpreting paragraph 10 of XRB A1 (it is considered overly complex) and cannot understand the outcome it is seeking to achieve. They note it

<sup>27</sup> An FMC reporting entity is defined by [section 451](#) of the FMC Act 2013

does not feel logical that an FMC reporting entity is not required to consider paragraph 8(b) of XRB A1 when considering whether it has public accountability, but non-FMC entities are required to consider paragraph 8(b).

70. The outcome of applying paragraph 10 is illustrated in [Appendix D](#).

#### AASB staff

71. Comments received from AAAB staff on the Tier 1 reporting criteria in Australia.
- The AASB also uses the IASB definition of public accountability to establish Tier 1 reporting requirements in Australia (as detailed in [Appendix C](#)).
  - They have also noted some application issues arising from time to time when an entity is considering whether they *hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses*. One example given of application challenges was whether securitisation trusts<sup>28</sup> are Tier 1 reporting entities, based on applying the IASB definition of public accountability.
  - The AASB is not currently considering any changes to the Tier 1 reporting criteria or the definition of public accountability in AASB 1053 (or any other related guidance material).

#### NZAuASB staff

72. The Tier 1 reporting criteria and the definition of public accountability in XRB A1 were discussed with the XRB's Interim Audit and Assurance Director.
73. The NZAuASB has received feedback from some audit practitioners that the current definition of public accountability in XRB A1 can be difficult to apply, is overly complex for certain types of entities and is difficult to understand. These concerns are consistent with the issues discussed above from audit practitioners.
74. Determining whether an entity has public accountability as defined by XRB A1 is important because this determines whether an entity is defined as a PIE for audit engagement purposes. Audit practitioners do not feel that the definition of a PIE is clear because of issues applying the definition of public accountability in XRB A1.

#### *Other concerns regarding PIE definition*

75. Audit practitioners have also expressed concerns that the XRB's PIE definition is capturing too many entities. Any entity with public accountability as defined by XRB A1 is required to apply Tier 1 reporting requirements, regardless of any other considerations (such as size), and as a result, is also defined as a PIE for assurance purposes. For example, many non-listed FMC reporting entities are classified as Tier 1 reporting entities because they are defined by FMA

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<sup>28</sup> A securitisation trust is usually established by a trust deed. This appoints a trustee to have ownership of the trust property (initially, a nominal amount of money to facilitate creation of the trust and then the receivables) on behalf of the beneficiaries (usually the originator/sponsor).

regulations as having “higher levels of public accountability” — this includes a large number of managed investment schemes.

- 76. As provided in Table 1 below, there are approximately 700–1,000 managed investment schemes in New Zealand that are classified as Tier 1 reporting entities, which as a result are also treated as PIEs for assurance purposes.
- 77. The indicative Tier 1 reporting (and PIE) population in New Zealand as summarised by NZAuASB staff.

<b>Table 1 – Tier 1 reporting entities</b>			
<b>For Profit</b>		<b>Not-for-profit</b>	<b>Public sector<sup>29</sup></b>
Listed (debt and equity)	Approx. 170	Approx. 70 Tier 1 charities  NFP entities with over \$30 million expenditure	Approx. 260 large Tier 1 public sector PBEs.  Some public sector entities are for-profit FMC reporting entities.
Banks, insurers, credit unions	Approx. 170		
Other issuers	Approx. 300		
Managed investment schemes	Approx. 700–1,000		
Other FMC reporting entities	Approx. 600		
	<b>2,000 – 2,500</b>	<b>70</b>	<b>260</b>

- 78. Recent concerns voiced by practitioners over the number of entities classified as PIEs for audit purposes has been exacerbated by the introduction of more stringent auditor rotation requirements for PIEs and the current audit staff shortage as a result of border restrictions.
- 79. NZAuASB staff are planning to advance a discussion on which entities should have be treated as PIEs for assurance purposes at the joint NZASB/NZAuASB meeting in the first quarter of 2022. Including whether the PIE definition should continue to be linked to Tier 1 reporting criteria in XRB A1.

**Staff recommendations —responding to issues identified**

- 80. Based on the feedback received, concerns about the application of the XRB A1 definition of public accountability can be broadly summarised into two issues:

Issue 1: Concerns (mainly from audit practitioners) that the current definition of public accountability in XRB A1 is too broad – the view that too many entities in New Zealand are required to apply the highest level of reporting (Tier 1) and as a result,

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<sup>29</sup> The Auditor-General’s independence requirements apply equally to all public entities and to all work carried out by, or on behalf of, the Auditor-General. In practice, this means that that the requirements in PES 1 that apply to “public interest entities” shall be applied to all public entities, unless the Auditor-General requires a different standard to be applied.

too many entities are being classified as PIEs for assurance purpose (and therefore required to comply with the highest level of assurance requirements).

Issue 2: Concerns that it is not clear whether certain types of entities have public accountability as defined by XRB A1 — specifically, security brokers/dealers and fund managers. This issue centres around concerns that the current definition is difficult to apply and amendments to reduce the diversity of application outcomes in practice would be welcomed.

#### Responding to issue 1

81. In response to issue 1, we recommend no standard-setting action be taken at this time. Instead, staff will continue to monitor the discussion on the PIE definition for assurance purposes by the international Boards<sup>30</sup> and the NZAuASB. We agree with NZAuASB staff that issue 1 should be considered at a broader XRB organisational level.
82. The New Zealand Accounting Standards Framework (the Framework) sets out the XRB’s current position on which entities should have Tier 1 reporting requirements. It concludes that in addition to using the IASB definition of public accountability, certain New Zealand entities should be deemed to have Tier 1 reporting requirements. This position is built around the following two Framework conclusions on the Tier 1 criteria.
  - The IASB definition of public accountability has been used to maintain alignment with the IASB’s views concerning which entities should be required to apply full IFRS; and
  - The deeming approach has been used to ensure that the definition of public accountability reflects current legislation, most notably the FMC Act.
83. The FMC Act empowers the FMA to designate an FMC reporting entity or class of FMC reporting entity as having a “higher level of public accountability” than other FMC reporting entities. Under the Framework, only FMC reporting entities that have a “higher level of public accountability” are deemed to have public accountability and are therefore required to apply Tier 1 reporting requirements. FMC entities that do not have a higher level of public accountability may report under Tier 2 for-profit reporting requirements.
84. Although the XRB has the authority to determine the appropriate reporting requirements for different types of FMC reporting entities (including which tier they apply), we do not believe it would be appropriate for the XRB to permit an FMC reporting entity with a “higher level of public accountability” (as classified by the FMC Act) to apply a lower tier of reporting. Any change to the Tier 1 reporting requirements of FMC entities with “higher levels of public accountability” would need to be led by the FMA.
85. Concerns raised by audit practitioners, that too many entities are classified as Tier 1 entities, are on their own not an appropriate reason for considering any significant changes to how public accountability is defined in XRB A1 (including the deeming provisions). Prima facie,

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<sup>30</sup> The International Ethics Standards Board for Accountants (IESBA) and the International Auditing and Assurance Standards Board (IASSB) are currently considering the PIE definition.

these concerns appear to be largely driven by ongoing auditor resourcing challenges across the accounting profession and the additional challenges arising from PIEs being subject to auditor rotation requirements.

86. The primary driver for any proposed change to the definition of public accountability as used in the XRB A1 Tier 1 reporting criteria (including the deeming provisions which are aligned with the definition of “higher level of public accountability” under the FMC Act) should be based on public interest considerations, including the need to maintain a trusted financial sector.<sup>31</sup>
87. We note that the XRB’s *Targeted Review of the New Zealand Accounting Standards Framework*, which was completed in the second half of 2019, did not highlight any significant concerns with the Tier 1 reporting criteria. One respondent noted that the definition of public accountability was not easy to apply to his organisation, being a not-for-profit trust. In response we acknowledged “*that some entities may need to apply more judgement than others when determining whether they have public accountability, but we believe that the current guidance on the meaning of ‘public accountability’ is sufficient, and reflects both the IASB’s internationally accepted definition of public accountability and New Zealand legislation.*”

*Staff recommendation*

88. In response to issue 1, staff recommend:
- (a) continuing to monitor the discussion on the definition of PIEs for assurance purposes by the IESBA, IAASB, and NZAuASB;
  - (b) working together with NZAuASB staff to develop a paper to advance a broader discussion on this issue at the next joint NZASB/NZAuASB meeting; and
  - (c) that no other standard-setting action be taken at this time.

**Questions for the Board**

1. Does the Board agree with the staff’s proposed response to issue 1?
2. Are there other actions that should be taken in response to issue 1?

Responding to issue 2

89. In response to issue 2, we have considered possible standard-setting options to address concerns that it is not clear whether certain types of entities have Tier 1 reporting requirements based on the definition of public accountability in XRB A1.
90. At recent international standard-setter meetings attended by the Director of Accounting Standards and the NZASB Chair, we made enquiries to assess the willingness of the IASB to consider amendments to improve the clarity of how the IASB definition of public

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<sup>31</sup> The reference to “finance sector” includes issuers, banks, insurers, and other entities who have provided a financial product through a public offering.

accountability should be applied in certain circumstances. IASB staff confirmed that there are no plans or intentions to amend this definition over the short-to-medium term.

91. We have therefore explored possible domestic standard-setting options, as outlined in Table 2.

Table 2	
Options to amend the Tier 1 reporting criteria in XRB A1	Staff comments
<p><b>Option 1</b></p> <p>Amend the definition of “public accountability” in XRB A1 by removing the IASB definition of public accountability, and instead, defining entities with public accountability as only those entities with “higher levels of public accountability” as defined by the FMC Act or other FMA regulations.</p> <p>This approach would involve amending paragraph 7 of XRB A1.</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>7 For the purpose of applying the Tier 1 criteria, an entity has public accountability if:</p> <p>(a) <del>it meets the IASB definition of public accountability as specified in paragraph 8 (subject to paragraph 10); or</del></p> <p>(b) it is deemed to have public accountability in New Zealand in accordance with paragraph 9.</p> </div>	<p><i>Pros</i></p> <ul style="list-style-type: none"> <li>This would resolve the application issue identified in practice, that it is not clear for certain non-FMC reporting entities when they are considered to hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.</li> <li>When XRB A1 was updated and exposed for comment in 2013, two of the six respondents recommended that XRB A1 should omit the IASB definition of public accountability and use only the deeming approach to define which entities in New Zealand are defined as having public accountability for Tier 1 reporting requirements.<sup>32</sup></li> <li>In response to the 2013 ED, the XRB agreed to keep under review the appropriateness of retaining the IASB’s definition of public accountability.<sup>33</sup></li> </ul> <p><i>Cons</i></p> <ul style="list-style-type: none"> <li>The rationale for retaining the IASB definition of public accountability (in addition to the deeming approach) is that it ensures that for-profit entities who are required to apply full NZ IFRS are generally aligned with those that the IASB consider should be applying full IFRS.</li> <li>The retention of the principles based IASB definition of public accountability will at times require the application of professional judgement, but it also importantly provides a ‘safety net’ to capture any reporting entities that are not caught deeming provisions but should in principle have Tier 1 reporting requirements.<sup>34</sup></li> </ul>

<sup>32</sup> XRB ED: *Amendments to XRB A1 Accounting Standards Framework: Omnibus Amendments (Legislative Update)* issued February 2014.

<sup>33</sup> *Feedback Statement on XRB ED: Amendments to XRB A1 Accounting Standards Framework: Omnibus Amendments (Legislative Update)*.

<sup>34</sup> A possible example may include New Zealand entities that have issued shares/debt on a public market overseas. These entities may not be caught in all instances by FMA regulations, but in principle should have Tier 1 reporting obligations.

Table 2	
Options to amend the Tier 1 reporting criteria in XRB A1	Staff comments
	<ul style="list-style-type: none"> <li>• Similar to the above point, there is a risk that the removal of the principles based IASB definition of public accountability could have unintended consequences. TRG members expressed nervousness about removing the IASB definition of public accountability.</li> <li>• This option would result in a loss of harmonisation between the New Zealand and Australia Tier 1 reporting criteria for for-profit entities.</li> </ul>
<p><b>Option 2</b></p> <p>Amend the IASB definition of public accountability in XRB A1, by removing the bracketed text from paragraph 8(b) of XRB 1.</p> <div style="border: 1px solid black; padding: 5px; margin: 10px 0;"> <p>8 In accordance with the IASB definition, an entity has public accountability if:</p> <p>(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or</p> <p>(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (<del>most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion</del>).</p> </div> <p>The purpose of this amendment is to remove the issue arising in practice that all “securities brokers/dealers” are perceived to be caught by the IASB definition of public accountability.</p>	<p><i>Pros</i></p> <ul style="list-style-type: none"> <li>• This option is consistent with the approach taken in Australia, where they have removed the bracketed text from their definition of public accountability. However, the bracketed text from paragraph 8(b) has been included in accompanying integral guidance material within the AASB standard.</li> <li>• This amendment would work well when accompanied by guidance material that explains that <u>some</u> securities brokers/dealers and fund managers will be considered to have public accountability and others will not – it will depend on the nature of the entity’s primary businesses. For example, securities brokers/dealers and fund managers that do not hold client assets, but instead only provide investment portfolio advice and/or transaction buy/sell services, will not in general be considered to have public accountability as defined by XRB A1.</li> </ul> <p><i>Cons</i></p> <ul style="list-style-type: none"> <li>• Introduces an inconsistency with IASB literature.</li> <li>• Under this approach, there is a risk that XRB guidance concerning whether securities brokers/dealers are considered to have public accountability for Tier 1 reporting may not be consistent with the FMA conclusions concerning when entities of this nature have a “higher level of accountability”.</li> <li>• The removal of the bracketed text will not fully resolve the interpretation issues arising in practice – some ‘greyness’ will remain.</li> </ul>

Table 2	
Options to amend the Tier 1 reporting criteria in XRB A1	Staff comments
<p><b>Option 3</b></p> <p>Amend the XRB A1 definition of public accountability so that fund managers and securities brokers/dealers are only considered to have “public accountability” when they are classified as having a “higher level of public accountability” as defined by the FMC Act or other FMC notices.</p> <p>This approach would not involve any amendments to the definition of public accountability in paragraph 7 of XRB A1 (i.e. the IASB definition of public accountability and the deeming approach would be retained), but paragraph 10 of XRB A1 would be amended as follows:</p> <div style="border: 1px solid black; padding: 5px; margin: 10px 0;"> <p>10 <del>Notwithstanding paragraph 8(b)), An FMC reporting entity is not considered to have public accountability under the second part of the IASB definition (paragraph 8(b)) unless it is deemed to have public accountability considered to have a “higher level of public accountability” than other FMC reporting entities</del> in accordance with paragraph 9(a) or 9(b).</p> </div> <p>The impact of the amendment is that any entity (including FMC reporting entities) that holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses will only be a Tier 1 reporting entity if they are classified as having a “higher level of public accountability” as defined by the FMC Act.</p>	<p><i>Pros</i></p> <ul style="list-style-type: none"> <li>Resolves one of the common interpretation issues identified in practice — that is, determining whether entities such as securities brokers/dealers, fund managers, and other entities are considered to “hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses”, and therefore have public accountability as defined by the IASB definition of public accountability.</li> <li>Maintains alignment with the IASB definition of public accountability (this will be retained in paragraphs 7 and 8 of XRB A1).</li> <li>Maintains broad alignment with how public accountability has been defined by the AASB for Tier 1 reporting purposes.</li> <li>Maintains the current deeming approach in paragraph 9.</li> </ul> <p><i>Cons</i></p> <ul style="list-style-type: none"> <li>There may be some non-FMC reporting entities, which hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses, that in principle should apply Tier 1 reporting requirements – but because of this amendment will fall through the cracks and apply Tier 2 reporting requirements instead (this risk is considered low).</li> <li>The risk above is low because most entities that hold holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses are caught by FMA regulations.</li> </ul>

*Staff recommendation*

92. In response to [issue 2](#), we recommend commencing a project to develop limited scope amendments to XRB A1 based on the Board preference for the proposed option(s) above. The scope of the project would be limited to addressing the specific application issues raised in practice – determining whether securities brokers/dealers and fund managers should have Tier 1 reporting requirements.



**Questions for the Board**

3. Should we commence a project to develop amendments to clarify the definition of public accountability to XRB A1?

*This would be a limited scope project in which the definition of public accountability in XRB A1 would continue to be based on the two-leg approach — based on applying the IASB definition of public accountability and the deeming approach. However, amendments (as discussed in Table 2) would be considered to clarify when certain types of entities would be considered to have public accountability.*

4. If you agree that we should commence a limited scope project, which option(s) from Table 2 would you support?
5. Are there any other actions that should be taken in response to the issues discussed in this paper?

**Next steps**

93. If the Board agrees to commence a project, proposed amendments in the form of a draft ITC and ED will be brought to a future NZASB meeting.
94. We will be updating the XRB Board on this possible project at its 14 December 2021 meeting.

## Appendix A — XRB A1 Definition of Public Accountability

The definition of public accountability from XRB A1 is as follows.

### Definitions

Public accountability, for the purposes of the Tier 1 criteria, has the meaning set out in paragraphs 7 to 13.

### Public accountability

- 7 For the purpose of applying the Tier 1 criteria, an entity has public accountability if:
- (a) it meets the IASB definition of public accountability as specified in paragraph 8 (subject to paragraph 10); or
  - (b) it is deemed to have public accountability in New Zealand in accordance with paragraph 9.
- 8 In accordance with the IASB definition, an entity has public accountability if:
- (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
  - (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).
- 9 An entity is deemed to have public accountability in New Zealand if:
- (a) it is an FMC reporting entity or a class of FMC reporting entities that is considered to have a “higher level of public accountability” than other FMC reporting entities under section 461K of the Financial Markets Conduct Act 2013<sup>35</sup>; or
  - (b) it is an FMC reporting entity or a class of FMC reporting entities that is considered to have a “higher level of public accountability” by a notice issued by the Financial Markets Authority (FMA) under section 461L(1)(a) of the Financial Markets Conduct Act 2013.
- 10 Notwithstanding paragraph 8(b), an FMC reporting entity is not considered to have public accountability unless it is considered to have a “higher level of public accountability” than other FMC reporting entities in accordance with paragraph 9(a) or 9(b).
- 11 Some entities may hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business, that does not mean that they have public accountability. For example:
- (a) this may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises requiring a nominal membership deposit and sellers that receive payment in advance of delivery of the goods or services such as utility companies;
  - (b) in the public sector, a government department whose primary business is the provision of state housing to tenants does not have public accountability if it also manages trust money (rental bonds) on behalf of those tenants as an incidental activity to its primary business; and

<sup>35</sup> The terms “FMC reporting entity” and an FMC reporting entity with a “higher level of public accountability” are set out in the Financial Markets Conduct Act 2013. Under the Financial Markets Conduct Act 2013, certain FMC reporting entities are considered to have a higher level of public accountability for financial reporting purposes. These include issuers of equity securities or debt securities under a regulated offer; managers of registered schemes (in respect of financial statements of a scheme or fund); listed issuers; registered banks; licensed insurers; credit unions and building societies. In addition, the FMA may, by notice, specify that an entity (or a group of entities) is considered to have a higher level of public accountability or not to have a higher level of public accountability than other FMC reporting entities.

- (c) in the not-for-profit sector, a not-for-profit entity that provides a wide range of welfare services to beneficiaries as its primary activity does not have public accountability merely because it holds welfare benefits on behalf of some of those beneficiaries to assist them with budgeting. While the entity is holding assets in a “fiduciary capacity for a broad group of outsiders” it is not holding them “as one of its primary businesses”. This is because providing the budgeting services is an incidental activity to its primary activity of providing a range of welfare services to beneficiaries.
- 12 Trustees of a trust are required to act in a fiduciary capacity for the benefit of the beneficiaries of that trust or in achieving the objects of the trust. However, this does not necessarily mean that the trust has public accountability as defined in paragraph 8(b). For example, a trust would not have public accountability when the financial resources or other resources held and managed by the trust are not the resources of specified individual beneficiaries, in the manner that the financial resources of the entities listed in paragraph 8(b) are the resources of the individual clients, customers and members of those entities.
13. Where the entity is a group in New Zealand, and the parent/controlling entity of the group has public accountability, the group is deemed to have public accountability. A group is not considered to have public accountability solely by reason of a subsidiary/controlled entity having public accountability.

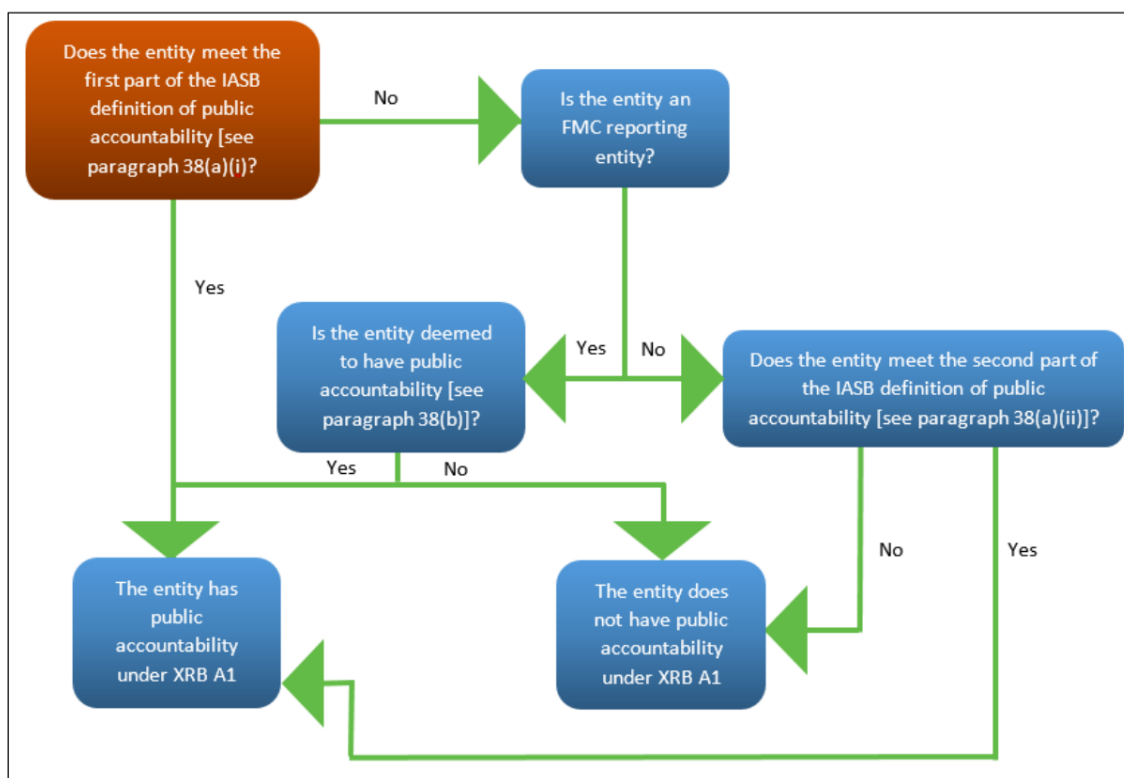
**Appendix B — EG A1 Guidance on Determining Whether an Entity has Public Accountability**

- B1. EG A1 provides guidance on determining which standard and which tier to apply when preparing general purpose financial reports.
- B2. Extracts from EG A1 regarding the determination of whether a reporting entity has “public accountability” for Tier 1 reporting purposes are provided below.

For-profit entities

- 38 Two groups of for-profit entities must report in accordance with Tier 1 requirements: entities that have “public accountability”; and public sector for-profit entities that have total expenses greater than \$30 million. For the purpose of the tier criteria, public accountability has a particular technical meaning which is defined in XRB A1. In general, an entity has public accountability if it:
- (a) Meets the International Accounting Standards Board (IASB) definition of public accountability, i.e.:
    - (i) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
    - (ii) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion); or
  - (b) Is deemed to have public accountability in New Zealand under XRB A1, with the following being so deemed: an FMC reporting entity or a class of FMC reporting entities that is considered to have a higher level of public accountability than other FMC reporting entities under the Financial Markets Conduct Act 2013 or by a notice issued by the Financial Markets Authority (FMA) under that Act.
- 39 However, XRB A1 also recognises that the FMA, under the Financial Markets Conduct Act 2013, has the ability to vary the level of public accountability of an FMC reporting entity. Therefore, an FMC reporting entity is not considered to have public accountability under the second part of the IASB definition (see paragraph 38(a)(ii)) unless it is deemed to have public accountability (see paragraph 38(b)). Figure 2 provides a decision tree to assist an entity identify whether it has public accountability.

Figure 2: Identifying Public Accountability



Public benefit entities

- 59 Two groups of PBEs must report in accordance with Tier 1 requirements: entities that have public accountability; and entities that have total expenses greater than \$30 million.
- 60 For the purpose of the tier criteria, public accountability has a particular technical meaning which is defined in XRB A1. The definition, is the same as that used for the for-profit tier structure. In general, an entity has public accountability if it:
- (a) Meets the IASB definition of public accountability, i.e.:
    - (i) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
    - (ii) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion); and
  - (b) Is deemed to have public accountability in New Zealand under XRB A1, with the following being so deemed: an FMC reporting entity or a class of FMC reporting entities that is considered to have a higher level of public accountability than other FMC reporting entities under the Financial Markets Conduct Act 2013 or by a notice issued by the FMA under that Act.
- 61 However, XRB A1 also recognises that the FMA, under the Financial Markets Conduct Act 2013, has the ability to vary the level of public accountability of an FMC reporting entity. Therefore, an FMC reporting entity is not considered to have public accountability under the second part of the IASB definition (see paragraph 60(a)(ii)) unless it is deemed to have public accountability (see

paragraph 60(b)). Figure 2 provides a decision tree to assist an entity identify whether it has public accountability.

- 62 It is important to note that the term public accountability is used in the tier framework in a particular technical way. This technical meaning is quite different from the way in which the term “publicly accountable” is normally used in the PBE context and in which it was used prior to 2011 in the Accounting Standards Framework.
- 63 One element of the Tier 1 public accountability test is where entities hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses. Applying this test in a PBE context will require the application of judgement. In doing so it is important to consider the three aspects of the test: the assets must be held in a fiduciary capacity; they must be held for a broad group of persons or organisations that are external to the reporting entity (and who are not involved in its management); and the assets must be held as part of the entity’s primary business. An example of a situation where these three aspects would typically be met is life insurance or superannuation schemes.
- 64 Some PBEs hold assets in a fiduciary capacity for a broad group of outsiders but do so in a way that is incidental to their primary business. In the public sector context, this is typically the case for central government entities that hold and/or manage trust money under the Public Finance Act 1989 (for example the Department of Corrections holds money for inmates). In the majority of cases the holding or management of money is not the entity’s primary business (i.e. its primary function) and therefore would not result in the entity meeting the public accountability test.
- 65 In the not-for-profit PBE context, this is typically the case where an entity that holds and/or manages trust money entrusted to it by a client, customer or member who is not involved in the management of the entity (for example, welfare benefits held on behalf of beneficiaries as part of the entity providing welfare services to the beneficiaries). In the majority of cases the holding or management of money is not the entity’s primary business (i.e. its primary function) and therefore would not result in the entity meeting the public accountability test.

**Appendix C — AASB Tier 1 Reporting Criteria**

- C1. AASB 1053 *Application of Tiers of Australian Accounting Standards*, establishes two tiers of reporting requirements for preparing general purpose financial statements.
- (a) Tier 1: Australian Accounting Standards;<sup>36</sup> and
  - (b) Tier 2: Australian Accounting Standards – Simplified Disclosures.
- C2. Paragraph 11 and 12 of AASB 1053 sets out the reporting entities who are required to apply Tier 1 reporting requirements.

11	The following types of entities shall prepare general purpose financial statements that comply with Tier 1 reporting requirements: <ul style="list-style-type: none"> <li>(a) for-profit private sector entities that have public accountability and are required by legislation to prepare financial statements that comply with either Australian Accounting Standards or accounting standards; and</li> <li>(b) the Australian Government and State, Territory and Local Governments.</li> </ul>
12	Subject to AASB 1049 <i>Whole of Government and General Government Sector Financial Reporting</i> , General Central Government Sector entities and State and Territory Governments shall apply Tier 1 reporting requirements.

- C3. We note that the AASB 1053 Tier 1 criteria does not include the same deeming provisions as provided in XRB A1. However, Appendix B<sup>37</sup> of AASB 1053 provides guidance on applying the definition of public accountability which has the same effect.

B2	The following for-profit entities are deemed to have public accountability: <ul style="list-style-type: none"> <li>(a) disclosing entities, even if their debt or equity instruments are not traded in a public market or are not in the process of being issued for trading in a public market;</li> <li>(b) co-operatives that issue debentures;</li> <li>(c) registered managed investment schemes;</li> <li>(d) superannuation plans regulated by the Australian Prudential Regulation Authority (APRA) other than Small APRA Funds as defined by APRA Superannuation Circular No. III.E.1 Regulation of Small APRA Funds, December 2000; and (e) authorised deposit-taking institutions.</li> </ul>
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- C4. To establish Tier 1 reporting criteria, AASB 1053 has based its definition of public accountability on the IASB definition.

<b>AASB 1053 – Appendix A, Defined Terms</b>	
Public accountability – an entity has public accountability if:	
(a)	its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

<sup>36</sup> Tier 1 incorporates IFRSs issued by the IASB and include requirements that are specific to Australian entities.

<sup>37</sup> Appendix B is an integral part of AASB 1053.

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

- C5. We note that paragraph (b) of the AASB 1053 definition of public accountability has not used the bracketed text from the IASB Definition – “(most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds, and investment banks would meet this second criterion)”. However, these examples are provided in Appendix B of AASB 1053,<sup>38</sup> which provides guidance on applying the definition of public accountability.

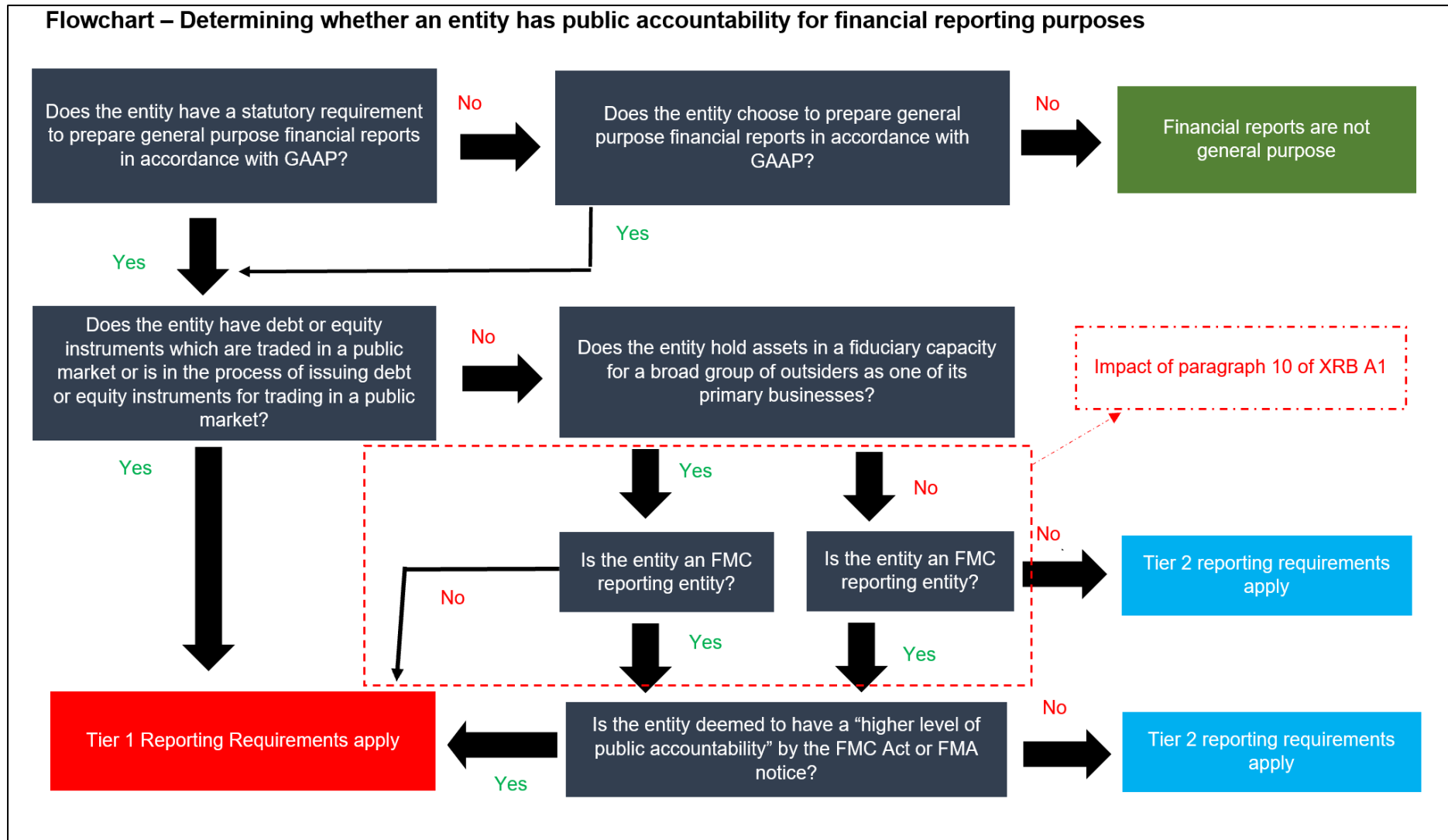
B4 Examples of entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses are most likely to include banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

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<sup>38</sup> Appendix B is an integral part of AASB 1053.



Appendix D — Flowchart of current Tier 1 reporting criteria



## Cover Memo

<b>Project:</b>	<b>Insurance Activities in the Public Sector</b>	<b>Meeting:</b>	AASB November 2021 (M184)
<b>Topic:</b>	Working draft Exposure Draft	<b>Agenda item:</b>	AASB 5.1
<b>Contacts:</b>	Angus Thomson <a href="mailto:athomson@asb.gov.au">athomson@asb.gov.au</a>	<b>Date:</b>	26 October 2021
	Vanessa Sealy-Fisher <a href="mailto:vanessa.sealy-fisher@xrb.govt.nz">vanessa.sealy-fisher@xrb.govt.nz</a>	<b>Project priority</b>	Medium
	Patricia Au <a href="mailto:pau@asb.gov.au">pau@asb.gov.au</a>	<b>Decision-making</b>	High
		<b>Project status</b>	Board deliberation

### Objectives of this agenda item

- The objectives of this agenda item are for the AASB and the NZASB to:
  - consider** a working draft Exposure Draft proposing the public-sector-specific modifications to AASB 17/PBE IFRS 17 agreed by the Boards at their meetings between April and September 2021; and
  - in relation to risk adjustments:
    - note** an interpretation issue on confidence levels; and
    - decide** whether to incorporate content in the Exposure Draft on the interpretation issue.
- The papers in this agenda item are being presented to the November 2021 AASB meeting and the December 2021 NZASB meeting.
- In respect of the working draft Exposure Draft (Agenda Paper 5.2), staff have not identified any specific questions for the Boards to answer. It is intended that the Boards consider the content of the working draft Exposure Draft on a page-by-page basis. With this in mind, **staff would be grateful for any feedback on the working draft Exposure Draft from members in advance of the meetings**, including any specific matters that you might wish to raise for Board discussion. (Please note this is not intended to preclude spontaneous debate that might occur in the course of the meetings on specific issues.)
- At this stage, it is planned that the Exposure Draft will be approved for issue at the Boards' February 2022 meetings.

### Reasons for bringing this agenda item to the Boards

- At their February 2021 meetings, the AASB and the NZASB decided the key issues to be deliberated in this project.<sup>1</sup>

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<sup>1</sup> The AASB project summary is available [here](#).

6. The following table outlines:
- the Board meetings at which topics have been considered; and
  - other activities needed to progress the project.
7. There is no overall change to the timetable since the June 2021 meetings, except for the explicit addition of liaison with the Public Sector Focus Sub-Group of the AASB 17 Transition Resource Group, and the explicit addition of field testing among key stakeholders. The field testing is likely to focus largely on applying the proposed indicators for determining the types of arrangements that fall within the scope of AASB 17/PBE IFRS 17.

Activity / Topic	AASB	NZASB
<b>Scope:</b> public sector activities to which AASB 17/PBE IFRS 17 should apply	April 2021	April 2021
<b>Risk adjustment:</b> relevance and measurement	April 2021	May 2021
<b>Discounting/inflating:</b> used to measure insurance liabilities	June 2021	June 2021
<b>PAA eligibility:</b> criteria for using 'simplified' measure of liabilities for remaining coverage	June 2021	June 2021
<b>Captive insurers</b>	Sept 2021	Sept 2021
<b>Non-contract costs:</b> classification	Sept 2021	Sept 2021
<b>Unit of account (including onerous contracts)</b>	Sept 2021	Sept 2021
<b>Measuring Investments</b> backing insurance liabilities	Sept 2021	Sept 2021
<b>Targeted redeliberation on scope and risk adjustment</b>	Sept 2021	Sept 2021
<b>Agree content of Exposure Draft</b>	Nov 2021	Dec 2021
<b>Discussion with the Public Sector Focus Group</b>	Dec 2021	Dec 2021
<b>Field testing among key stakeholders</b>	Commencing Nov 2021	Commencing Nov 2021
<b>Issue Exposure Draft</b> (probably with 60-day comment period, in view of other stakeholder outreach)	Planned March 2022	Planned March 2022
<b>Consider feedback on ED and proposals for addressing issues raised</b>	Planned June 2022	Planned June 2022
<b>Address any sweep issues and agree on revised Standards</b>	Planned July–Aug 2022	Planned July–Aug 2022
<b>Issue revised Standards</b>	Planned Sept 2022	Planned Sept 2022

### Papers for this agenda item

- Agenda Item 9.2: Risk adjustment – alignment of confidence levels
- Agenda Item 9.3: Working draft Exposure Draft *Proposed Amendments to AASB 17/PBE IFRS 17 Insurance Contracts*
- Agenda Item 9.4: Draft Invitation to Comment (in part)

## Staff Paper

<b>Project</b>	<b>Insurance Activities in the Public Sector</b>	<b>Meeting</b>	AASB November 2021 (M184) NZASB December 2021
<b>Topic</b>	Risk adjustment – alignment of confidence levels	<b>Agenda item</b>	AASB 5.3
		<b>Date</b>	26 October 2021
<b>Contacts</b>	Angus Thomson <a href="mailto:athomson@asb.gov.au">athomson@asb.gov.au</a> Vanessa Sealy-Fisher <a href="mailto:vanessa.sealy-fisher@xrb.govt.nz">vanessa.sealy-fisher@xrb.govt.nz</a> Patricia Au <a href="mailto:pau@asb.gov.au">pau@asb.gov.au</a>	<b>Project priority</b>	Medium
		<b>Decision-making</b>	High
		<b>Project status</b>	Board deliberation

### Objective of this paper

1. The objective of this paper is for the AASB and the NZASB to:
  - (a) be briefed on an interpretation issue potentially affecting all insurers regarding whether, under AASB 17/PBE IFRS 17 *Insurance Contracts*, the risk adjustment for a liability for remaining coverage and the risk adjustment for the related liability for incurred claims must achieve the same confidence level;<sup>1</sup> and
  - (b) **decide** whether to incorporate content on this issue in the forthcoming Exposure Draft *Accounting for insurance contracts in the public sector – Proposed Amendments to AASB 17/PBE IFRS 17 Insurance Contracts*.

### Summary of staff recommendations

2. Staff recommend that the Boards not make any specific proposals in the Exposure Draft about the interpretation issue noted in paragraph 1(a).
3. Staff also recommend, in the Basis for Conclusions to the Exposure Draft, the Boards:
  - (a) acknowledge the interpretation issue; and
  - (b) include observations of current public sector practices<sup>2</sup> regarding confidence levels used to determine risk adjustments for liabilities for remaining coverage and risk adjustments for the related liabilities for incurred claims.

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1 The 'confidence level' generally refers to a percentage of adequacy. That is, for example, a liability having a confidence level of 75% means that the liability is estimated to be adequate to meet actual claims (and related costs) three years in every four years (i.e. 75% of the time).

2 That is, current practices in the context of AASB 1023/PBE IFRS 4 and the risk margins used in measuring 'unexpired risk liabilities' (under the liability adequacy test) and the related 'outstanding claims liabilities'.

4. Please note that the working draft Exposure Draft (Agenda Paper 5.2) does not currently mention this issue.

### Structure of this paper

5. This staff paper is set out in three sections:
  - [Section 1](#) summarises the current proposals of each Board on public sector entities applying the risk adjustment requirements of AASB 17/PBE IFRS 17 to measure liabilities for incurred claims (paragraphs 6–8).
  - [Section 2](#) discusses confidence levels to be used for measuring liabilities for remaining coverage versus confidence levels used for measuring related liabilities for incurred claims under IFRS 17 (paragraphs 9–22).
  - [Section 3](#) includes the staff recommended approach (paragraphs 23–26).

### Section 1 Boards’ current proposals on risk adjustments regarding measurement of liabilities for incurred claims

6. The AASB has decided to propose no modifications to AASB 17 regarding the requirement to include a risk adjustment for non-financial risk in measuring a liability for incurred claims, for the reasons identified in paragraphs BC165 to BC166 of the working draft Exposure Draft (Agenda Paper 5.2).
7. The NZASB has decided to propose modifications to PBE IFRS 17 that would require a public sector entity to apply a rebuttable presumption that the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk is an adjustment to reflect a 75% confidence level for liabilities for incurred claims.
8. The NZASB’s reasons for proposing the modifications are identified in paragraphs BC167–BC171 of the working draft Exposure Draft.

### Section 2: Confidence levels – liability for remaining coverage versus liability for incurred claims

9. The Table below outlines the liability measurement (including risk adjustment) requirements under AASB 17/PBE IFRS 17 and AASB 1023/PBE IFRS 4.

AASB 17/PBE IFRS 17	AASB 1023/PBE IFRS 4	Comments
<b>Liability for remaining coverage</b>		
<b>General model:</b> The fulfilment cash flows, which include a <b>risk adjustment</b> for non-financial risk related to expected future events, plus a contractual service margin, if any [AASB 17/PBE IFRS 17.32]	<b>Unearned premium (UEP):</b> Premium that has not been recognised in the statement of comprehensive income is premium that is unearned and recognised in the statement of financial position as an unearned premium liability	There is an explicit risk adjustment under the general model. The risk adjustment under the PAA and UEP is (only) implicit in the
<b>Premium Allocation Approach (PAA):</b> Premiums, if any, received, minus any insurance acquisition cash flows, plus or		

AASB 17/PBE IFRS 17	AASB 1023/PBE IFRS 4	Comments
minus any amount arising from the derecognition any asset for insurance acquisition cash flows ... [AASB 17/PBE IFRS 17.55]	[AASB 1023.7.1/PBE IFRS 4 Appendix D.7.1]	pricing of the premiums.
<b>Inadequacy of liability for remaining coverage (loss components)</b>		
<b>General model:</b> As above, automatically takes into account expected losses – instead of a contractual service margin there is a ‘loss component’ [AASB 17/PBE IFRS 17.49]	<b>UEP:</b> If the PV of cash flows for expected future claims, plus an additional <b>risk margin</b> to reflect inherent uncertainty in the central estimate, exceed the UEP less related deferred acquisition costs (DAC) – DAC is written off and any remaining deficiency is a loss and unexpired risk liability [AASB 1023.9.1/PBE IFRS 4 Appendix D.9.1]	Risk adjustments are taken into account in determining whether a liability for remaining coverage is adequate under all measurement approaches (general model, PAA and UEP).
<b>PAA:</b> If facts and circumstances indicate insurance contracts are onerous – the loss equals the difference between the PAA and general model liabilities for remaining coverage [AASB 17/PBE IFRS 17.57]		
<b>Liability for incurred claims</b>		
<b>General model:</b> As above, the fulfilment cash flows, which include a <b>risk adjustment</b> for non-financial risk related to expected future events [AASB 17/PBE IFRS 17.40(b)]	The central estimate of the PV of expected future payments for claims incurred with an <b>additional risk margin</b> to allow for inherent uncertainty [AASB 1023.5.1/PBE IFRS 4 Appendix D.5.1]	Risk adjustments are taken into account in determining liabilities for incurred claims under both Standards.

**Current practice**

10. Practice has developed under AASB 1023/PBE IFRS 4<sup>3</sup> such that the risk margin used to determine whether a liability for remaining coverage (unearned premium liability) is inadequate/onerous can be different (usually a lower confidence level) than the risk adjustment used to determine a liability for incurred claims. For example, it is common in the private for-profit sector for:
  - (a) the confidence level applied to a liability for incurred claims to be between 80% and 90%, while
  - (b) the confidence level implicit in premiums (used as the basis for an unearned premium liability) to be 75%.

If a commercial private sector insurer were to charge premiums that met an 80% to 90% confidence level, in many markets, the insurer would be uncompetitive.
11. Practice in the public sector is varied:
  - (a) some entities (probably most) are applying the same confidence level to the risk adjustments in their liability for incurred claims as they apply to the risk adjustments

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3 Please note the same issue has emerged in many jurisdictions, not only Australia-New Zealand.

used in performing the liability adequacy test and, therefore, measuring their unexpired risk liability; and

- (b) some entities are applying a higher confidence level to the risk adjustments in their liability for incurred claims compared with the confidence level for the risk adjustment they use in performing the liability adequacy test and, therefore, measuring their unexpired risk liability.

**Interpretation issue**

- 12. An issue that is currently being debated within the insurance industry is whether, under IFRS 17, insurers are permitted to continue using different confidence levels for the risk adjustments for measuring different insurance liabilities. That is, for example, can an insurer apply:
  - (a) a 75% confidence level to measure the risk adjustment either:
    - (i) under the general model for a liability for remaining coverage; or
    - (ii) in assessing the adequacy of a PAA, the liability for remaining coverage; versus
  - (b) an 85% confidence level to measure the risk adjustment for a related liability for incurred claims?
  
- 13. Some stakeholders consider that the confidence level for risk adjustments relating to the two liabilities must be the same, while others do not.

**What’s changed?**

- 14. Some stakeholders might argue that AASB 1023/PBE IFRS 4 already implies that the same confidence level would be used for risk adjustments in measuring unexpired risk liabilities and the related liabilities for incurred claims. However, other stakeholders consider there are two main differences (see the Table below) between AASB 1023/PBE IFRS 4 and AASB 17/PBE IFRS 17 that more strongly imply the same confidence levels should be used.

<b>AASB 17/PBE IFRS 17</b>	<b>AASB 1023/PBE IFRS 4</b>	<b>Comments</b>
<p>The PAA is designed to be a simplified measure of the general model liability for remaining coverage.</p> <p>[The general model is the default approach and involves discounting expected future cash flows – it can be applied to measure both liabilities for remaining coverage and liabilities for incurred claims<sup>4</sup>]</p>	<p>Under AASB 1023/PBE IFRS 4:</p> <ul style="list-style-type: none"> <li>(a) the unearned premium liability is based on actual premiums, and not directly on expected cash flows; whereas</li> <li>(b) the liability for incurred claims is measured using discounted expected cash flows</li> </ul>	<p>Under AASB 17/PBE IFRS 17, there is a direct connection between the measurement bases for liabilities for remaining coverage and liabilities for incurred claims</p> <p>Under AASB 1023/PBE IFRS 4 the two liabilities are measured on two different bases</p>

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4 Under the general model, the measurement basis for a liability for remaining coverage and a liability for incurred claims are the same, except the liability for incurred claims has no CSM or loss component.

<b>AASB 17/PBE IFRS 17</b>	<b>AASB 1023/PBE IFRS 4</b>	<b>Comments</b>
<p>The notion of a risk adjustment being ‘compensation’ for bearing risk can be viewed as needing to be applied consistently to liabilities for remaining coverage and liabilities for incurred claims</p> <p>That is, in concept, all other things being equal, the extent to which an insurer wants to be compensated shouldn’t change as between coverage and claims in terms of the confidence level<sup>5</sup></p>	<p>There is no underlying principle (such as compensation for bearing risk) for measuring risk margins – they can be regarded as simply reflecting the inherent uncertainty of cash flows for a nominated confidence level</p>	<p>The absence of an underlying principle (such as compensation for bearing risk) potentially leaves the way open to wider interpretation under AASB 1023/PBE IFRS 4 (relative to AASB 17/PBE IFRS 17)</p>

**What would be the impact on public sector entities if the same confidence levels must apply?**

15. An example helps to illustrate the potential impacts. Assume a public sector entity with arrangements that are routinely onerous uses a 75% confidence level for measuring the unexpired risk liability and an 85% confidence level for measuring the liability for incurred claims. If the entity has to align the confidence levels, it could:
  - (a) align the confidence levels at 75% and have a lower liability for incurred claims;
  - (b) align the confidence levels at 85% and have a higher unexpired risk liability (up-front onerous contract loss); or
  - (c) align the confidence levels at some other percentage, such as 80% and have both a lower liability for incurred claims and higher unexpired risk liability.
  
16. Accordingly, there would be a balance sheet impact but, year-on-year, there would probably be no material impact for the income statement.

**A range of possible interpretations**

17. A range of possible (interrelated) interpretations has emerged from discussion within the insurance industry, including the following:
  - [1] confidence levels **must be the same** for the two liabilities;
  - [2] confidence levels **can be different** for the two liabilities:
    - (a) confidence levels for either liability can be **higher or lower** than for the other liability;
    - (b) the confidence level for a liability for remaining coverage can only be **lower** than for its related liability for incurred claims;

---

<sup>5</sup> If the incurred claims are inherently riskier than the expected claims (originally covered), the same confidence level would allow that to be reflected in a relatively larger risk adjustment.



(c) the confidence level for a liability for remaining coverage can only be **higher** than for its related liability for incurred claims; and

[3] confidence levels **can be different** for the two liabilities, **but not significantly different**.

18. The Table below uses the following abbreviations:

CL = confidence level

LfRC = liability for remaining coverage

LfIC = liability for incurred claims

CSM = contractual service margin (deferred profit under the general model when measuring LfRC)

RA = risk adjustment.

Please note that staff do not necessarily subscribe to one or other of the interpretations or to the comments identified in the table in support of each interpretation. The comments have been gleaned from outreach across the industry.

Interpretation	Comments in support of interpretation
[1] CLs must be the same	The general model measurement is the same for LfRC and LfIC (except for CSM/loss components) so, logically, the risk adjustment CLs must be the same. On expiry of coverage, unpaid incurred claims are transferred from the LfRC to the LfIC – if the CLs are different, there would be an immediate recognition of revenue/expense simply due to that difference. See <a href="#">Appendix A</a> to this agenda paper for an illustrative example.
[2](a) CLs can be higher or lower	RAs = compensation an insurer requires for bearing risk – so an insurer might determine different levels of compensation for different liabilities, even though the LfIC relates to contracts from within the same pool of contracts to which the LfRC relates.  IFRS 17 does not specify the technique used to measure RAs. By applying a technique other than a CL technique (e.g. a ‘cost of capital’ technique), the equivalent CLs for the LfRC and LfIC are bound to be different.
[2](b) CL for LfRC can only be lower than CL for LfIC	When pricing contracts, insurers need to be competitive, and the competition in most markets drives down premiums and limits the extent to which insurers can seek compensation for bearing risk. In contrast, the compensation the insurer might require for the related claims is not limited by competition.
[2](c) CL for LfRC can only be higher than CL for LfIC	When pricing contracts and providing coverage, insurers have less information about how the contracts will perform than after the coverage period has expired. Once the coverage period has expired and claims experience is known, this additional information should mean the insurer requires a lower CL for LfIC relative to the LfRC.
[3] CLs can be higher or lower, but not significantly	While the comments for [2](a) are correct, their impact would be limited because the LfRC and LfIC are drawn from the same pool of contracts. It would be counterintuitive for the CLs to be markedly different. Even though a different technique (e.g. a ‘cost of capital’ technique) can result in different CLs, they would never be expected to be significantly different.

### Could the interpretation differ between the public and private sectors?

19. The modifications agreed by the Boards for the purposes of the [DRAFT] Exposure Draft that could potentially impact on the basis for determining confidence levels used to measure risk adjustments include:
  - (a) not requiring the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition (AASB and NZASB);
  - (b) not requiring the sub-grouping of contracts based on whether they are issued more than a year apart (AASB and NZASB);
  - (c) requiring a risk adjustment that reflects an amount that is estimated to achieve a 75% confidence level for the relevant insurance liabilities, which can be rebutted (NZASB).
20. For most public sector entities, the unit of account modifications [(a) and (b) above] would mean that the liability for remaining coverage relates to contracts issued over a period of a year, whereas the liability for incurred claims could relate to multiple generations of contracts. On balance staff do not consider that this would, of itself, lead to a different outcome on confidence levels in the public sector. For example, if an entity changed its view on compensation required to bear risk from year to year, the overall confidence level for the liability for incurred claims should not change depending on whether the calculation is performed on a weighted average basis for multiple generations of contracts or separately for each generation of contracts.
21. If interpretation [1] (confidence levels **must be the same** for the two liabilities) is valid, the NZASB proposal for a rebuttable 75% confidence level might imply that 75% applies to both liabilities, not just the liability for incurred claims. However, an entity could theoretically rebut the 75% confidence level for one liability and not the other.
22. Accordingly, staff consider that a public sector entity applying the:
  - (a) AASB and NZASB proposals on not requiring the sub-grouping of contracts; and
  - (b) NZASB proposal for a rebuttable 75% confidence level for risk adjustment;
 would not necessarily be any more affected by the outcome of the interpretation issue than an insurer applying AASB 17/PBE IFRS 17 unmodified.

### Section 3: Staff recommendation

23. Staff suggest not making any specific proposals on the interpretation issue in the Exposure Draft in order to avoid disrupting any interpretation process that might occur at the IASB or across the industry over the coming months. [Staff note that it is currently unclear when a consensus might be reached on the interpretation issue explained in Section 2 relating to confidence levels.]
24. However, staff consider that it would be beneficial for the Basis for Conclusions to the Exposure Draft to:
  - (a) acknowledge the interpretation issue relating to whether the risk adjustment for a liability for remaining coverage and the risk adjustment for the related liability for incurred claims must achieve the same confidence level; and
  - (b) include observations of current public sector practices.

25. Staff support acknowledging the interpretation issue in the Exposure Draft because the measurement of risk adjustments is a relatively significant matter for public sector entities.
26. Depending on the Exposure Draft feedback, either Board retains the right to alter their existing proposals and/or also mandate a particular interpretation of risk adjustments for public sector entities in their jurisdiction. This is the case regardless of whether the interpretation issue:
  - (a) remains unresolved by the IASB or through industry practice; or
  - (b) is resolved in favour of a particular interpretation that either Board considers unsuitable for the public sector.

**Questions for Board members**

- Q1 Do Board members agree to not make any specific proposals in the Exposure Draft on the interpretation issue relating to whether the risk adjustment for a liability for remaining coverage and the risk adjustment for the related liability for incurred claims must achieve the same confidence level?
- Q2 Do Board members agree that the Basis for Conclusions to the Exposure Draft should:
- (a) acknowledge the interpretation issue; and
  - (b) include observations of current public sector practices?
- Q3 If you disagree with Q1 or Q2, what alternative approach do you wish to take?

**Appendix A: Illustrative example – Insurance liabilities**

- A1. On expiry of coverage, unpaid incurred claims are transferred from the liability for remaining coverage to the liability for incurred claims.
- A2. If the confidence levels are different for the two liabilities, there would be an immediate recognition of revenue/expense simply due to that difference.
- A3. This difference would not typically be evident because of the number of other changes occurring as coverage is provided and claims are incurred. However, the highly-simplified example below seeks to demonstrate the impact.

**Facts**

- (a) one contract is issued for a premium of \$100, which is paid up-front
- (b) one claim is expected of \$100 (best estimate)
- (c) the actual claim is \$100 (best estimate) and remains unpaid at year end
- (d) the risk adjustment for the liability for remaining coverage at a 75% confidence level is \$15
- (e) the risk adjustment for the liability for incurred claims at an 85% confidence level is \$20
- (f) ignoring discounting/inflating:
  - (i) the liability for remaining coverage would be \$115 (\$100 plus \$15 risk adjustment) up to the time the claim is incurred
  - (ii) at the time the claim is incurred (assuming it is still expected to be the only claim), the liability for remaining coverage would be \$0, and a liability for incurred claims of \$120 ((\$100 plus \$20 risk adjustment) would be recognised
- (g) when the claim is incurred, the journal entries would be as follows:

	Debit	Credit	
Liability for remaining coverage	\$115		Derecognition of liability
Insurance service expense	\$5		Due to different confidence level
Liability for incurred claims		\$120	Recognition of liability



## NZASB EXPOSURE DRAFT 2022-1

### Accounting for Insurance Contracts in the Public Sector

#### Issued [date]

This [draft]<sup>1</sup> Standard was issued on [Date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This [draft] Standard is a disallowable instrument for the purposes of the Legislation Act 2019, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [Date].

Reporting entities that are subject to this [draft] Standard are required to apply it in accordance with the effective date, which is set out in Part D.

In finalising this [draft] 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 [draft] Tier 1 and Tier 2 PBE Standard modifies some of the requirements in PBE IFRS 17 *Insurance Contracts* for its application by public sector entities.

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<sup>1</sup> References to “this Standard” throughout this Exposure Draft should be read as referring to “this draft Standard”.

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Draft



## Part A – Introduction

This Standard modifies some of the requirements in PBE IFRS 17 *Insurance Contracts* for its application by public sector entities.

Tier 2 public benefit entities are required to comply with all the requirements in this Standard.

## Part B – Scope

This Standard applies to Tier 1 and Tier 2 public benefit entities.

## Part C – Amendments

### Amendments to PBE IFRS 17 *Insurance Contracts*

Paragraph 2.1 is amended. Deleted text is struck through.

#### Scope

2.1 **This Standard applies to Tier 1 and Tier 2 ~~not-for-profit~~ public benefit entities.**

Paragraphs 16.1 and 22.1 are added. New text is underlined. Paragraphs 16 and 22 are not amended but are shown for context.

#### Level of Aggregation of Insurance Contracts

...

16. An entity shall divide a portfolio of insurance contracts issued into a minimum of:

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

16.1 Notwithstanding paragraph 16, a public sector entity need not sub-group a portfolio of contracts based on whether, at initial recognition, they are (a) onerous; or (b) have no significant possibility of becoming onerous subsequently; or (c) are neither (a) nor (b).

...

22. An entity shall not include contracts issued more than one year apart in the same group. To achieve this the entity shall, if necessary, further divide the groups described in paragraphs 16–21.

22.1 Notwithstanding paragraph 22, a public sector entity need not sub-group insurance contracts within a portfolio based on when they are issued.

...

Paragraph 25.1 is added. New text is underlined. Paragraph 25 is not amended but is shown for context.

## Recognition

25. An entity shall recognise a group of insurance contracts it issues from the earliest of the following:

- (a) The beginning of the coverage period of the group of contracts;
- (b) The date when the first payment from a policyholder in the group becomes due; and
- (c) For a group of onerous contracts, when the group becomes onerous.

25.1 Notwithstanding paragraph 25, a public sector entity shall recognise a group of insurance contracts it issues from the earliest of the following:

- (a) The beginning of the coverage period of the group of contracts; and
- (b) The date when the first payment from a policyholder in the group becomes due.

...

Paragraphs 34.1–34.3 and 37.1 are added. New text is underlined. Paragraphs 33, 34 and 37 are not amended but are shown for context.

## Measurement

...

*Estimates of Future Cash Flows (paragraphs AG36–AG71)*

33. An entity shall include in the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group (see paragraph 34). Applying paragraph 24, an entity may estimate the future cash flows at a higher level of aggregation and then allocate the resulting fulfilment cash flows to individual groups of contracts. The estimates of future cash flows shall:

- (a) Incorporate, in an unbiased way, all reasonable and supportable information available without undue cost or effort about the amount, timing and uncertainty of those future cash flows (see paragraphs AG37–AG41). To do this, an entity shall estimate the expected value (i.e., the probability-weighted mean) of the full range of possible outcomes.
- (b) Reflect the perspective of the entity, provided that the estimates of any relevant market variables are consistent with observable market prices for those variables (see paragraphs AG42–AG53).
- (c) Be current—the estimates shall reflect conditions existing at the measurement date, including assumptions at that date about the future (see paragraphs AG54–AG60).
- (d) Be explicit—the entity shall estimate the adjustment for non-financial risk separately from the other estimates (see paragraph AG90). The entity also shall estimate the cash flows separately from the adjustment for the time value of money and financial risk, unless the most appropriate measurement technique combines these estimates (see paragraph AG46).

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 AG61–AG71). 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.

34.1 In respect of paragraph 34(a) and (b)(i):

- (a) Assessing a public sector entity’s practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on future pricing or benefits;
- (b) A public sector entity’s monopoly position in providing coverage for risks in a particular community, of itself, would not affect the entity’s practical ability to fully price for risks or benefits; and
- (c) Any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits.

34.2 Notwithstanding paragraph 34(b)(ii), a public sector entity would not be regarded as failing to meet the criterion in paragraph 34(b)(ii) simply because its premium pricing for coverage up to the date when the risks are reassessed takes into account risks that relate to periods after the reassessment date, due to having a policy of determining prices and benefits based on a medium to long term view.

34.3 When a public sector entity takes into account risks that relate to periods after the reassessment date because of its policy of determining prices and benefits based on a medium to long term view, it shall disclose information about the manner in which pricing or benefits are determined either in the notes to the financial statements or by reference to an authoritative source.

...

***Risk Adjustment for Non-Financial Risk (paragraphs AG86–AG92)***

37. An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

37.1 Notwithstanding paragraph 37, for a public sector entity, there is a rebuttable presumption that the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk is an adjustment to reflect a 75% confidence level (that is, a 75% probability of liabilities for incurred claims being adequate to meet actual claims).

...

Paragraph 132.2A is added. New text is underlined.

**Effective Date and Transition**

**Effective Date**

...

132.2A Accounting for Insurance Contracts in the Public Sector, issued in [date] broadened the scope of PBE IFRS 17 to include public sector public benefit entities. It amended paragraph 2.1 and added paragraphs 16.1, 22.1, 25.1, 34.1–34.3, 37.1. AG16.1–AG16.25 and the related headings and AG 64.1. A public sector entity shall apply these amendments for annual financial statements covering periods beginning on or after 1 January 2025. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

...

Paragraphs AG16.1–AG16.25 and their related headings are added. For ease of reading, new text is not underlined.

## Appendix B

### Application Guidance

*This Appendix is an integral part of PBE IFRS 17 Insurance Contracts*

...

### Definition of an Insurance Contract (paragraph 13.1)

...

#### Identifying Insurance Contracts in a Public Sector Context

[Aus/NZBAG16.1](#) The guidance in paragraphs [BAG7](#) to [BAG16](#) on distinguishing between insurance risks and other risks applies equally to public sector entities. However, because public sector entities often undertake a much wider range of risk-bearing activities than private sector entities, additional guidance is needed to identify insurance contracts in a public sector context.

[Aus/NZBAG16.2](#) Governments often arrange to provide support as a result of events that affect individuals and communities. Some of these arrangements involve transactions that are best accounted for as insurance contracts, while many of these arrangements relate to a government's role in providing services such as: social benefits, universal health care and disaster relief. In making the distinction between these types of arrangements, the indicators outlined in paragraphs [Aus/NZBAG16.3](#) to [BAG16.25](#) are considered collectively so that a balanced judgement can be made.

[Aus/NZBAG16.3](#) Individual indicators would not necessarily be regarded as definitive in determining whether public sector arrangements would be accounted for as insurance contracts.

#### Similarity of Risks Covered and Benefits Provided

[Aus/NZBAG16.4](#) Under an insurance contract, significant insurance risk is transferred from an insured to an insurer. Private sector insurers accept a wide range of risks. These include risks relating to, for example: property loss, loss of income, professional and trade indemnity, public and legal liability, medical costs, mortality and disability. In the event that an insured event occurs, to the extent required under an insurance contract, the insurer would typically provide a benefit commensurate with the loss.

[Aus/NZBAG16.5](#) Many of the risks covered by private sector insurers are also the subject of social benefits provided by governments. Accordingly, judgement needs to be applied to determine the relevance of this indicator.

[Aus/NZBAG16.6](#) It is a strong indicator that a public sector entity's arrangements would be accounted for as insurance contracts when they involve accepting risks and providing benefits that are the same as, or similar to, those offered by private sector insurers. In some cases, public sector entities operate alongside private sector insurers to accept risks and provide benefits that are the same, for example, in respect of employer liability for workers' compensation risks.

[Aus/NZBAG16.7](#) In some cases, public sector entities are monopolies in their jurisdictions, and there are no relevant counterpart arrangements of private sector entities to consider. In these cases, consideration is given to whether a public sector entity's arrangements involve accepting risks and providing benefits that are the same as, or similar to, those offered by private sector insurers in other, similar, jurisdictions. In relation to other jurisdictions, only information that is 'readily available' need be considered. That is, public sector entities need not conduct an exhaustive search for counterpart arrangements.

[Aus/NZBAG](#)16.8 In some cases there will be a clear similarity between the risks being accepted and the benefits being provided by a public sector entity and private sector insurers, and this would be a strong indicator that a public sector entity's arrangements would be accounted for as insurance contracts.

[Aus/NZBAG](#)16.9 Conversely, the greater the level of dissimilarity between the risks accepted and benefits provided by a public sector entity and those offered by any relevant counterpart private sector insurer, the more likely it would be that the public sector entity's arrangements would not be accounted for as insurance contracts.

### ***Identifiable Coverage Period***

[Aus/NZBAG](#)16.10 An insurance contract has an identifiable coverage period – either the period during which insured events occur (losses-occurring coverage) or the period during which claims become known (claims-made coverage). The coverage period might be explicitly stated in the contract or otherwise be determinable from the terms of the contract.

[Aus/NZBAG](#)16.11 An indicator that a public sector entity's arrangements would be accounted for as insurance contracts is the existence of an identifiable coverage period.

[Aus/NZBAG](#)16.12 Conversely, open-ended arrangements to provide benefits based on eligibility criteria would not be accounted for as insurance contracts.

### ***Enforceable Nature of Arrangement***

[Aus/NZBAG](#)16.13 Under AASB Standards and NZ IFRS,<sup>2</sup> a contract is an agreement between two or more parties that creates enforceable rights and obligations. An insurance contract is a contract under which one party (the 'insurer') accepts significant insurance risk from another party (the 'insured') by agreeing to compensate the insured if a specified future event adversely affects the insured.<sup>3</sup>

[Aus/NZBAG](#)16.14 When a public sector entity or its controlling government does not have the practical ability under existing or substantively enacted legislation to deny or change promised benefits, it indicates that an arrangement would be accounted for as an insurance contract. That is, the policyholder has enforceable rights under the arrangement and the public sector entity has enforceable obligations.

[Aus/NZBAG](#)16.15 Conversely, when a public sector entity or its controlling government has the practical ability under existing or substantively enacted legislation to retrospectively deny or change promised benefits or compensation, it indicates that an arrangement is not enforceable. For example, if an entity can retrospectively change the amount of benefits or compensation being paid to a beneficiary in relation to a past event under existing legislation, this would indicate that the arrangement would not be accounted for as an insurance contract.

[Aus/NZBAG](#)16.16 An arrangement that involves a public sector entity issuing documentation to another party, similar to an insurance contract issued by a private sector insurer, would be indicative of an agreement that creates enforceable rights and obligations. A substantive reliance on legislation or other regulation as a part of that arrangement would not generally be an indicator that the arrangement is unsuitable to be accounted for as an insurance contract. In common with the private sector, arrangements need to be interpreted within a regulatory framework and, when applying AASB 17/PBE IFRS 17, an entity is required to consider its substantive rights and obligations, whether they arise from a contract, law or regulation under paragraph 2.

### ***Source and Extent of Funding***

[Aus/NZBAG](#)16.17 Under an insurance contract, a policyholder usually pays premiums to an insurer. In most cases, the premiums are the primary source of funding the payment of any claims and the costs of operating the insurance business. Insurers usually also generate investment income and might sometimes receive supplementary contributions from governments, for example, such as those aimed at encouraging the use of private health insurance.

---

<sup>2</sup> AASB 15/NZ IFRS 15 *Revenue from Contracts with Customers* and AASB 16/NZ IFRS 16 *Leases*

<sup>3</sup> AASB 17/PBE IFRS 17, Appendix A

[Aus/NZBAG](#)16.18 When a public sector entity receives ‘premiums’ under an arrangement in exchange for accepting risks from those who stand to benefit, it indicates that an arrangement would be accounted for as an insurance contract.

[Aus/NZBAG](#)16.19 Conversely, when a public sector entity receives all of its funding from sources other than the ‘premiums’ from policyholders (that is, sources such as appropriations), it indicates that arrangements would not be accounted for as insurance contracts.

[Aus/NZBAG](#)16.20 The lower is the proportion of a public sector entity’s funding to meet benefits that is received in exchange for accepting risks from those who stand to benefit, the less likely is it that those arrangements would be accounted for as insurance contracts. For example, a co-payment that is intended to help ration services and is not intended to fully fund services is unlikely to indicate that arrangements would be accounted for as insurance contracts.

[Aus/NZBAG](#)16.21 Under most general insurance contracts issued by private sector insurers, in the event that an insured cancels its coverage prior to the end of the coverage period, the policyholder would ordinarily receive a pro rata premium refund, possibly adjusted for administrative costs. Although not all contracts issued by private sector insurers allow for refunds, the practice is indicative of insurance contracts. Accordingly, a public sector entity arrangement that allows for a refund of premium when the policyholder terminates the arrangement early indicates that an arrangement would be accounted for as an insurance contract.

### ***Management Practices and Assessing Financial Performance***

[Aus/NZBAG](#)16.22 An indicator that an arrangement would be accounted for as an insurance contract would be that the public sector entity has objectives, policies and processes for managing risks associated with those arrangements and has its financial performance assessed against those objectives and how successfully it applies those policies and processes. In that context, the entity would be expected to conduct the following activities (either itself or via outsourcing):

- (a) underwriting and risk assessment;
- (b) the measurement of risks and uncertainties and their impacts; and
- (c) fair and prudent claims management.

The presence of all three of these factors would be a strong indicator that those arrangements would be accounted for as insurance contracts. Conversely, the fewer of these three factors that are present, the less likely it would be for arrangements to be accounted for as insurance contracts.

### ***Assets Held to Pay Benefits***

[Aus/NZBAG](#)16.23 Consistent with the guidance above on ‘Management practices and assessing financial performance’, the existence of a separate fund, or earmarked assets, that are restricted to being used to pay benefits can be regarded as evidence that a public sector entity is operating and being managed as an insurer. The existence of a separate fund, or earmarked assets is also consistent with the guidance above on ‘Source and extent of funding’ because it would generally involve investing funds raised via premiums or levies received in exchange for accepting risks from those who stand to benefit.

[Aus/NZBAG](#)16.24 Accordingly, the existence of a separate fund, or earmarked assets, that are restricted to being used to pay benefits is an indicator that those arrangements would be accounted for as insurance contracts. The alternative would be when a public sector entity receives its funding from sources such as appropriations, which indicates that arrangements would not be accounted for as insurance contracts.

[Aus/NZBAG](#)16.25 To be relevant, the separate fund, or earmarked assets need not be managed by the public sector entity itself. It is the existence of a separate fund, or earmarked assets, that is indicative, not the performance of investing activities.

...

Paragraph AG64.1 is added. For ease of reading, new text is not underlined. Paragraph AG64 is not amended but the first sentence is shown for context.

## Measurement (paragraphs 29–71)

...

### *Cash Flows within the Contract Boundary (paragraph 34)*

...

AG64. Paragraph 34 refers to an entity's practical ability to set a price at a future date (a renewal date) that fully reflects the risks in the contract from that date. ...

Aus/~~NZB~~AG64.1 Public sector entities often operate within a broad government policy framework that takes into account general economic circumstances and community needs and not only the circumstances specific to the entity and its policyholders. For example, there may be cases when the entity's management, including relevant government Minister(s), deliberately phases in price increases or decreases (or benefit adjustments) over a long period to help individuals or businesses manage through an economic cycle. Although the phasing in process might notionally take into account risks relating to a number of coverage periods, this is not the motivating factor. The broader policy objectives are the motivating factor. Therefore, in the context of AASB 17/PBE IFRS 17.34(b)(ii), the public sector entity would not be regarded as taking into account the risks that relate to periods after the reassessment date

## Basis for Conclusions

Paragraphs BC13–BC xx and the related headings are added. For ease of reading, new text is not underlined.

### Public Sector Amendments [date]

BC13 This Basis for Conclusions summarises the Australian Accounting Standards Board's and New Zealand Accounting Standards Board's considerations in reaching the conclusions in this Exposure Draft. It sets out the reasons why the Boards developed the Exposure Draft, the approach taken to developing the Exposure Draft and the bases for the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

### Reasons for Proposing these Amendments

BC14 AASB 17 *Insurance Contracts* (as amended by AASB 2020-5 *Amendments to Australian Accounting Standards – Insurance Contracts*) and PBE IFRS 17 *Insurance Contracts* (August 2020) have a mandatory application date of annual reporting periods beginning on or after 1 January 2023.

BC15 IFRS 17 *Insurance Contracts*, which is incorporated into AASB 17/PBE IFRS 17 has been developed largely for the for-profit private sector, and to a limited extent also for a (not-for-profit) mutual entity context [AASB 17/PBE IFRS 17.B16]. IFRS 17 has not been designed to cater for the public sector context. Accordingly, the AASB and the NZASB are undertaking a joint project to include modifications in AASB 17/PBE IFRS 17 to suit the public sector context in Australia and New Zealand.

BC16 Other jurisdictions, such as the UK and Canada, are also considering the application of IFRS 17 in the public sector. At the time of preparing this Basis for Conclusions, those projects were not yet at the proposals stage.

BC17 At the time of preparing this Basis for Conclusions the IPSASB were not considering the development of an insurance Standard based on IFRS 17.

BC18 In addition, there are possibly inconsistencies in Australia in the application of Standards as some Australian public sector entities with similar arrangements are currently applying AASB 1023 *General*

*Insurance Contracts* and others are applying AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. This project might help achieve a greater level of consistency.

BC19 The AASB and the NZASB each commenced a project in 2017 to consider expanding the scope of AASB 17/PBE IFRS 17 to include insurance contracts and arrangements that have similar characteristics to insurance contracts in the public sector and address any public-sector-specific issues. Each Board has previously issued a public consultation document:

- (a) AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities*; and
- (b) NZASB Exposure Draft ED 2018-7 *PBE IFRS 17 Insurance Contracts* (NZASB ED 2018-7).

Each Board has considered respondents' comments to their respective consultation documents. Paragraphs BC257245 and 258246 outline a brief project history relating to this earlier stage of the project.

### Joint Project

BC20 Currently, AASB 17 does not apply to not-for-profit public sector entities [under paragraph 6A of AASB 1057 *Application of Australian Accounting Standards* (July 2015, as amended by AASB 17)].

BC21 PBE IFRS 17 currently applies to not-for-profit public benefit entities [PBE IFRS 17.2.1]; however, it is not regarded as applying to arrangements of public sector public benefit entities.

BC22 In 2020, the AASB and the NZASB decided to work jointly to progress the project with the following background and objectives.

BC23 Both Boards maintain different tiers of reporting, which among other things, use the 'public accountability' distinction developed by the IASB. Entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses are identified as having public accountability. Both Boards generally regard entities engaged in insurance activities as being in Tier 1.

BC24 Some of the public sector entities in Australia that conduct insurance activities have self-identified as for-profit entities – most have self-identified as not-for-profit entities. In principle, Tier 1 for-profit public sector entities apply AASB Standards incorporating IFRS Standards without modification. The *AASB Not-for-Profit Entity Standard-Setting Framework* notes the Financial Reporting Council's broad strategic direction that the AASB applies the principle of transaction neutrality (modified as necessary) in setting standards for not-for-profit and public sector entities. This Framework notes (emphasis added):

22 IFRS Standards (including Interpretations) are appropriate as a base for the following reasons: ...

- (d) **IFRS Standards can be modified appropriately for NFP-specific issues**, as demonstrated by the International Public Sector Accounting Standards Board (IPSASB) using IFRS Standards as a base for their corresponding Standards, **departing only to the extent appropriate for public sector issues**.

BC25 The following background applies for the NZASB.

- (a) The *New Zealand Accounting Standards Framework* notes (emphasis added):

28. The accounting standards applying to the PBE tiers are as follows: ...

- PBE Tier 1: Tier 1 PBE Accounting Requirements – These are the requirements in the accounting standards (referred to as PBE Standards) and applicable authoritative notices.

They comprise International Public Sector Accounting Standards (IPSAS), **modified as appropriate for New Zealand circumstances** (for either public sector or NFP entities), together with additional standards as necessary and applicable authoritative notices.

- (b) Additional standards for PBEs include IFRS Standards for which there is no equivalent IPSAS (for example, PBE IFRS 4) and domestic standards.
- (c) In February 2018, the NZASB considered the application of the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach) and decided to develop PBE IFRS 17. The trigger in the PBE Policy Approach for developing PBE IFRS 17 is the change to an IFRS Standard (IFRS 4 is superseded by IFRS 17) that has been used as the basis for a PBE Standard.



- (d) A further motivation for developing PBE IFRS 17 was to capture schemes that are eligible<sup>4</sup> to apply the insurance approach as permitted under IPSAS 42 *Social Benefits* [PBE IFRS 17.BC7]. (The ‘insurance approach’ would involve applying IFRS 17 [IPSAS 42.AG19].)

### **Consistency in Financial Reporting – within and between Jurisdictions**

- BC26 The AASB Discussion paper (2017) proposals identified as an objective “to achieve greater consistency of financial reporting across the public sector among entities engaging in insurance activities for the benefit of users of that information” [page 6]. While the NZASB has fewer public sector stakeholders with arrangements that might be accounted for as insurance contracts, consistency remains a key issue.
- BC27 Although there is no binding agreement in place regarding public sector entities, to the extent feasible, the Boards consider it would be desirable to have the same standards applying in Australia and New Zealand. This is because, for example, there can be useful benchmarking of financial position and performance of public sector entities between the two jurisdictions. Accordingly, the Boards are taking a ‘best endeavours’ approach to trying to achieve a consistent outcome in the two jurisdictions.
- BC28 Both Boards are making the same proposals in this Exposure Draft, except the proposed approach on risk adjustments.
- BC29 In developing [Draft] Accounting Standard AASB 2022-X, the Boards considered the responses received from stakeholders to earlier consultative documents and also conducted a series of interviews with key stakeholders in 2020 and early 2021 to gain insights into operations of those entities (and their users and auditors) most likely to be impacted by the project.
- BC30 The Boards have also consulted the Public Sector Focus Group, a sub-group of the AASB’s Insurance Transition Resource Group for Insurance Contracts, which includes members from both jurisdictions.

### **Application Date of the Standard**

- BC31 The existing mandatory application date of AASB 17/PBE IFRS 17 is periods beginning on or after 1 January 2023. For public sector entities that typically have a July to June, that would mean first applying AASB 17/PBE IFRS 17 for the period 1 July 2023 to 30 June 2024, with comparative information for the period 1 July 2022 to 30 June 2023.
- BC32 The Boards noted that they typically provide at least a one-year gap between the time a new or revised Standard is issued and the beginning of the comparative reporting period to which it applies. This is designed to allow stakeholders to adequately prepare for any changes to processes for preparing and auditing financial statements.
- BC33 Accordingly, the Boards concluded they would propose that public sector entities falling within the scope of AASB 17/PBE IFRS 17 be required to apply it for annual reporting periods beginning on or after 1 July 2025. Consistent with existing practice, the Boards also concluded on proposing that entities would be permitted to apply AASB 17/PBE IFRS 17 earlier and, if an entity does apply the Standard early, it must disclose this fact.

### **Identifying Public Sector Arrangements Scoped into the Standard**

- BC34 The general approach of the Boards to establishing proposals for identifying which arrangements in the public sector should be accounted for as insurance contracts is based on:
- (a) considering the definitions and guidance on ‘insurance contracts’, ‘insurance contract services’ and ‘insurance risk’ in AASB 17/PBE IFRS 17; and
  - (b) identifying a range of indicators that are to be considered collectively, along with related guidance.
- BC35 The Boards regard a collective consideration of the indicators set out in paragraphs Aus/[NZBAG](#)16.1 to Aus/[NZBAG](#)16.25 as meaning that:
- (a) the existence of a particular indicator would not necessarily mean that AASB 17/PBE IFRS 17 would apply; and

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<sup>4</sup> IPSAS 42 does not require an entity that meets the criteria to apply the ‘insurance approach’ – only that the entity is eligible to apply that approach.

- (b) the absence of a particular indicator would not necessarily mean that AASB 17/PBE IFRS 17 would not apply.

- BC36 In developing the indicators, the Boards noted that the main alternative requirements applicable to liabilities of public sector entities are set out in AASB 137/PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. Accordingly, the Boards were mindful of the key differences between the requirements of AASB 17/PBE IFRS 17 and AASB 137/PBE IPSAS 19, which include different discount rate requirements for present valuing cash flows and the specific requirement in AASB 17/PBE IFRS 17 for a risk adjustment.
- BC37 Paragraphs BC2638 to BC95107 outline the Boards' deliberations in identifying indicators for determining when AASB 17/PBE IFRS 17 would be applied. This includes deliberations on indicators that were considered and rejected.

### **Similarity of Risks Covered and Benefits Provided**

- BC38 The AASB Discussion Paper (2017) proposals identified, as a suggested criterion for determining whether activities relate to insurance, that the transactions or arrangements entered into have similar characteristics and relate to a similar level of insurance risk as those entered into by for-profit private sector entities that are accounted for as insurance contracts [AASB DP.E14(c)]. This is not a factor explicitly identified in NZASB ED 2018-7, although it can be argued that it was proposed implicitly via other proposed indicators.
- BC39 The Boards observed that some public sector arrangements have direct counterparts with private sector insurance contracts, including for example, workers' compensation contracts. In the context of a transaction neutral approach to accounting standard setting, the Boards regard this as a strong indicator that some types of arrangements in the public sector would be accounted for by applying AASB 17/PBE IFRS 17.
- BC40 The Boards noted that an arrangement in the public sector might provide a combination of types of coverage and benefits that are not matched by a private sector insurance contract, but that components of the arrangement might be directly comparable to a private sector insurance contract. For example, in Australia, compulsory third party motor insurance arrangements provided by a public sector entity includes coverage for serious or catastrophic injuries; whereas, the counterpart private sector insurance contracts typically do not. That serious or catastrophic injury coverage is often provided under a separate public sector arrangement.
- BC41 Accordingly, the Boards acknowledge the limitations in some circumstances of using the similarity of risks covered and benefits provided as an indicator of whether AASB 17/PBE IFRS 17 would apply because directly comparable forms of coverage may not be identifiable. However, the Boards note that considering the similarity of risks covered and benefits provided would involve a broader analysis than simply assessing whether directly comparable forms of coverage exist.

### **Conclusions**

- BC42 Based on the above deliberations, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the similarity of risks covered and benefits provided.
- BC43 The Boards considered how widely entities would be expected to search for counterpart insurance contracts and concluded it would be reasonable for entities to consider counterpart contracts both within and outside Australia and New Zealand, using information that is 'readily available'. That is, public sector entities would not need to conduct an exhaustive global search for counterpart contracts.

### **Binding Nature of Arrangement**

- BC44 The Boards noted that an indicative criterion in IPSAS 42 for being eligible to apply the insurance approach (and apply IFRS 17) is that the arrangements between the entity and its participants are binding in a similar manner to an insurer being bound by an insurance contract [IPSAS 42.AG25(a)]. Both the AASB Discussion Paper (2017) [AASB DP.E13(b)] and NZASB ED 2018-7 [ED 2018-7.AG1.6] proposed a similar indicator. The AASB Discussion Paper proposal identified as a key criterion that a scheme participant's beneficial rights cannot be altered without a specific change in legislation or relevant governing measures and cannot be retrospectively amended.

- BC45 The Boards observed that, in a for-profit private sector setting, an insurer is bound by the terms of the contract with a policyholder in terms of the types of risks covered and what constitutes insured events and, therefore, could be the subject of a valid claim. The actual amounts of compensation paid in respect of claims are determined by reference to the terms of the contract. Typically, those terms would be based on:
- (a) the extent of loss; and
  - (b) the extent to which the policyholder or another party are responsible for the events that led to the loss (that is, which party is at fault), including failure to take reasonable steps to avoid the loss. However, there may be an identified insured amount (for example, an agreed value for motor vehicle write-off) and sometimes the amount is a function of a number of factors and possibly negotiation.
- BC46 Nevertheless, the extent of a claim in a for-profit private sector setting would need to be determined in the context of the insurance contract terms – there would ordinarily not be an opportunity for an insurer to arbitrarily change those terms under an existing contract.
- BC47 In the public sector, there can be the capacity for governments to change the benefits payable to scheme participants. This is potentially a distinguishing feature of some public sector schemes (relative to the binding nature of contracts in the for-profit private sector). However, the significance of this capacity may be mitigated by the extent to which benefits could be changed for existing scheme participants under arrangements in place at the reporting date.
- BC48 The Boards considered three examples to help illustrate the relevance of this capacity. Assume a public sector scheme has a liability for providing income support for permanently disabled motor accident victims based on paying 50% of Average Weekly Earnings (AWE).
- (a) Example A: The entity has the power to change the rate of benefits to future scheme participants to less than 50% of AWE. However, the entity has a binding commitment to paying 50% of AWE to existing scheme participants, for example, by way of settlements.
  - (b) Example B1: The entity (or the government that controls the entity) has the power to change the rate of benefits to existing scheme participants to less than 50% of AWE but only after obtaining a change to existing legislation.
  - (c) Example B2: The entity (or the government that controls the entity) has the unilateral power to change the rate of benefits to existing scheme participants to less than 50% of AWE, for example, based on projected budget priorities.
- BC49 The Boards noted that:
- (a) the terms in Example A are like those under most insurance contracts sold in the for-profit private sector;
  - (b) the terms in Example B1 are unlike those under most insurance contracts sold in the for-profit private sector; however, the fact that a legislative change would be needed to change the benefits is significant; and
  - (c) the terms in Example B2 are unlike insurance contracts sold in the for-profit private sector because insurers would not be able to arbitrarily change benefits.
- BC50 The Boards consider that the binding nature of an arrangement is consistent with the basis for the accounting in AASB 17/PBE IFRS 17. Accordingly, the Boards considered that the extent to which the existing benefits under an arrangement are binding on the relevant public sector entity is a key indicator for determining when that arrangement is accounted for as an insurance contract. [Correspondingly, the Boards also observed that cases when an entity would be able to arbitrarily change benefits seems indicative of a conventional social benefit arrangement.]
- BC51 The Boards observed that, relative to private sector insurers, governments are in a unique position to be able to legislate, which is relevant to Example B1 above. Having established an arrangement that provides benefits to scheme participants in a scheme, in theory, the government subsequently has the power to take those benefits away or at least adjust the amount of benefits.

- BC52 The Boards also observed that AASB 17/PBE IFRS 17 relies on the notion of an insurer having a ‘practical ability’ for the purposes of, for example:
- (a) determining the boundary of an insurance contract (practical ability to set a new price or new benefits [AASB 17.34(a)/PBE IFRS 17.34(a)]); and
  - (b) relief from recognising a separate onerous contract group (when contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity’s practical ability to set a different price or level of benefits [AASB 17.20/PBE IFRS 17.20]).
- BC53 The Boards identified that the notion of ‘practical ability’ could be used to help distinguish those cases when a public sector arrangement should be regarded as binding from cases when an arrangement is not binding. That is, an indicator that it is relevant to account for public sector arrangements as insurance contracts would be that the entity (or its controlling government) does not have the practical ability to change a benefit retrospectively.
- BC54 The Boards noted that some insurance contracts include a range of options in their original terms about subsequently amending coverage and AASB 17/PBE IFRS 17 requires an insurer to determine the probabilities of those options being exercised in measuring insurance liabilities. When expectations are different from actual events, the insurer recognises ‘experience adjustments’ and remeasures insurance liabilities based on updated expectations. However, these contract options are at the discretion of the insured and are different from changes to existing contract terms made by an issuer.

### Contract versus Statute

- BC55 The Boards noted that the AASB Discussion Paper (2017) proposals included the following [page 5].

The AASB’s view is that although AASB 17 applies only to contracts, the *Framework for the Preparation and Presentation of Financial Statements* (Conceptual Framework) does not limit liability recognition to that arising from contracts, and specifically indicates that obligations may arise from statute. In applying its principle of transaction neutrality, the AASB considers that public sector entities with insurance risk created by statute, that are in substance similar to public and private sector entities with insurance risk created by contracts, should account for insurance risk in the same way.

The respondents to the Discussion Paper either explicitly or implicitly accepted the view that AASB 17 could apply when there is an insurance arrangement based on statute (and not contracts).

- BC56 The Boards also noted that PBE IFRS 17.BC5 explains that, when developing NZASB ED 2018-7, the NZASB observed that some public sector PBEs were applying the requirements of PBE IFRS 4 for ‘insurance-like’ activities that arose from statute rather than contract.
- BC57 The Boards observed that the stakeholder outreach conducted in 2020-21 identified three broad types of response from stakeholders.
- (1) The manner in which the scheme or arrangement has been established (contract versus statute) is a matter of form rather than substance. These stakeholders have observed that:
    - (a) virtually identical forms of coverage are provided under either statutory or private sector (contractual) arrangements (such as comprehensive third-party motor coverage) – accordingly, the insurance Standards would apply by analogy to statutory arrangements under the accounting policy hierarchy;<sup>5</sup>
    - (b) the purpose of having a statutory (rather than contractual) arrangement is generally to mandate that people obtain coverage from the one entity (usually a public sector entity); and
    - (c) individuals and entities are required by statute to pay for some types of insurance coverage from private sector insurers (such as workers’ compensation coverage) and the arrangements are effectively a combination of contractual and statutory terms.
  - (2) Literally, the insurance Standards are considered to apply only to ‘contracts’, and entities’ activities in respect of relationships based only on statute are (strictly interpreted) not within the scope of the insurance Standards. These stakeholders have observed that:

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<sup>5</sup> AASB 108/PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* [paragraphs 10 and 11/paragraph 14].

- (a) AASB 15 *Revenue from Contracts with Customers* and AASB 16 *Leases* provide clear definitions and descriptions of ‘contracts’ that can be used as a ‘bright line’; and
  - (b) there is currently at least one case when the contract versus statute distinction is used to determine the accounting that should be applied – that is, the impairment of tax receivables – refer to the discussion in Appendix B to this Basis for Conclusions on ‘Scope of AASB 9/PBE IPSAS 41’.
- (3) For some types of risks (such as workers’ compensation coverage), the existence of a documentation that includes substantive information about risks and benefits (well beyond the detail in any relevant enabling legislation or regulations), is a strong indication of an insurance contract.

BC58 The Boards noted that, under AASB 17/PBE IFRS 17, the description of the rights and obligations that should be accounted for under insurance contracts is broad (and go beyond the contract). AASB 17.2/PBE IFRS 17.2 says (emphasis added):

- 2 An entity shall consider its substantive rights and obligations, whether they arise from a **contract, law or regulation**, when applying IFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations<sup>6</sup>. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity’s **customary business practices**. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on the economics of the contract). **Implied terms in a contract include those imposed by law or regulation**. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services).

### Conclusions

BC59 Based on the above deliberations, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the absence of practical ability to retrospectively change coverage or benefits. The Boards also concluded that they would propose the ‘practical ability’ is linked to existing or substantively enacted legislative powers. [The Boards noted that, otherwise, in a public sector context, an assessment of ‘practical ability’ would probably need to take into account a range of factors, including whether the entity (or its controlling government) has sufficient political capital to make a change that reduces a benefit, which would not be workable].

BC60 The Boards also concluded that the existence or otherwise of ‘contracts’ versus legislative requirements is not, of itself, likely to be a useful indicator of arrangements that would be accounted for as insurance contracts. Instead, the Boards consider the binding nature of the arrangements (the absence of a practical ability to retrospectively change coverage or benefits) is the most relevant focus, not the form of the arrangements.

### Identifiable Coverage Period

BC61 A key feature of an insurance contract in the context of AASB 17/PBE IFRS 17 is the existence of an identifiable coverage period, which is defined as: the period during which the entity provides insurance contract services. The coverage period provides the basis for determining the cash flows to include in measuring insurance contracts.

- (a) Most insurance contracts provide protection for events that occur during the coverage period – for example, coverage for claims that might arise from an incident over a one-year contract period. The claims may not come to light until after the coverage period has ended. These are sometimes referred to as ‘claims incurred’ contracts because the time when the event occurs is crucial to identifying valid claims.
- (b) Some insurance contracts provide protection for claims that arise during the coverage period, regardless of when the incidents that gave rise to the claims have occurred. These are sometimes

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<sup>6</sup> The second sentence of AASB 17.2/PBE IFRS 17.2 is the same as the definition for ‘contract’ used more generally in IFRS Standards (including: AASB 15 *Revenue from Contracts with Customers*).

referred to as 'claims made' contracts because the time when the claim emerges is crucial to identifying valid claims.

BC62 The Boards observed that, instead of having an identifiable coverage period, social benefit type schemes tend to be open-ended and depend on participants continuing to meet eligibility criteria, which might include, for example, being unemployed, being a student, or being above a certain age. In that context, IPSAS 42.5 defines 'social benefit' as:

cash transfers provided to:

- (a) specific individuals and/or households who meet eligibility criteria;
- (b) mitigate the effect of social risks; and
- (c) address the needs of society as a whole.

The social benefit eligibility criteria relate to someone's inherent status, rather than relating to an uncertain future event that occurs within a particular coverage period.

### **Conclusion**

BC63 Based on the above deliberations, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the existence of an identifiable coverage period.

### **Source and Extent of Funding**

#### **Fully Funded**

BC64 One of the criteria in IPSAS 42 for being eligible to apply the insurance approach is that a scheme is intended to be 'fully funded' from contributions and levies. NZASB ED 2018-7 proposed using the 'fully-funded' criterion for determining whether PBE IFRS 17 would apply [ED 2018-7.AG1.1 to AG1.4].

BC65 IPSAS 42.AG20 explains 'fully funded' as follows.

AG20 A social benefit scheme is intended to be fully funded from contributions when:

- (a) The legislation or other arrangement governing the social benefit scheme provides for the scheme to be funded by contributions or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the social risks which are mitigated by the social benefit scheme, together with investment returns arising from the contributions or levies; and
- (b) One or both of the following indicators (individually or in combination) is satisfied:
  - (i) Contribution rates or levy rates are reviewed (and, where appropriate, adjusted in line with the scheme's funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the revenue from contributions or levies will be sufficient to fully fund the social benefit scheme; and/or
  - (ii) Social benefit levels are reviewed (and, where appropriate, adjusted in line with the scheme's funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the levels of social benefits provided will not exceed the level of funding available from contributions or levies.

BC66 Some respondents to NZASB ED 2018-7 commented that the meaning of 'fully funded' is not necessarily clear for entities that aim to be self-funded over the long term, but that in any given year might be:

- (a) overpricing to make up for past deficits;
- (b) underpricing to use up past surpluses; or
- (c) underpricing to suit current economic conditions.

### ***Substantially Self-funded***

- BC67 The AASB was also mindful of the IPSASB's work on social benefits in preparing its Discussion paper (2017) proposals, but considered that 'fully funded' would be too much of a 'bright line' [AASB DP.BC28(b)(ii)].
- BC68 Instead, one of the non-mandatory criteria proposed in the AASB Discussion Paper for determining whether AASB 17 should apply in the public sector was that the arrangement be 'substantially self-funded' [AASB DP.E14(a)]. Under the proposal, there were two aspects to 'self-funding':
- (a) the source of funding should be those who stand to benefit from the arrangement or those who exacerbate the risks to potential beneficiaries; and
  - (b) the revenue being sufficient and/or the benefit levels being managed such that the scheme is self-sustaining.
- BC69 There was a limited response to the proposal of a 'substantially self-funded' criterion. Those who did respond generally supported using the criterion.

### ***Beneficiary Pays***

- BC70 The Boards observed that all of the public sector entities in Australia and New Zealand that are currently applying the insurance standards, or have contemplated applying the insurance standards, receive contributions from scheme participants either directly or indirectly via 'premiums' or 'levies'. Some of these entities might require top-up funding from consolidated revenue from time-to-time. However, this has been the exception rather than the rule (and might be regarded as an 'equity' injection in some cases, rather than a source of ongoing funding). In general, most or all of the funding for these entities is sourced from scheme participants, who stand to benefit from the coverage.
- BC71 The Boards also observed that some of the public sector entities in Australia that are currently not applying the insurance standards also source most or all of their funding from those who stand to benefit from the coverage.
- BC72 The Boards noted that, if this indicator were applied, it would at least have the benefit of immediately ruling out the application of the insurance standards to a range of 'social benefits' such as aged pensions or universal healthcare activities and disability support. The Boards also noted a possible complication is that schemes such as Medicare in Australia, at least notionally, have dedicated funding through the Medicare levy on taxpayers. However, the Boards considered the Medicare levy to probably be sufficiently 'tax-like' to be regarded as being a levy as intended under this criterion. Accordingly, the Boards considered whether it might also be helpful to explain that the significance of the indicator would be on a spectrum relating to the extent to which premiums or levies represented a 'beneficiary-pays' model.
- BC73 The Boards observed that a payment/contribution to the insurer from a policyholder is not a part of the 'insurance contract' definition in AASB 17/PBE IFRS 17. However, they noted that some type of funding from a scheme participant is probably a reasonable indicator of the relevance of applying AASB 17/PBE IFRS 17 in the sense that it helps to establish a binding contract-like relationship between the entity providing the coverage and the scheme participants.
- BC74 The Boards observed that the practice of refunding pro rata amounts of payments/contributions in the event that a scheme participant cancels its coverage prior to the end of the coverage period would be further evidence of a binding contract-like relationship between the entity providing the coverage and a scheme participant. The Boards noted that this is a widespread practice in the private sector general insurance industry.

### ***Conclusions***

- BC75 Based on the above considerations, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the extent to which a scheme participant is responsible for paying a contribution. This is on that basis that it provides evidence of a contract-like relationship between a scheme participant and the public sector entity. The Boards concluded that references to 'fully-funded' and 'substantially self-funded' are probably not useful because they are difficult to interpret, but that relevant contributions would be expected to be more than, for example, a relatively small co-payment.

- BC76 Consistent with this perspective, the Boards also concluded that the extent to which a contribution from a scheme participant is an indicator of public sector arrangements to be accounted for as insurance contracts is dependent on:
- (a) the strength of the association between the contribution and the risks covered – for example, a motor vehicle owner (scheme participant) contributes in return for being registered to use roads; and
  - (b) the extent to which the contribution is substantive relative to the risks being transferred.
- BC77 The Boards also noted the level of contributions from scheme participants that might be sought in any given period could be affected by the extent to which the public sector entity is currently fully funded. That is, contributions might be higher or lower in any given period to either make up for earlier funding shortfalls or use up existing surpluses.<sup>7</sup> Accordingly, a medium-term view (rather than a year-by-year view) might need to be taken when assessing whether contributions are substantive relative to the risks being transferred in any given period.

### **Assets Held to Pay Benefits**

- BC78 IPSAS 42 identifies the existence of assets being held in a separate fund, or otherwise earmarked, and restricted to being used to provide benefits as being an indicator of insurance contracts [IPSAS 42.AG26(b)]. Similarly, the AASB Discussion Paper (2017) proposals identified that assets and liabilities arising from the arrangements being held in a separate fund, or otherwise specifically identified as used solely to provide benefits to beneficiaries as indicating an insurance arrangement [AASB DP.E14(d)]. However, the AASB Discussion Paper proposals also noted that the absence of separately allocated assets is not necessarily an indicator the arrangement is not insurance.
- BC79 The Boards noted that there is a link between the indicator on ‘Source and extent of funding’ (discussed above) and ‘Assets held to pay benefits’ because funds that are sourced from scheme participants are more likely to be set aside in a scheme fund than would the case for an appropriation of funds from general taxation.
- BC80 The Boards also noted that there is a link with the indicator on ‘Management practices and assessing financial performance’ (discussed below) because public sector entities that manage their own assets intended to meet claims would be more likely to have management practices that more generally mirror those of private sector insurers. The Boards observed that this perspective is supported by feedback received in recent stakeholder outreach, with many public sector entities having been established to be self-sustaining and having responsibility for overseeing an area of risk while achieving a breakeven result from all of their activities, including investment performance. This is a characteristic of private sector for-profit insurers, some of which routinely operate on a long-term sustainable basis by generating underwriting losses that are more than offset by investment returns.
- BC81 The Boards noted that some public sector entities have assets set aside for benefits, but are not actively involved in the management of the underlying investments, which is handled centrally, for example, by a government agency established for this purpose. The public sector entity’s role might be limited to advising that agency about its liquidity needs. The Boards consider the existence of assets set aside to meet benefits to be the crucial factor, and do not regard the extent of a public sector entity’s active involvement in the management of its underlying investments as effecting the validity of this indicator.

### **Conclusions**

- BC82 Based on the above considerations, the Boards concluded they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the existence of assets being held in a separate fund, or an entity having access to earmarked assets, that are restricted to being used to provide benefits to scheme participants.

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<sup>7</sup> Public sector entities often occupy a monopoly position and are able to raise or lower contributions to either make up for earlier funding shortfalls or use up existing surpluses.



## Management Practices and Assessing Financial Performance

### *Assessing Financial Performance (in general)*

- BC83 The Boards noted that an indicative criterion in IPSAS 42 for being eligible to apply the insurance approach is that the entity assesses its financial performance and financial position of a scheme on a regular basis where it is required to report internally on the financial performance of the scheme, and, where necessary, to take action to address any under-performance by the scheme [IPSAS 42.AG25(d)].
- BC84 The Boards noted that NZASB ED 2018-7 included a proposed indicator similar to this indicative criterion in IPSAS 42 [ED 2018-7.AG1.6(d)]. The Boards also noted that the AASB Discussion Paper (2017) included a proposed indicator similar to this indicative criterion in IPSAS 42, but that the Discussion Paper proposal placed an emphasis on the assessment of claims performance [AASB DP.E14(b)].
- BC85 The Boards observed that there was little feedback on this proposal in response to NZASB ED 2018-7 and a mixed response to the AASB Discussion Paper proposal, with most respondents saying the criterion was not helpful in distinguishing insurance activities from other types of activities. In general, respondents considered there are accountability and performance mechanisms across the spectrum of social benefit and insurance arrangements in most jurisdictions.

### *Management Focus of the Entity (more specifically)*

- BC86 The Boards noted that, in stakeholder outreach conducted in 2020-21, there was more interest in discussing the ways in which they managed their particular activities, rather than the more general matter of assessing financial performance.
- (a) Most of the stakeholders from entities that are currently applying AASB 1023/PBE IFRS 4 expressed the view that they have been established to manage an area of risk and effectively provided with 'seed capital' and a licence to charge levies/premiums in order to operate with relative financial independence. They are generally expected to be self-funding with a view to not making further calls on government funding and consider themselves to be operating an insurance-like business on a long-term sustainable basis. Within the constraints imposed upon them, they price risk based on commercial principles and manage claims fairly and prudently.
  - (b) Most of the Australian stakeholders from entities that are currently applying AASB 137 expressed the view that they are operating a compensation scheme based on terms that have largely been dictated to them (for example, through their enabling legislation) and do not have the scope to manage the risks in the manner of a private sector insurer.
  - (c) A small number of Australian stakeholders indicated that they consider the way their entities are currently managed would be better reflected in a change to their existing accounting – some from AASB 1023 to AASB 137 and some from AASB 137 to AASB 1023/AASB 17.
- BC87 The Boards considered that, the manner in which an entity is managed is, in principle, an important indicator of which Standards should be applied on the basis that faithfully reflecting the 'business model' in financial statements is something that Standards ordinarily aim to achieve. However, this type of indicator is likely to be subject to wide interpretation unless it is associated with specific insurance liability management practices. In that context, the Boards considered those insurance liability management practices could include the following.
- (a) *Underwriting and pricing specific types of risks:* although few (if any) public sector entities are completely unconstrained in their ability to differentially price their services, many of them are able to price risk based on a scheme participant's characteristics (for example, industry of employment, claims experience or type of vehicle).
  - (b) *Use of reinsurance contracts to manage capital:* this is not to say that the existence of a reinsurance contract, of itself, is indicative. However, in association with other factors, such as a policy of protecting its own capital base (rather than relying on the taxpayer) for its continuing operation, it can indicate that the entity is expected to manage its liabilities prudently in a manner consistent with a private sector insurer.
  - (c) *Fair and prudent management of claims and remediation of significant claims risks:* although fair and prudent claims management would typically be a feature of a broad range of

compensation schemes, it is a particularly significant feature of managing insurance risk, especially when coupled with possible remediation activities. Remediation will necessarily be different in a monopoly context compared with a typical commercial context. In a commercial context, remediation will often include resetting underwriting terms to exclude certain types of (high-risk) customers; whereas, monopoly public sector entities are not generally able to filter their scheme participant base. Accordingly, for public sector entities, remediation would usually take other forms, such as interventions with education programs or campaigns.

### ***Conclusions***

- BC88 The Boards concluded that general practices of assessing scheme financial performance and financial position on a regular basis, reporting internally on financial performance and, where necessary, taking action to address any scheme under-performance is not a potentially useful indicator of public sector arrangements to be accounted for as insurance contracts. The Boards consider the inference that social benefit schemes versus insurance schemes are less likely to monitor performance in this way is probably not supportable.
- BC89 Instead, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts that the entity has objectives, policies and processes for managing risks associated with those arrangements and for its financial performance to be assessed based on how the entity meets those objectives and how successfully it applies those policies and processes. The Boards concluded that, in this context the public sector entity would be expected to conduct the following activities (either itself or via outsourcing):
- (a) underwriting and risk assessment;
  - (b) the measurement of risks and uncertainties and their impacts; and
  - (c) fair and prudent claims management and, when relevant, engage in remediation work.
- BC90 The Board concluded that the presence of all three of these factors would be a strong indicator of public sector arrangements to be accounted for as insurance contracts; and, conversely, the fewer of these three factors that are present, the less likely it would be for arrangements to be accounted for as insurance contracts.

### **Profit Seeking**

#### ***Australian Entities***

- BC91 Most of the Australian public sector entities currently applying AASB 4 and AASB 1023 classify themselves as not-for-profit entities, with some classifying themselves as for-profit entities.
- BC92 The AASB Discussion Paper (2017) proposed that the amendments to AASB 17 for public sector entities should apply to both for-profit and not-for-profit public sector entities and the respondents who directly commented on this issue agreed with the AASB's proposal.
- BC93 In the stakeholder outreach conducted in 2020–21, there was virtually no support for excluding a public sector entity from applying AASB 17 on the basis that it is a not-for-profit entity. For the few stakeholders who supported automatically including a public sector entity within the scope of AASB 17 on the basis that it is a for-profit entity, their support hinged on a view that a for-profit entity is more likely to be seeking to profit from the service of bearing risk. These stakeholders viewed this as consistent with AASB 17 requiring a risk adjustment in measuring insurance liabilities and recognising revenue from bearing risk in a pattern based on the release from risk.
- BC94 The AASB observed that the differing classifications (for-profit versus not-for-profit) across Australian jurisdictions seem to be driven largely by the funding structure and, for example, whether the entity has been tasked with paying dividends to government in recognition of the cost of government capital deployed to the entity. The AASB also observed that there are a number of entities deemed by their governments to be for-profit entities that seemingly have highly similar operations to entities that have been deemed not-for-profit.

### ***New Zealand Entities***

- BC95 Currently, the New Zealand public sector entities applying PBE IFRS 4 all classify themselves as not seeking to profit from their activities.<sup>8</sup>
- BC96 NZASB ED 2018-7 did not include any proposals relating to the profit-seeking motive.

### ***Conclusions***

- BC97 The Boards noted that the IASB did not regard the not-for-profit nature of mutual insurance entities to be a factor that would cause IFRS 17 to be inapplicable. The IFRS 17 Basis for Conclusions makes it clear that, in the IASB's view, IFRS 17 can be applied consistently to for-profit entities and mutual entities [IFRS 17.BC264 to BC269]. For-profit insurance entities and mutual insurance entities often compete for customers in the same markets.
- BC98 Based on the above deliberations, the Boards concluded that they would propose that the not-for-profit nature of an entity should not be a barrier to public sector arrangements being accounted for as insurance contracts, and this has not been proposed as an indicator. However, the Boards also noted that the classification (as for-profit versus not-for-profit) would be a part of the context in which the proposed indicators are considered and, therefore, could impact on the outcome of a collective assessment of those indicators.

### **Scoping Out 'Social Benefits' or Specific Entities**

- BC99 The Boards noted that IPSAS 42.5 includes a definition of 'social risks', which mentions events or circumstances that are intended to give rise to distinct benefits from the causes of other forms of aid, such as benefits provided as the result of a disaster [IPSAS 42.AG10]. The IPSAS 42 definition is:

Social risks are events or circumstances that:

- (a) relate to the characteristics of individuals and/or households – for example, age, health, poverty and employment status; and
- (b) may adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income.

- BC100 The Boards observed that 'social risks' identified in the definition are indicative, rather than implying that the same risks might not also be the subject of insurance contracts. They further noted that most, if not all, the classes of 'social risks' mentioned in the definition could be the subject of insurance contracts sold by for-profit private sector entities, such as: annuities (age-related); health insurance (health-related); and income protection (related to health, poverty and/or employment status). Accordingly, the Boards concluded that it would not be productive to propose scoping out 'social benefits' using the definition in IPSAS 42.
- BC101 The Boards also considered whether it might be feasible to identify particular entities or activities that would not fall within the scope of AASB 17/PBE IFRS 17. For example, whether entities such as those closely associated with the hospital/health system, as a way of automatically excluding them and removing the need for an analysis of indicators to determine whether they need to apply AASB 17/PBE IFRS 17. In that context, the Boards noted that AASB 17/PBE IFRS 17 specifically scopes out particular types of transactions conducted by particular types of entities that would otherwise probably need to be accounted for as insurance contracts, including, for example, warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer [AASB 17/PBE IFRS 17.7(a)].

### ***Conclusions***

- BC102 The Boards concluded that, while it would provide certainty for some entities, they are generally opposed to specifically identifying public sector schemes that are not within the scope of AASB 17/PBE IFRS 17

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<sup>8</sup> Public benefit entities (PBEs) are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders (paragraph 6 of XRB A1 *Application of the Accounting Standards Framework*). PBEs comprise not-for-profit entities and public sector entities

because it is typically not the role of the Board to identify specific entities that should, or should not, apply particular Standards.

- BC103 The Boards also concluded that, while there may be some merit in proposing that specifically identified types of activities are not within the scope of AASB 17/PBE IFRS 17:
- (a) this could be problematic due to the potential interface between the public health system and the medical nature of many claims that might be the subject of arrangements that would be accounted for as insurance contracts; and
  - (b) the relevant types of excluded activities should be able to be identified based on applying other proposed indicators.

#### **Fault-based Nature of an Arrangement**

- BC104 In respect of many classes of risk, for-profit private sector insurers attribute fault in determining whether claims are valid or the amount of those claims. For example, a policyholder that is negligent may receive a lower claim benefit than a policyholder who is not at fault, which is designed to avoid moral hazard issues. Accordingly, it could be argued that fault-based arrangements are more likely to result in insurance activities.
- BC105 The Boards noted that public sector schemes vary across jurisdictions. For example, some of the Australian Compulsory Third Party motor insurance arrangements for non-serious injury are fault-based, while all the Compulsory Third Party motor insurance arrangements that include serious injury are no-fault schemes. Currently, Australian stakeholders' application of either AASB 4 and AASB 1023 versus AASB 137 has not reflected the fault status of the arrangements. That is, some public sector entities operating no-fault arrangements are applying AASB 4 and AASB 1023, while others are applying AASB 137. However, the Boards are not aware of any public sector entities operating fault-based arrangements that are applying AASB 137.
- BC106 The Boards also observed that, while no-fault arrangements are more prevalent in the public sector, many classes of risk covered by for-profit private sector insurers do not involve attributing fault in determining whether claims are valid or the amount of those claims. For example, insurance contracts for risks such as health/disease and longevity are typically no-fault contracts.

#### **Conclusion**

- BC107 Based on the above deliberations, the Boards concluded that the no-fault versus fault-based nature of public sector arrangements would not be helpful in indicating whether the arrangements are to be accounted for as insurance contracts and this distinction has not been proposed as an indicator.

#### **Captive Insurers**

- BC108 The Boards noted that large consolidated group (non-insurer) entities sometimes establish a 'captive insurer' subsidiary to coordinate risk management for all (or most) entities within the group. The subsidiary typically charges premiums to other entities in the group and pays them valid claims in respect of insured events, and ordinarily reinsures some or all of the risks with a third-party reinsurer. Australian or New Zealand-based captive insurers would need to be registered as insurers and, therefore, required to prepare general purpose financial statements and meet relevant regulatory and prudential requirements.
- BC109 The Boards noted that governments also create captive insurers and the key motivations are typically to:
- (a) centralise the administration of insurable risks across a complex group of entities and coordinate risk management policies and processes;
  - (b) charge premiums to other government agencies and, thereby, create incentives for them to manage risks; and
  - (c) in some cases, coordinate in a cost-beneficial manner the acquisition of insurance/reinsurance coverage from an external insurer/reinsurer.
- BC110 The Boards observed that, at the whole-of-government level, transactions between the captive insurer and other government agencies are eliminated; and any reinsurance contracts between the captive and third-party insurers are treated as insurance contracts in which the government is a policyholder.

BC111 The Boards considered whether they should:

- (a) in the context of the requirements imposed on private sector Australian-based and New Zealand-based captive insurers, explicitly require public sector captive insurers to prepare general purpose financial statements, including applying AASB 17/PBE IFRS 17; or
- (b) given the eliminations at the whole-of-government level, explicitly scope public sector captive insurers out of applying AASB 17/PBE IFRS 17.

BC112 The Boards noted the following in respect of the AASB Discussion Paper (2017).

- (a) It was proposed that public sector captive insurers should be permitted an optional exemption to not apply AASB 17 on the basis that:
  - (i) some captive public sector entities do not currently apply insurance accounting to their insurance transactions; and
  - (ii) the cost of doing so is likely to be greater than the benefits given the accounting would be reversed on consolidation. (In the consolidated entity, since insurance risk has not been transferred to a party outside the group, any claim liabilities would probably be accounted for as provisions).
- (b) It was also proposed that, in the event there is a public sector entity that accepts insurance risk from both related and unrelated parties, the optional exemption from applying AASB 17 would apply only to transactions with related parties.
- (c) Respondents expressed mixed views, including:
  - (i) support for captive insurers being scoped out of AASB 17;
  - (ii) support for the optional exemption;
  - (iii) strong disagreement with the proposals based on a view they would create complexity for some entities within a group reporting structure that are required to use two different measurement bases; and
  - (iv) when there are no users dependent upon the financial statements of a captive insurer, it would be up to the appropriate government to exempt the entity from preparing general purpose financial statements.

BC113 The Boards noted that NZASB ED 2018-7 did not raise the issue of captive insurers and nor did any of the respondents to the ED.

BC114 The Boards also noted that more recent stakeholder consultation revealed a variety of reasons for different practices among Australian governments in terms of whether separate general purpose financial statements are presented for captive insurers.

- (a) Various accountability mechanisms and reporting requirements apply across the public sector and captive insurers either report separately (or not) based on those general requirements.
- (b) Historical responsibilities for bearing risks have been allocated to the entity, which were accompanied by particular (usually legislated) accountability mechanisms and reporting requirements.
- (c) A deliberate policy has been adopted to impose accountability mechanisms and reporting requirements on a captive insurer, consistent with (for example) having an independent board of directors. Entities with independent boards of directors/management might be particularly keen to demonstrate accountability and prepare separate financial statements. Some stakeholders consider the fact that their customers are related entities makes it all the more important that they have separate financial reporting.

### ***Conclusion***

BC115 The Boards considered that the issues surrounding captive insurers are essentially reporting entity issues, rather than issues of particular relevance to the insurance project.

BC116 Accordingly, the Boards concluded it is not relevant to specifically exempt public sector captive insurers from applying AASB 17/PBE IFRS 17 in their separate financial statements. They noted that, if a jurisdiction determines that an entity should prepare general purpose financial statements, provided the entity's activities fall within the scope of AASB 17/PBE IFRS 17, that Standard should be applied.

## Sub-grouping of Contracts

### Requirements under AASB 1023/PBE IFRS 4

BC117 The Boards observed that, under AASB 1023/PBE IFRS 4, the liability for remaining coverage is measured as the amount of premium received and or receivable for the contract period that remains unearned. An insurer is required to apply a Liability Adequacy Test to the carrying amount of the liability for remaining coverage (represented by 'unearned premium') when there is an indication that the liability may be inadequate [AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1)]. The Liability Adequacy Test is applied at a portfolio of contracts level. The Boards noted that, in the case of some public sector entities, there is only one portfolio of contracts and, for those entities, the Liability Adequacy Test is effectively conducted at the whole-of-entity level.

BC118 The Liability Adequacy Test involves comparing:

- (a) the balance of the liability for remaining coverage recognised on the balance sheet; with
- (b) current estimates of the present value of the expected future cash flows relating to future claims arising from existing insurance contracts, plus a risk margin that reflects the inherent uncertainty in the central estimate.

There is a deficiency if (a) is less than (b), in which case an additional 'unexpired risk liability' is recognised for the deficiency,<sup>9</sup> which is also recognised immediately as a loss.<sup>10</sup>

### Requirements in AASB 17/PBE IFRS 17: Sub-grouping of Onerous versus Non-onerous Contracts

BC119 AASB 17/PBE IFRS 17 has a much greater emphasis (than AASB 1023/PBE IFRS 4) on identifying onerous contracts and that their identification has fundamental impacts on a wide range of accounting outcomes. In particular, at initial recognition, insurance contracts within each portfolio of contracts must be sub-grouped as:

- (a) contracts that are onerous at initial recognition, if any;
- (b) contracts that have no significant possibility of becoming onerous subsequently, if any; and
- (c) other (non-onerous) contracts [AASB 17/PBE IFRS 17.16].<sup>11</sup>

BC120 The Boards noted the following.

- (a) In the private for-profit sector, the presumption is that insurers issue insurance contracts that are intended to be profitable. In practice, the profit component should act as a 'buffer' to any liability inadequacy and private for-profit sector insurers only occasionally need to test for liability inadequacy and few entities need to recognise an unexpired risk liability under AASB 1023/PBE IFRS 4.
- (b) In contrast, for most public sector entities applying AASB 1023/PBE IFRS 4, the liability for remaining coverage based on unearned premium is routinely inadequate because they price to break even after taking into account projected investment returns.<sup>12</sup> That is, the amounts collected in levies/premiums are typically inadequate to meet expected claims. Accordingly, many public sector entities routinely recognise unexpired risk liabilities under AASB 1023/PBE IFRS 4.

<sup>9</sup> Because a deficiency is not represented by 'unearned premium' in the context of AASB 1023/PBE IFRS 4, the deficiency is separately recognised as an 'unexpired risk liability'.

<sup>10</sup> An entity with deferred acquisition costs and intangible assets related to insurance contracts would write those off before recognising any remaining deficiency [AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1)]; however, public sector entities do not ordinarily have material deferred acquisition costs or intangible assets.

<sup>11</sup> In practical terms, there are two sub-groups: (a) onerous; and (b) non-onerous. Early indications are that most insurers consider 'contracts that have no significant possibility of becoming onerous subsequently' would be a rarity.

<sup>12</sup> The expected investment returns are ordinarily higher than the discount rates (for time value) applied to measure insurance liabilities.

The Boards highlighted this as a key distinguishing factor among public sector entities compared with private sector for-profit entities.

BC121 The Boards acknowledged that there are no public sector specific modifications to AASB 1023/PBE IFRS 4 based on this key distinguishing factor and that the routine recognition of unexpired risk liabilities, which are typically offset by investment income/gains, is an accepted practice. However, the Boards noted that the AASB 17/PBE IFRS 17 requirement to sub-group contracts based on whether they are onerous versus non-onerous raises further potential accounting complications. In particular, the Boards observed that:

- (a) accounting for a whole portfolio that is onerous is likely to be relatively simple compared with having to identify some (possibly) non-onerous contracts from within a largely onerous portfolio of contracts and account for them separately;
- (b) the level of interest among public sector entities and their users in knowing about profitable sub-groups of contracts that might exist within a wider loss-making portfolio, would be lower than the level of interest among private sector insurers and their users in knowing about loss-making sub-groups of contracts that might exist within a wider profitable portfolio; and
- (c) any interest among users of public sector entities' financial statements in knowing about cross-subsidisation among different classes of policyholders would probably be best met through disclosures (rather than disaggregation that affects recognition and measurement).

#### ***Analysis on Sub-grouping by Onerous Versus Non-onerous Contracts***

BC122 The Boards noted that:

- (a) there is no impact on the long-run overall results from taking different approaches to onerous contract units of account and annual cohorts of contracts versus a portfolio unit of account; and
- (b) the main impact of AASB 17/PBE IFRS 17 (relative to AASB 1023/PBE IFRS 4) would be to recognise losses upfront that would otherwise have been recognised over the coverage period. The Boards thought that, since most of the coverage periods are typically one year, the timing of loss recognition would typically not be very different as between AASB 17/PBE IFRS 17 and AASB 1023/PBE IFRS 4.

BC123 The Boards observed that the IASB decided on the requirements in AASB 17/PBE IFRS 17.16 to divide each portfolio of contracts into sub-groups because it regards information about onerous contracts to be useful information about an entity's decisions on pricing contracts and about future cash flows, and wants this information to be reported on a timely basis. The IASB does not want this information to be obscured by offsetting onerous contracts in one group with profitable contracts in another group [IFRS 17.BC119].<sup>13</sup> The Boards acknowledged that the upfront recognition of losses may be particularly useful in a private sector for-profit context.

BC124 The Boards observed that the impact of AASB 17/PBE IFRS 17 would depend on the nature of the arrangements and how they have been priced and they considered the following examples by way of illustration.

- (a) Worker's compensation insurance contracts are typically priced for the expected actual risks by employer and/or industry. At initial recognition, unless a deliberate decision has been taken to under-price for risk on some contracts and over-price others, ordinarily there would not be onerous and non-onerous sub-groups. Typically, in a public sector context (of break-even pricing before taking into account investment earnings), the portfolio would be expected to comprise only one group of onerous contracts.
- (b) Transport accident insurance contracts are typically priced for the expected actual risks over the whole portfolio. However, the public sector entity might have relatively granular information available about policyholders by risk profile. For example, it may be known that drivers living in particular geographic regions are likely, on average, to give rise to fewer claims and are largely

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<sup>13</sup> The IASB chose groups of contracts as a way of striking a compromise between accounting on an individual contract basis (that would be particularly burdensome) and accounting at the portfolio level of aggregation [IFRS 17.BC123 & BC124].

profitable. In such a case there may be onerous and non-onerous groups of contracts based on geographic regions.

- BC125 The Boards noted that AASB 17/PBE IFRS 17.20 provides relief from sub-grouping under onerous versus non-onerous contracts when contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics. Accordingly, in the transport accident case noted above, if the pricing constraints on the entity are the cause of overpricing for low-claim geographic regions, they need not be separately accounted for (as a non-onerous contract group). However, the Boards remained concerned that this relief may be difficult to apply in some cases due to possible ambiguity about where price/levy/benefit decision-making power may reside – with the entity itself, or with the government [for example, the relevant Minister(s)].
- BC126 The Boards considered feedback received from stakeholders on sub-grouping of contracts in response to earlier consultation documents.
- BC127 NZASB ED 2018-7 proposed no changes to PBE IFRS 17 in respect of onerous contracts; however, it specifically sought feedback from stakeholders on the requirements in PBE IFRS 17.16. The responses to NZASB ED 2018-7 generally argued for public-sector-specific modifications based on a view that the requirements in PBE IFRS 17.16 are not relevant to the circumstances of public sector insurers in New Zealand. The responses included the following:
- (a) pricing decisions and the resulting onerous contracts will often be a consequence of broader policy decisions of government;
  - (b) the level of aggregation should be the same as the level used for setting levies;
  - (c) while for profit insurers use granular information to improve profitability and avoid adverse selection by policyholders – this is not relevant to public sector entities, which typically deliberately cross-subsidise across communities;
  - (d) public sector entities do not choose their customers or seek to market their services to particular customers, and risks are usually community rated – accordingly, grouping by onerous/non-onerous arrangements is not relevant.
- BC128 The AASB Discussion Paper (2017) did not specifically request input on this topic and there were no comments from stakeholders on onerous contract groups. However, the topic was raised in stakeholder outreach conducted in 2020-21 and the following matters were raised.
- (a) In any given year, all contracts in a portfolio are likely to be onerous at initial recognition because the entity relies on investment returns to break even. That is, amounts raised from the levies/premiums charged are inadequate relative to expected claims and there will be a negative insurance service result (negative underwriting result). Accordingly, unless there is sound evidence of a non-onerous group of contracts there would be no disaggregation of the portfolio under AASB 17/PBE IFRS 17.
  - (b) Given that some entities do not price differentially based on policyholder-specific risks, they do not monitor (and may not possess) the information necessary to differentiate between onerous versus non-onerous contracts at initial recognition. For example, some entities are not permitted to hold information on gender or age; however, if available, gender and/or age-related information would enable the entity to identify onerous versus non-onerous contracts.
  - (c) Ordinarily, all of a public sector entity's onerous contracts and non-onerous contracts would be the result of regulatory impediments that are covered by the 'relief' in AASB 17/PBE IFRS 17.20; however, there may be exceptions.
  - (d) The entity takes a long-term view to avoid volatility in premiums/levies – periodically, there may be profitable or onerous contracts that depend on whether, for example, there are deficits to be 'rectified' or surpluses to be 'used up'.
- BC129 The Boards considered a number of possible approaches to addressing the sub-grouping of contracts in a public sector context, including the following.
- (a) Exempt all public sector entities from AASB 17/PBE IFRS 17.16, on the basis that timely information on profitability is not relevant to most public sector entities; and most public sector



entities have portfolios of onerous contracts and sub-groups of onerous contracts are not relevant. However, it was acknowledged that information on sub-groups of onerous contracts might be useful in helping to inform users about cross-subsidies between different classes of policyholders.

- (b) Exempt only not-for-profit public sector entities (which is the majority of the relevant entities) from AASB 17/PBE IFRS 17.16 for the reasons noted in (a) above.
- (c) Exempt all public sector entities from AASB 17/PBE IFRS 17.16; however, require disclosure about the nature of the pricing process, including constraints under which an entity operates to cross-subsidise different policyholder cohorts, that can lead to some groups of contracts being onerous. This might provide additional relevant information about the impact of price constraints on each entity. However, it was acknowledged that the additional disclosure would be a burden and may already be readily available from other sources (although the burden might be mitigated by permitting disclosure by cross-reference).
- (d) Retain application of AASB 17/PBE IFRS 17.16 and provide guidance for the public sector context on the manner in which AASB 17/PBE IFRS 17.20 would provide relief from the need to sub-group contracts.

### ***Sub-grouping Onerous Versus Non-onerous Contracts – Conclusions***

BC130 Based on the above deliberations, the Boards concluded that they would propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16. That is, public sector entities would not be required to sub-group contracts based on whether, at initial recognition, they are:

- (a) onerous;
- (b) have no significant possibility of becoming onerous subsequently, or
- (c) are neither (a) nor (b).

BC131 The practical impact of this proposed exemption is that public sector entities would have a basic unit of account that is a portfolio (also see the discussion below on annual sub-grouping). Accordingly, their liabilities for remaining coverage and liabilities for incurred claims would be measured for each portfolio as a whole (and, for those entities with only one portfolio, effectively at the whole-of-entity level).

BC132 The Boards consider this exemption is justified for the following reasons.

- (a) The motivation behind the AASB 17/PBE IFRS 17 requirements for information about onerous contracts is useful information about an entity's decisions on pricing contracts, which is not as relevant in the public sector context (relative to the private sector). This is particularly the case for not-for-profit entities. However, even public sector entities that are identified as for-profit entities are typically not able to underwrite risks in the manner available to private sector insurers and, therefore, disaggregating onerous versus non-onerous contracts would not provide useful information for assessing a public sector entity's financial position or performance.
- (b) Public sector entities' information systems are often geared to identifying, at a broad level, high-risk groups of policyholders for strategic and government policy decision-making (for example, to conduct safety campaigns), but not necessarily for identifying separate groups of contracts that give rise to accounting profits or losses. The managements of public sector entities (whether for-profit or not-for-profit) typically do not seek to financially remediate groups of onerous contracts or seek to attract more profitable customers in the same manner as private sector insurers. And, unlike private sector insurers, public sector entities do not ordinarily choose the customers to which they market their products. Accordingly, the costs for public sector entities of disaggregating onerous versus non-onerous groups of contracts would exceed any likely benefits.
- (c) If public sector entities are subject to AASB 17/PBE IFRS 17.16 it would be necessary to explain how the relief in AASB 17/PBE IFRS 17.20 could be applied in a public sector context. That would mean explaining whether the constraints identified in AASB 17/PBE IFRS 17.20 would be constraints imposed only on the entity itself or on the entity and its controlling government [Minister(s)]. In the context of AASB 17/PBE IFRS 17, there is the potential for ambiguity in considering whether:

- (i) a public sector entity's practical ability to fully price for risks or benefits includes the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits in their capacity as managers of the public sector entity; versus
- (ii) overall pricing constraints relevant to AASB 17/PBE IFRS 17.20 in respect of government policy more broadly.

BC133 The Boards also considered that the differences (from the private sector) in the accountability/regulatory, governance and financial management frameworks in general among public sector insurers might also justify an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16.<sup>14</sup>

BC134 The Boards concluded that they would propose requiring additional disclosures about the nature of the pricing process; including, for example, information about the manner in which pricing/benefits are determined, the timeframes over which they are typically determined, and any other relevant constraints under which an entity operates that result in cross-subsidising different classes of policyholders. The Boards noted that this information may already be publicly available from other sources and that the proposed requirement could be met by cross-reference to relevant authoritative sources.

BC135 The Boards acknowledged that, in general, Accounting Standards do not require disclosures around pricing decisions and whether they involve cross-subsidisation among customers. However, the Boards consider this additional disclosure is justified due to the likely significance of the manner in which pricing/benefits are determined on the performance and financial position of public sector entities that bear insurance risk.

#### **Sub-grouping of Contracts Issued no more than a Year Apart**

BC136 The Boards observed that portfolios of contracts might include contracts entered into over successive years, but that AASB 17/PBE IFRS 17 requires entities to divide each portfolio of contracts into sub-groups of contracts issued no more than a year apart [AASB 17/PBE IFRS 17.22]. The purpose behind this requirement is to reveal cases of entities masking the existence of onerous contracts issued in a particular year by accounting for them together with profitable contracts issued in other years. This is mainly an issue when there are contracts with multi-year coverage periods.

BC137 The Boards noted that, given the monopoly position of many public sector entities, they may phase in increases and decreases to levies/premiums and the extent to which arrangements might be onerous or non-onerous for any given annual cohort of contracts is likely to be less relevant than for a private sector for-profit insurer.

BC138 The Boards noted that some of the responses to NZASB ED 2018-7 argued that a public sector modification is needed because the requirement in PBE IFRS 17.22 is not relevant to the circumstances of some public sector insurers that take a long view on pricing. That is, grouping by annual cohort is irrelevant when the insured risk is for highly uncertain and infrequent events where the entity is a monopoly provider (and cannot withdraw from the market).

#### ***Analysis of Sub-grouping of Contracts Issued no more than a Year Apart***

BC139 The Boards noted that the IASB decided to require sub-grouping of contracts issued no more than a year apart because it considers annual grouping by the underwriting year to be important to ensure that trends in the profitability of a portfolio of contracts are reflected in the financial statements on a timely basis [IFRS 17.BC136].

BC140 In the context of the Australian and New Zealand public sectors, the Boards observed the following.

- (a) Many public sector entities would only issue contracts with one year of coverage and the difference between the portfolio perspective versus sub-grouping by annual cohort would not be particularly relevant. However, some public sector entities issue contracts that provide multi-year coverage – for example, in respect of domestic building risk coverage arrangements, and there may exist onerous versus non-onerous annual cohorts of contracts.

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<sup>14</sup> In that context, the Boards noted: paragraph 30(g) of the [AASB Not-for-Profit Entity Standard Setting Framework](#); and, to some extent, paragraph 62 of the [New Zealand Accounting Standards Framework](#).

- (b) When relevant, the requirement in AASB 17/PBE IFRS 17.22 to identify separate groups of contracts by their year of issue is expected to result in insurers identifying their reporting period as the relevant period. Australian and New Zealand public sector entities have 1 July to 30 June financial years and, if they were to comply with AASB 17/PBE IFRS 17.22, would be expected to regard all contracts issued between 1 July and 30 June as being within one group of contracts.

BC141 The Boards noted that the AASB 17/PBE IFRS 17.22 requirement to determine groups of contracts based on the underwriting year as the unit of account for the liability for remaining coverage could have flow-on consequences for the ways in which the liability for incurred claims would also be managed (unless insurers operate two parallel systems). This might be the case for the following reasons.

- (a) Claims are usually monitored in the context of the related levies/premiums ‘earned’, and premium ‘earning’ under AASB 17/PBE IFRS 17 would be based on the underwriting year used for the liability for remaining coverage under AASB 17/PBE IFRS 17.22.
- (b) Many public sector entities tend to manage claims on an ‘accident year’ basis because claims management plays a prominent role for public sector entities, rather than profitability and underwriting performance.<sup>15</sup> Under an accident year basis, all claims arising from incidents/accidents within a particular annual period are tracked over time and compared year-on-year with levies/premiums earned in that year for the related contracts, regardless of when those contracts were issued/underwritten.
- (c) For some public sector entities, the underwriting year and the accident year are the same due to most (or all) contracts being issued with coverage that coincides with the annual reporting period. However, for other public sector entities they are different.

BC142 The Boards also noted that some insurance risks relate to providing coverage for highly uncertain infrequent events. While the coverage period for contracts for these risks are often only one year, the insured events might be expected to occur many years apart. Accordingly, in years when there are no relevant events, the contracts are highly profitable; while in years when a relevant event occurs, the contracts result in large losses. The Boards observed that:

- (a) from the perspective of a private sector insurer that can choose to engage in these contracts or withdraw from the market, sub-grouping contracts by their year of issue (underwriting year) based on AASB 17/PBE IFRS 17.22 might help track this profit or loss volatility; while
- (b) from the perspective of a public sector entity that is a monopoly and cannot choose to withdraw from the market, sub-grouping contracts by their year of issue (underwriting year) based on AASB 17/PBE IFRS 17.22 seems much less relevant. For these entities, tracking sub-groups of contracts by the year in which the infrequent events occur (accident year) might be more relevant.

#### ***Sub-grouping of Contracts Issued no more than a Year Apart – Conclusions***

BC143 Based on the above deliberations, the Boards concluded that they would propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.22. The Boards consider this exemption is justified for the following reasons:

- (a) The IASB’s reasoning behind the requirements (annual groupings by issue date are important to ensure that trends in the profitability of a portfolio of contracts are reflected in the financial statements on a timely basis) is generally less crucial (or is unimportant) to public sector entities.
- (b) The main focus of interest among public sector entities is on claims experience rather than profitability or underwriting performance. Some of those entities would track and manage claims on an accident year basis (not an underwriting year). Others use an underwriting year basis. Some entities track claims on both bases. Managements are likely to continue their existing tracking focus (which they have found to be effective) even if the external reporting requirements changed to groups based on the date when contracts are issued. The costs for some entities of operating a parallel tracking system (based on the underwriting year) to facilitate external reporting would not justify any benefits that might arise from applying AASB 17/NZ IFRS 17.22.

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<sup>15</sup> The liability for incurred claims is also the focus of management attention for most public sector entities because their liabilities for incurred claims are usually much larger than their liabilities for remaining coverage.

- (c) The requirement in AASB 17/PBE IFRS 17.57 to compare the liability for remaining coverage<sup>16</sup> with the fulfilment cash flows that relate to remaining coverage when facts and circumstances indicate a group of insurance contracts is onerous could be applied at the portfolio level.<sup>17</sup> Given that, for most public sector entities, the liability for remaining coverage is routinely inadequate because they price to break even after taking into account projected investment returns, exempting public sector entities from applying the requirements in AASB 17/PBE IFRS 17.22 would rarely (if ever) result in delayed recognition of onerous contracts.

## Initial Recognition when Contracts are Onerous

BC144 In general, the following applies under AASB 1023/PBE IFRS 4.

- (a) An insurance liability is recognised when premium is received or receivable, because the measurement model simply defers unearned premiums received or receivable on the balance sheet. Premiums might be received before coverage begins, on the day coverage begins or after coverage begins.
- (b) An unexpired risk liability (onerous contract loss) is recognised based on whether unearned premiums are adequate to meet expected future claims and other relevant costs. Accordingly, loss recognition is dependent on when unearned premiums are recognised on the balance sheet.

BC145 In contrast, AASB 17/PBE IFRS 17.25 requires a group of insurance contracts an entity issues to be recognised from the earliest of the following:

- (a) the beginning of the coverage period of the group of contracts;
- (b) the date when the first payment from a policyholder in the group becomes due; and
- (c) for a group of onerous contracts, when the group becomes onerous.

BC146 The Boards observed that, for the onerous contract trigger in AASB 17/PBE IFRS 17.25(c) to be the earliest date, the insurer would have already accepted the insured's risk before coverage commences and before premiums are due and there are facts and circumstances indicating a group of insurance contracts is onerous.<sup>18</sup> Accordingly, there would need to be up-front loss recognition for any onerous contracts that have been entered into as at the balance date, even though the coverage period may only commence in the subsequent financial year. This reflects the emphasis in AASB 17/PBE IFRS 17 on the early recognition of onerous contract losses.

BC147 The Boards observed that the differing circumstances of public sector entities compared with their private sector counterparts would potentially mean that applying AASB 17/PBE IFRS 17.25(c) would have unhelpful accounting consequences.

- (a) Private sector for-profit insurers would typically only by exception knowingly issue onerous contracts [see the perspective in IFRS 17.BC135]. However, most public sector entities routinely issue onerous contracts (because levies/premiums charged are inadequate to cover expected claims).
- (b) Private sector insurers will typically have contracts commencing throughout their financial year and, therefore, only a relatively small portion of contracts that commence in the following year would typically be binding on the entity at any given reporting date. However, some public sector entities have a large portion of their contracts covering periods that coincide with their financial year. Accordingly, for these entities, all or most of next year's contracts could be binding on the entity at each reporting date.

The Boards noted that, for an entity that has binding arrangements in the weeks before year end for the following 1 July to 30 June coverage period, applying AASB 17/PBE IFRS 17.25(c) would mean all of the onerous contract losses associated with next year's arrangements would need to be included in the current year's results. While this may not have a major impact year-on-year, the Boards thought it would be a counter-intuitive outcome.

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<sup>16</sup> Calculated using the premium allocation approach, which is expected to be the main approach used by public sector entities applying AASB 17/PBE IFRS 17.

<sup>17</sup> This is the level at which the Liability Adequacy Test is currently applied under AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1.)

<sup>18</sup> Based on IFRS 17.BC140 to BC144.

## **Conclusions**

BC148 Based on the above deliberations, the Boards concluded that they would propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.25(c). The Boards consider this exemption is justified for the following reasons.

- (a) The consequences of applying AASB 17/PBE IFRS 17.25(c) to some public sector insurers would be potentially burdensome from a practical viewpoint, since their systems are not currently set up to capture this information, and would lead to information that is not useful for users of the financial statements. This is because, for some public sector entities, on an ongoing basis, the results for the current period would include the onerous contract losses of all or most of the following year's contracts.
- (b) AASB 17/PBE IFRS 17.25(c) was conceived in the context of private sector for-profit insurers for which, in theory, onerous contracts would be the exception and for which binding contracts as at the reporting date that relate to the following year of coverage would be a relatively small proportion of total contracts.

## **Risk Adjustments**

### **Background**

BC149 The Boards noted that:

- (a) under AASB 17/PBE IFRS 17, a risk adjustment is: “the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts”; while
- (b) under AASB 1023/PBE IFRS 4, a risk margin relates to the inherent uncertainty in the central estimate of the present value of the expected future payments.

BC150 The Boards noted that the notion of a risk adjustment in AASB 17/PBE IFRS 17 is the compensation the entity would require to make it indifferent between fulfilling a liability of fixed amount and a liability of uncertain amount that has a central estimate equivalent to the fixed liability [AASB 17/PBE IFRS 17.B87]. It is designed to convey information to users of financial statements about the amount charged by the entity for the uncertainty arising from non-financial risk associated with the amount and timing of cash flows.

BC151 The Boards noted that AASB 1023/PBE IFRS 4 has no equivalent to the AASB 17/PBE IFRS 17 notion of compensation – instead, the risks are regarded as being inherent in the cash flows. Conceivably, it might be argued that, under AASB 17/PBE IFRS 17, a public sector entity could have a risk adjustment of ‘zero’ if the entity does not seek compensation for bearing non-financial risk, while AASB 1023/PBE IFRS 4, assumes an entity includes a risk margin based on the inherent uncertainty around the cash flows.

BC152 The Boards noted that:

- (a) there is a presumption that for-profit private sector entities would need to be compensated for bearing risk and, as risk is released, that revenue would be recognised; and
- (b) public sector entities may have a different perspective and not need to be compensated for bearing risk on the basis that:
  - (i) they are often monopolies and there may be the opportunity to increase premiums/levies to meet future claims; and
  - (ii) they have explicit or implicit government guarantees of financial support.

### **Industry Benchmarks and Current Practices**

BC153 The Boards noted that neither Standard requires a particular technique to be used to measure risk adjustments; however, currently entities typically use a confidence level (probability of adequacy) approach. The Boards also noted that:

- (a) under AASB 1023/PBE IFRS 4, many entities benchmark to a 75% confidence level (indicating the liability for incurred claims would be adequate to meet actual claims three years in four); and

- (b) under AASB 17/PBE IFRS 17, when an approach other than the confidence level technique is used, an entity must disclose the technique used and the confidence level corresponding to the results of that technique [AASB 17/PBE IFRS 17.119].

BC154 The Boards observed that the 75% confidence level benchmark originally arose from a minimum prudential reporting benchmark and has become a widely used reference point in Australia and New Zealand and more broadly in other jurisdictions. Additionally, although other methods (such as cost of capital techniques) may be used to measure risk adjustments, they are often only permitted by regulators subject to achieving a minimum confidence level.

BC155 The Boards observed that most of the public sector entities applying AASB 1023/PBE IFRS 4 recognise risk margins at a 75% confidence level, or some level close to that benchmark. The Boards also observed that some of the Australian public sector entities applying AASB 137 also recognise risk margins at a 75% confidence level, or some level close to that benchmark. In outreach conducted in 2020-21, some stakeholders indicated that information about uncertainties in the cash flows are important to them, even in measuring provisions (under AASB 137).

### **Previous Public Sector Proposals and Stakeholder Feedback**

BC156 The Boards noted that the AASB Discussion Paper (2017) and NZASB ED 2018-7 did not propose any modifications in respect of the risk adjustment requirements in AASB 17/PBE IFRS 17. However, they noted that the AASB Discussion Paper Basis for Conclusions [AASB DP.BC8 to BC13] raised the possibility of a risk adjustment of zero is based on a case of a public sector entity with a government guarantee and/or a monopoly position in which it can recoup current and past losses from its controlling government or via future contracts. However, the AASB Discussion Paper concluded that, while the risk adjustment might differ from a for-profit private sector entity, it is unlikely to be nil because:

- (a) the uncertainties associated with outstanding claims cash flows in respect of past transactions, that would be reflected in a risk adjustment are a characteristic of the claims liability; and
- (b) in respect of the current (usually annual coverage) transactions, the entity is bearing risk for that period and an entity's monopoly position is not relevant [AASB DP.BC10].

BC157 The Boards noted that, in response to the AASB Discussion Paper (2017) proposals:

- (a) some respondents considered that there would be risk adjustments (above zero) and also noted various considerations, including:
  - (i) disclosures around the techniques used to determine risk adjustments should be required to help ensure transparency;
  - (ii) if the AASB expects risk adjustments to be different from those in the private sector, the implication is that they would be lower (compared with the private sector) and guidance would be needed to help entities make those calculations; and
  - (iii) whether it is appropriate to imply that risk adjustments in the public and private sectors should be aligned;
- (b) other respondents considered that there would be circumstances in which a risk adjustment could be zero, such as:
  - (i) when there is absolute certainty around the government backing of the best estimate liability; and
  - (ii) the liability cash flows are so long term that the volatility is mitigated by long-term investment returns.

BC158 The Boards noted that some respondents to NZASB ED 2018-7 considered that risk adjustments would not be relevant to many public sector entities and, if they were to be required:

- (a) explicit guidance on determining risk adjustments in the public sector would be needed; and/or
- (b) the Standard should specify that risk adjustments are zero for public sector entities.

BC159 The Boards noted the comments of respondents to NZASB ED 2018-7, which included the following:

- (a) risk adjustments are predicated on the liability being an estimated amount a third party would likely want to be paid to assume the risk of settling claims, which is akin to an exit price; however, the liabilities will be settled by the entity itself;
- (b) if the entity seeks to fund a liability that includes a risk adjustment, in order to report a break-even result, the entity would need to set levies and other forms of income at amounts that (on average) would be higher than necessary; and
- (c) if the entity is funded to meet a best estimate liability, including a risk adjustment in the liability would automatically result in reported losses, which may never eventuate.

BC160 The Boards also noted the following feedback received from stakeholder outreach conducted in 2020-21.

- (a) AASB 1023/PBE IFRS 4 are regarded as requiring a risk margin to be included in measuring liabilities for outstanding claims, while AASB 137/PBE IPSAS 19 is generally regarded as not requiring a risk margin to be included in measuring provisions, but can be interpreted as permitting a risk/prudential margin to be included.
- (b) A key reason for some stakeholders choosing to apply AASB 137/PBE IPSAS 19 (rather than AASB 1023/PBE IFRS 4) is that they do not regard risk margins as appropriate to their circumstances.
- (c) Some stakeholders had assumed that their risk adjustments under AASB 17/PBE IFRS 17 would be the same as their risk margins under AASB 1023/PBE IFRS 4, while others had yet to consider whether they would have a risk adjustment under AASB 17/PBE IFRS 17 and, if they did, whether it would be more or less than any risk margin they currently apply.

#### **Alternative Approaches Considered by the Boards**

BC161 The Boards considered the following possible approaches regarding the risk adjustments requirement:

- (a) Approach 1: require public sector entities to apply AASB 17/PBE IFRS 17 with no modifications or guidance;
- (b) Approach 2: require public sector entities to have a zero risk adjustment; and
- (c) Approach 3: require a particular confidence level for determining risk adjustments for liabilities for incurred claims for all public sector entities.

#### ***Approach 1: Apply AASB 17/PBE IFRS 17 with no Modifications or Guidance***

BC162 The Boards considered the possible advantages of applying AASB 17/PBE IFRS 17 with no modifications or guidance.

- (a) It could be considered consistent with the principle of only making modifications to the IFRS Standards if there is a strong case based on substantive differences in circumstances of public sector entities (compared with the entities for which IFRS Standards are developed).
- (b) It would allow for different risk adjustments to be recognised to suit the nature of each entity's claims liabilities, which would be helpful since different public sector entities hold claim liabilities with different characteristics. For example, very long-tail, relatively predictable claims (such as regular income support payments), would result in a relatively small risk adjustment. In contrast, claims subject to future legal judgements might result in a relatively large risk adjustment.
- (c) Different public sector entities hold different views on whether they should include a risk adjustment in measuring their claim liabilities based on their circumstances. Each entity would be able to determine its position consistent with its own objectives, management philosophy, and level of risk aversion.
- (d) A for-profit public sector entity could recognise a risk adjustment on the basis that it expects to profit from bearing risk, while a not-for-profit entity might not recognise a risk adjustment because it does not seek to profit from bearing risk.

BC163 The Boards considered the possible disadvantages of applying AASB 17/PBE IFRS 17 with no modifications or guidance.

- (a) IFRS 17 was designed to be applied by private sector entities. The public sector context is often different; in particular, due to entities holding a monopoly position and being driven by public policy objectives.
- (b) Different public sector entities may determine different outcomes even though they have similar operations. Accordingly, their reported financial position and financial performance would not be comparable.
- (c) Public sector entities might expend a disproportionate amount of time and resources determining the compensation they might notionally require for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils its arrangements. There may be little or no additional information value achieved for users of the financial statements through this process.

***Approach 2: Require Public Sector Entities to have a Zero Risk Adjustment***

BC164 The Boards noted that opinions differ about whether, in concept, an entity can have a risk adjustment of zero and still claim to have contracts that transfer insurance risk. For the purposes of discussion, the Boards assumed that, in particular circumstances, a zero risk adjustment is compatible with the transfer of insurance risk and noted the example of a risk-pooling arrangement that involves accepting risk from each policyholder and sharing the risk with other policyholders. Although a public sector entity might be regarded as simply an administrator of such a pooling arrangement, it could nevertheless also be seen as bearing risk for the current in-force arrangements because the risk is typically pooled over a number of coverage periods.

BC165 The Boards considered the possible advantages of requiring public sector entities to have a zero risk adjustment.

- (a) All public sector entities would have a consistent approach (based on best estimate claim liabilities).
- (b) Best estimates (with no risk adjustment) are typically relevant to user decision making because they ordinarily provide a basis for determining how much levies or other charges need to be generated to sustain the entity in the long term.
- (c) All the relevant public sector entities are monopolies and/or have the power to adjust future levies and charges to meet any shortfalls in funding the existing claim liabilities. Accordingly, risk adjustments are not relevant because these entities have no reason to be risk averse.
- (d) Zero risk adjustments (and, therefore, zero changes from period to period in risk adjustments) would avoid misleading impacts on the income statement, since risk adjustments tend to create short term losses and longer-term gains as actual claims revert to the best estimate over the long term.
- (e) Zero risk adjustments would reduce report preparation costs by removing the need for management (and auditors) to determine (and assess) risk adjustments and to make disclosures about risk adjustments.

BC166 The Boards considered the possible disadvantages of requiring public sector entities to have a zero risk adjustment.

- (a) Many public sector entities hold strong views on the need to show their users that claim liabilities carry a level of uncertainty as to timing and amount, and consistency does not necessarily lead to comparability. All entities are risk averse to varying degrees.
- (b) There would be no changes in risk adjustments to provide useful information about changes in the levels of uncertainty among cash flows over time.
- (c) There are often obstacles to exercising monopoly and other powers. For example, it might not currently be feasible to increase levies in either the short to medium term to meet shortfalls in a timely manner. The risks that exist within in-force arrangements should not be regarded as being able to be offset by possible future transactions.



- (d) It is normal commercial practice to determine risk adjustments and many public sector entities, particularly those with independent boards of management, would wish to have a risk adjustment for financial reporting purposes to match their risk management activities (and management reporting).

***Approach 3: Require a Particular Confidence Level for Determining Risk Adjustments for Liabilities for Incurred Claims for all Public Sector Entities***

BC167 The Boards considered the possible advantages of requiring a particular confidence level for determining risk adjustments for liabilities for incurred claims for all public sector entities.

- (a) All public sector entities would have a consistent approach (based on a common confidence level).
- (b) A common confidence level would reduce report preparation costs by removing the need for management (and auditors) to determine (and assess) risk adjustments. In particular, this requirement would be generally consistent with prevailing current practice (which is long-standing) and be readily understood by all relevant stakeholders.
- (c) Relative to having a zero risk adjustment, the common confidence level approach would show, from period to period, the impacts of any changes in risk adjustments, which provides useful information about changing levels of uncertainty among cash flows over time.

BC168 The Boards considered the possible disadvantages of requiring a particular confidence level for liabilities for incurred claims for determining risk adjustments for all public sector entities.

- (a) It would be inconsistent with principle-based standard setting to set an arbitrary benchmark such as a 75% confidence level.<sup>19</sup>
- (b) The approach prevents entities from determining risk adjustments appropriate to their particular circumstances. Requiring a percentage confidence level also presumes that this is the best technique for determining risk adjustments in all circumstances; however, an entity might consider that another technique (e.g. a 'cost of capital' technique) is more appropriate.
- (c) Consistency does not necessarily lead to comparability.
- (d) If there is a general shift in expectations about the uncertainty surrounding cash flows, the required confidence level might need to be updated by the Boards.

***Disclosures***

BC169 The Boards considered that each of the three approaches outlined above could be supplemented with disclosures such as the following.

- (a) If Approach 1 is adopted (no modifications), the entity could also be required to disclose a risk adjustment for benchmark confidence level (such as 75%) to provide a point of reference for comparison.
- (b) If Approach 2 is adopted (zero risk adjustment), the entity could also be required to disclose what the risk adjustment would have been if AASB 17/PBE IFRS 17 were applied unmodified.
- (c) If Approach 3 is adopted and each public sector entity recognises a risk adjustment for a standardised confidence level (such as 75%), the entity could also be required to disclose what its risk adjustment would have been if AASB 17/PBE IFRS 17 were applied unmodified.

BC170 The Boards also considered whether, if Approach 3 were proposed as a rebuttable presumption, disclosure should be proposed of the basis for any rebuttal. However, they observed that this would go beyond counterpart disclosures already required in AASB 17/PBE IFRS 17. For example, they noted that AASB 17/PBE IFRS 17.119 requires that an entity using a technique other than the confidence level technique for determining the risk adjustment need only disclose the technique used and the confidence level corresponding to the results of that technique.

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<sup>19</sup> The Boards noted that some Australian public sector entities are required (via regulation imposed in that jurisdiction) to benchmark to APRA prudential requirements, which include a minimum risk margin.

## Analysis of Approaches by the Boards

- BC171 The Boards analysed the basis for the IASB's decisions on requiring a risk adjustment and reflected on how each of the benefits the IASB identified might still be met in a public sector context under each of the approaches (no modifications, mandated zero risk adjustment, or mandated 75% confidence level).
- BC172 The Boards noted that requiring a risk adjustment is intended to provide a clear insight into the insurance contracts and distinguishes them from risk-free liabilities [IFRS 17.BC211(a)]. The Boards thought this reasoning seems as relevant in the public sector as it is for private sector insurers and would suggest that requiring a zero risk adjustment would be inappropriate.
- BC173 The Boards noted that requiring a risk adjustment results in a profit recognition pattern that reflects both the profit recognised by bearing risk and the profit recognised by providing services [IFRS 17.BC211(b)]. The Boards considered this reasoning would be less relevant in respect of public sector entities that are not seeking to profit from bearing risk (albeit IFRS 17 applies to not-for-profit mutual entities). However, on balance, the Boards thought that, if this reasoning is relevant to a public sector entity, it would probably best support the view that the risk adjustment requirements of AASB 17/PBE IFRS 17 should be applied unmodified.
- BC174 The Boards noted that requiring a risk adjustment can be necessary to faithfully represent circumstances in which the entity has charged insufficient premiums for bearing the risk that the claims might ultimately exceed expected premiums [IFRS 17.BC211(c)]. The Boards thought this reasoning seems as relevant in the public sector as it is for private sector insurers and would suggest that requiring a zero risk adjustment would be inappropriate.
- BC175 The Boards noted that requiring a risk adjustment should result in changes in estimates of risk being reported promptly and in an understandable way [IFRS 17.BC211(d)]. The Boards thought this reasoning seems as relevant in the public sector as it is for private sector insurers and would suggest that requiring a zero risk adjustment would be inappropriate.
- BC176 The Boards also analysed the following criticisms of risk adjustments considered by the IASB in developing IFRS 17 and reflected on whether they might be more relevant in the public sector and, therefore, justify a different outcome from the requirements in AASB 17/PBE IFRS 17.
- (a) Currently, there is no single well-defined measurement approach to risk adjustments that would necessarily provide consistency and comparability of results [IFRS 17.BC210(a)]. This criticism is no more relevant, in a general sense, in the public sector than it is for private sector insurers.
  - (b) Some measurement techniques for risk adjustments are difficult to explain to users of financial statements [IFRS 17.BC210(b)]. This criticism may be more relevant in the public sector than it is for private sector insurers because the public sector users might be relatively less familiar with actuarial techniques. The NZASB in particular thought that this criticism might imply that mandating a widely-understood basis of measurement (such as a confidence level approach) could be useful in a public sector context.
  - (c) It is impossible to assess retrospectively whether a particular adjustment was reasonable, including whether (for example) a decision to set a confidence level at a particular percentile was appropriate [IFRS 17.BC210(c)]. This criticism is no more relevant in the public sector than it is for private sector insurers.
  - (d) Developing systems to determine risk adjustments will involve costs that are not justified by the benefits [IFRS 17.BC210(d)]. This criticism may be more relevant in the public sector than it is for private sector insurers because the public sector entities may not otherwise have to determine risk adjustments for management or prudential reporting purposes and typically do not price arrangements to be compensated for risk. The NZASB in particular thought that this criticism might imply that it would be inappropriate to simply leave public sector entities to apply the risk adjustment requirements of AASB 17/PBE IFRS 17 unaided.
  - (e) Including a risk adjustment in identifying any loss on initial recognition is inconsistent with IFRS 15 (on revenue) [IFRS 17.BC210(e)]. This criticism is no more relevant (and possibly less relevant given the infrequent application of AASB 15) in the public sector than it is for private sector insurers.

- (f) If including a risk adjustment results in a loss, that loss will reverse in later periods as the entity is released from that risk, which may confuse some users of financial statements [IFRS 17.BC210(f)]. This criticism may be more relevant in the public sector than it is for private sector insurers because many public sector entities would be aiming to break even over the long term, rather than earn profits or incur losses. In contrast, private sector entities would typically aim to profit from bearing risk. However, the Boards also acknowledged that any tendency of risk adjustments to create short term losses and longer-term gains would generally be a ‘once-off’ impact and would not usually affect ongoing reported financial performance unless the volumes of transactions are volatile year-on-year.
- (g) A risk adjustment could be used to introduce bias into the measurement of insurance contracts [IFRS 17.BC210(g)]. This criticism is no more relevant in the public sector than it is for private sector insurers.

### ***AASB Conclusions***

BC177 The AASB observed that:

- (a) most public sector entities do not seek to profit from bearing insurance risk;
- (b) under AASB 17, public sector entities might determine a zero risk adjustment on the basis that they are monopolies and can adjust future prices to make up for higher than expected past claims;
- (c) under AASB 17, public sector entities might determine a risk adjustment based on a particular level of adequacy based on their facts and circumstances; and
- (d) providing a benchmark confidence level, even as a rebuttable presumption, is not consistent with principle-based standard setting.

BC178 Accordingly, the AASB concluded that it would support Approach 1 and propose not making public-sector-specific modifications to the requirement to include a risk adjustment in measuring liabilities for incurred claims.

### ***NZASB Conclusions***

BC179 A primary concern for the NZASB is that entities, their advisors and auditors might expend considerable effort to identify and measure a relevant ‘compensation-based’ risk adjustment for little benefit to users.

BC180 The NZASB observed that existing practice under AASB 1023/PBE IFRS 4 has developed over many years and most public sector entities applying these standards benchmark to a 75% confidence level. The benchmark seems to have become widely accepted (including outside Australia and New Zealand) because it is:

- (a) relatively easy (and low cost) to measure;<sup>20</sup>
- (b) relatively easy to understand; and
- (c) financial statement users and entity managements have found it informative.

BC181 The NZASB considered that the 75% benchmark has been an effective and low-cost way for public sector entities to measure risk margins under AASB 1023/PBE IFRS 4. Nevertheless, the NZASB also acknowledged that there may be circumstances in which a benchmark other than a 75% confidence level is more relevant and that entities should be able to rebut the 75% benchmark.

BC182 Accordingly, the NZASB concluded that it supports Approach 3 and to propose a public-sector-specific modification of a rebuttable presumption that risk adjustments are measured at an amount that achieves a 75% confidence level in respect of liabilities for incurred claims. The NZASB also concluded that, in the event that an entity rebuts the presumption, the existing PBE IFRS 17 already requires disclosure of the actual confidence level applied and that no further disclosures need be proposed.

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<sup>20</sup> The Boards observed that, of itself, very little additional actuarial effort is likely to be needed to determine a risk adjustment – most of the relevant work is performed to determine the best estimate.

BC183 While acknowledging that providing a benchmark confidence level is not consistent with principle-based standard setting, the NZASB considers that the proposed modification is justified because:

- (a) the cost-saving benefits of using the benchmark will exceed any loss of information value; and
- (b) the rebuttable presumption would still allow for flexibility in circumstances in which a 75% confidence level may not be appropriate.

#### ***Conclusions on Further Disclosures about Risk Adjustments in a Public Sector Context***

BC184 The Boards noted that there are comprehensive disclosure requirements in AASB 17/NZ IFRS 17 about risk adjustments, particularly in the requirements for reconciliations of insurance liabilities.

BC185 Both Boards concluded that it would be inappropriate to require more disclosure of public sector entities than is required of other entities applying AASB 17/NZ IFRS 17 about risk adjustments in general.

#### **Determining Contract Boundaries, Coverage Periods and Eligibility for the Premium Allocation Approach (PAA)**

BC186 AASB 17/PBE IFRS 17 includes two approaches to measuring liabilities for remaining coverage:

- (a) a general measurement model that involves discounting fulfilment cash flows and, when relevant recognising a ‘contractual service margin’ (deferred profit/loss); and
- (b) the premium allocation approach, which is a ‘simplified approach’ and typically much less burdensome to apply than the general measurement model.

BC187 The Boards noted that identifying contract boundaries and coverage periods under AASB 17/PBE IFRS 17 are crucial for two main reasons:

- (a) identifying the cash flows used to measure liabilities for remaining coverage for in-force arrangements; and
- (b) determining whether liabilities for remaining coverage for in-force arrangements are eligible to be measured by applying the premium allocation approach.

BC188 The Boards also noted that eligibility for the premium allocation approach is available on a ‘group of contracts’ basis<sup>21</sup> – that is, an entity might apply the general measurement model to some groups of contracts and the premium allocation approach to other (eligible) groups of contracts. However, they further noted that creating an accounting system capable of implementing the general measurement model, of itself, could involve significant costs, even if it only needs to be applied to some of an entity’s arrangements.

BC189 The Boards observed that, for most public sector entities currently applying AASB 1023/PBE IFRS 4, the liability for incurred claims<sup>22</sup> is typically much larger than the liability for remaining coverage.<sup>23</sup> Nonetheless, the liability for remaining coverage would be expected to be a material amount for most public sector entities with arrangements that would be scoped into AASB 17/PBE IFRS 17. Accordingly, eligibility to apply the premium allocation approach is a key issue for public sector stakeholders.

BC190 The Boards noted the two bases on which arrangements might be eligible for the premium allocation approach under AASB 17/PBE IFRS 17.53 – at the inception of a group:

- (a) the entity reasonably expects the premium allocation approach would produce a measurement of the liability for remaining coverage that would not differ materially from the one that would be produced applying the general measurement model; or
- (b) the coverage period of each contract in the group is one year or less (determined at that date applying AASB 17/PBE IFRS 17.34).

The Boards observed that the same criteria apply in respect of reinsurance contracts held under AASB 17/PBE IFRS 17.69. They also observed that, when there are contracts with coverage periods

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<sup>21</sup> Although the Boards propose that, effectively, the basic unit of account for public sector entities would be portfolios.

<sup>22</sup> Generally referred to as the ‘outstanding claims liability’ under AASB 1023/PBE IFRS 4.

<sup>23</sup> Akin to the ‘unearned premium liability’ referred to in AASB 1023/PBE IFRS 4.

longer than a year, criterion (a) would involve creating a system to periodically test for material differences that, of itself, could involve significant costs.

BC191 The Boards considered that, given the difficulty that can be associated with meeting the criterion in AASB 17/PBE IFRS 17.53(a), the manner in which the criterion in AASB 17/PBE IFRS 17.53(b) might apply in a public sector context could be crucial.

#### **Coverage Periods of Public Sector Arrangements**

BC192 The Boards noted that, of the public sector arrangements that might fall within the scope of AASB 17/PBE IFRS 17:

- (a) most have 'stated' coverage periods of one year; however
- (b) a minority of arrangements have coverage periods longer than a year, including:
  - (i) for example, arrangements issued in respect of construction and home building risks; and
  - (ii) some reinsurance contracts held.

BC193 Arrangements between public sector entities and their policyholders ordinarily include an identified period that is presumed to be the coverage period for the purposes of applying AASB 1023/PBE IFRS 4. For example, the stated period of cover for arrangements relating to transport accidents or workers' compensation would usually be one year and the liabilities and revenues recognised on this basis.

BC194 The Boards acknowledged that AASB 17/PBE IFRS 17 does not make this same presumption. Under AASB 17/PBE IFRS 17, the 'coverage period' might be different from the stated period in a contract or arrangement because it is determined, in large part, based on identifying the cash flows that are within the 'contract boundary'. In that context, the Boards noted that cash flows are regarded as being within the boundary of an insurance contract to the extent that the entity can compel the policyholder to pay premiums or the entity has a substantive obligation to provide the policyholder with insurance contract services [AASB 17/PBE IFRS 17.34].

BC195 The Boards further noted that, an entity's 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 [AASB 17/PBE IFRS 17.34(a)]; 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 [AASB 17/PBE IFRS 17.34(b)].

BC196 The Boards observed the following.

- (a) Criterion (a) relating to individual policyholders, would usually only be applicable for large risks that are individually underwritten. This might, for example, be relevant for large construction risk arrangements entered into by some public sector entities.
- (b) The vast majority of the public sector arrangements that might fall within the scope of AASB 17/PBE IFRS 17 would be priced at a level higher than individual contracts and the criteria in AASB 17/PBE IFRS 17.34(b) would be relevant.

BC197 The Boards acknowledged that these criteria mean a coverage period could be either longer or shorter than the contractually-stated term, and noted 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.

- (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.

BC198 The Boards observed that the criteria in AASB 17/PBE IFRS 17.34 are 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. Accordingly, the fact that an entity might have the 'practical ability' to fully price for risks/benefits but choose not to use that ability, is not relevant to determining the cash flows within the boundary of an insurance arrangement.

BC199 In relation to the contract boundary criteria, the Boards noted there may be issues specific to the public sector that were not necessarily considered in the development of IFRS 17, which they might need to specifically address in AASB 17/PBE IFRS 17. In particular, those issues include:

- (a) whether a public sector entity (itself) would be regarded as having the practical ability to set prices and benefits, or whether that power lies more broadly with government, including for example, the relevant Minister(s); and
- (b) assessing the practical ability to set prices and benefits for a monopoly provider that cannot cease insuring risks by withdrawing from the market.

#### **Coverage Periods and 'Practical Ability'**

BC200 The Boards observed that the levy/premium and benefit decision-making power may reside with the public sector entity itself, or more commonly, resides with the government [for example, the relevant Minister(s) or regulatory pricing supervisor].

BC201 The Boards noted that a typical public sector model involves:

- (a) benefits largely being determined by reference to regulation or legislation, which would be the product of consultation and review; and
- (b) levies/premiums being set under a process where the public sector entity makes recommendations to a government regulatory pricing supervisor or Minister for approval. The recommendations may be approved with or without alterations.

In these circumstances, literally, the public sector entity (itself) does not have the practical ability to set prices/levies and benefits. A strict interpretation of AASB 17/PBE IFRS 17.34 might mean that the public sector entity's arrangements are open-ended and coverage is virtually perpetual. The Boards noted a flow on consequence of this would be that, under AASB 17/PBE IFRS 17, a public sector entity may need to account for arrangements as if they were issuing very long-term multi-year contracts with the need to estimate cash flows over long forecast periods.

BC202 The Boards considered the main alternative perspective to be that the entity and its controlling government<sup>24</sup> [including any relevant Minister(s) or regulatory pricing supervisor] would be regarded collectively as having the practical ability to fully price for risks/benefits. The Boards noted a flow on consequence of this perspective is that, under AASB 17/PBE IFRS 17, a public sector entity's arrangements would be regarded as having contract boundaries based on the timing (often annual) of pricing/benefit reviews by government, rather than being open-ended.

BC203 The Boards also considered whether the practical ability of a government or public sector entity should be affected by constraints imposed by the political and economic environment. However, they noted that:

- (a) all entities face political and/or economic constraints of some kind; including, for example, competitive pressures facing private sector insurers; and
- (b) the 'practical ability' benchmark needs to be applied in the context of AASB 17/PBE IFRS 17.B64, which says (in part): "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 characteristics as the existing contract issued on that date ...".

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<sup>24</sup> Under existing (or substantively enacted) legislation.

BC204 Accordingly, provided the constraints (political or commercial) apply to new (current) arrangements 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. The Boards considered that, instead, the focus should be on the constraints operating under existing and substantively enacted legislation.

#### ***Coverage Periods and 'Practical Ability' – Conclusions***

BC205 The Boards concluded that, for the avoidance of doubt, it would be appropriate to propose guidance to the effect that an entity's practical ability to fully price for risks/benefits also includes the ability of its controlling government [including any relevant Minister(s) and/or regulatory pricing supervisor] under existing and/or substantively enacted legislation to decide on pricing and benefits. The Boards consider this guidance to be supportable for the following reasons.

- (a) The approach seems reasonable given that the government 'owns and controls' the public sector entity and users of the financial statements would know, when relevant, that the ultimate decision-making power lies with the government.
- (b) Without guidance, 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 inconsistent determinations about 'practical ability' might be made by different entities in similar circumstances.

#### ***Coverage Periods – Impact of Monopoly and Standing Ready over the Long-run***

BC206 The Boards observed that:

- (a) the IASB presumably developed IFRS 17 largely with competitive markets in mind [IFRS 17.BC167 & BC168(a)]; and
- (b) all of the public sector entities that are the subject of the joint AASB/NZASB project are monopolies or near monopolies,<sup>25</sup> and are not able to withdraw from the market(s) they serve without a change of legislation.

BC207 The Boards also observed that, for a public sector entity, a monopoly position can mean:

- (a) the power to charge above-market levies/premiums; but
- (b) the responsibility to keep providing insurance services to a community of policyholders in perpetuity, or at least until there is legislative change and/or structural changes to the markets served.

BC208 The Boards considered whether the responsibility to keep providing insurance services to a community of policyholders might have consequences for the 'contract boundary'; and the 'coverage period' of a public sector entity's arrangements and noted the following possible views.

- (a) The responsibility to keep providing insurance services to a community of policyholders 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 policyholders may or may not continue to be policyholders next year and, accordingly, the responsibility to keep providing insurance services to a community of policyholders over the long term is not relevant to determining coverage periods.

#### ***Coverage Periods and 'Monopolies' and Standing Ready over the Long Run – Conclusions***

BC209 The Boards concluded that, for the avoidance of doubt, it would be appropriate to propose guidance to the effect that an entity's monopoly status (and the possible inference that there is a legislative obligation to stand-ready to insure future policyholders), of itself, does not affect an entity's practical ability to fully

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<sup>25</sup> The reference to 'near monopolies' 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.

price for risks/benefits and, therefore, would not affect the coverage period. The Boards consider this guidance to be supportable for the following reasons.

- (a) 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. The Boards consider that providing some direction to the affected public sector entities could have a cost-beneficial impact on the application of AASB 17/PBE IFRS 17.34(b)(ii). Accordingly, to the extent that providing guidance that these circumstances do not, of themselves affect an entity's practical ability to fully price for risks/benefits is a 'modification' of IFRS 17, it would be justified under the Boards' frameworks for setting standards for public sector entities.
- (b) In relation to (a) above, 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. However, it seems unlikely that this would have been a scenario contemplated in developing IFRS 17.
- (c) The guidance could be regarded as reasonable under the principles in AASB 17/PBE IFRS 17 given that typically there is turnover among 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.
- (d) Without guidance, 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 inconsistent determinations about 'practical ability' might be made by different entities in similar circumstances.

#### **Coverage Periods – Impact of Monopoly and Long-run Pricing**

BC210 The Boards observed that 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 be regarded as, for example, involving a multi-year coverage period, even though the contractually-stated coverage period might be one year.

BC211 The Boards noted that 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 might be expected to apply for workers' compensation and transport accident risks. 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 such as earthquakes.

BC212 The Boards noted the following possible scenarios:

- (a) A legislative change has been made to significantly increase benefits relating to certain types of injuries that occur after July 20X1. Based on government policy, the entity is gradually increasing levies/premiums over the 20X2 to 20X7 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 20X2 until 20X7 and possibly beyond.
- (b) 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, in the private sector context, 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.

BC213 The Boards observed that applying AASB 17/PBE IFRS 17 unamended might have a range of related implications. This could include public sector entities having to estimate the average time that a policyholder is expected to keep participating in the scheme to determine a coverage period for the purposes of AASB 17/PBE IFRS 17. This could have flow-on consequences for uncertainty around the estimated length of coverage periods and the volatility of cash flows.

#### ***Coverage Periods – Impact of Monopoly and Long-run Pricing – Conclusions***

BC214 The Boards concluded that, for the avoidance of doubt, it would be appropriate to propose guidance that a public sector entity would not fail to meet the criterion that pricing up to the date when the risks are reassessed does not take into account risks for periods after the reassessment date simply because it has a deliberate policy of setting prices and benefits based on a medium to long term view.

BC215 The Boards considered the guidance is justified on the basis that public sector entities are more likely than their private sector counterparts to have overriding public policy objectives imposed upon them that would necessitate medium to long-term pricing and benefits approaches. The Boards were also concerned that, without guidance, entities might need to engage in costly analysis in consultation with their auditors to determine how medium to long-term pricing and benefits would affect their ability to meet the criterion in AASB 17/PBE IFRS 17.34(b)(ii).

BC216 The Boards also noted that, in principle, such pricing policies are unlikely to mean that the entity has lost its practical ability to price its arrangements based on risks and benefits for the relevant (current) periods of coverage. They simply mean the entity [together with its controlling government, Minister(s) and/or regulatory pricing supervisor] has chosen to take a longer-term perspective.

#### **Disclosure and Long-run Pricing**

BC217 The Boards considered that, given the impact on public sector entities of medium to long-term pricing and benefits approaches on the application of the requirements of AASB 17/PBE IFRS 17.34, where those approaches exist, they should be the subject of disclosure. This is because the disclosure could provide useful context for users of the financial statements.

BC218 The Boards observed that the pricing and benefit approaches of public sector entities might be the subject of transparent public processes and, therefore, adequate disclosures might already be made.

#### ***Disclosure and Long-run Pricing – Conclusions***

BC219 For the reasons noted immediately above, the Boards concluded they would propose that, when a public sector entity takes into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits based on a medium to long term view, it should be required to disclose information about the manner in which pricing/benefits are determined. The Boards concluded that the proposed disclosure could be made either directly in the notes to the financial statements or by reference to an authoritative source.

#### **Discounting and Inflating**

BC220 Based on public sector arrangements that seem likely to fall within the scope of AASB 17/PBE IFRS 17 and the Boards' proposals on contract boundaries and coverage periods (paragraphs Aus/NZ34.1 to 34.3 and [BAG64.1](#)), the Boards noted that:

- (a) most coverage periods are one year or less; and
- (b) levies/premiums are typically received either shortly before coverage commences or early in the coverage period.

BC221 Accordingly, the Boards observed that the discounting requirements in AASB 17/PBE IFRS 17 (such as in AASB 17/PBE IFRS 17.36 and 56):

- (a) would not be expected to be relevant in measuring levies/premiums and in measuring most liabilities for remaining coverage;
- (b) might be relevant in the unlikely event that the general model would need to be applied to measure liabilities for remaining coverage for arrangements that provide multi-year coverage.

BC222 However, the Boards observed that public sector arrangements which seem likely to fall within the scope of AASB 17/PBE IFRS 17 often involve claims that are settled over long periods – sometimes many decades – and that discounting and inflating is usually an important aspect of measuring liabilities for incurred claims.

BC223 The Boards noted that, under AASB 1023/PBE IFRS 4, expected future cash flows are:

- (a) discounted for the time value of money at a risk-free rate based on current observable, objective rates that relate to the nature, structure and term of the future obligations;
- (b) may need to be inflated because the ultimate cost of settlement will be affected by inflationary factors likely to occur during the period to settlement; and
- (c) not expected to be either discounted or inflated when they are settled within a year.

BC224 The Boards noted that, under AASB 17/PBE IFRS 17, essentially the same notions of discounting and inflating cash flows apply, but that the discount rate relates to a current time value of money and the liquidity characteristics of the insurance contracts. That is, all other things being equal, the discount rates under AASB 17/PBE IFRS 17 would be expected to be higher than under AASB 1023/PBE IFRS 4 due to the adjustment for illiquidity.

BC225 The Boards noted the various sources of guidance and requirements (outside the Standards) for determining discount rates and inflation rates, including:

- (a) Australian and New Zealand actuarial guidance on valuation of general insurance claims;
- (b) Australian Prudential Regulation Authority prudential requirements on insurance liability valuation;
- (c) the risk-free discount rates and consumer price index (CPI) assumptions published by the New Zealand Treasury that must be used for the purpose of preparing the financial statements of government reporting entities submitting valuations to Treasury for measuring insurance claims liabilities under PBE IFRS 4.

BC226 The Boards noted that, in respect of discount rates, all the various sources of guidance have a common starting point of sovereign bond yields for durations that match the relevant claims liabilities, with extrapolation when needed.

### **Illiquidity Premium**

BC227 The Boards observed that, in concept, the size of an illiquidity premium would be positively correlated 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 illiquidity premium.

BC228 The Boards noted that, in general, private sector insurers have yet to settle on their approach to determining an illiquidity premium under AASB 17/PBE IFRS 17 and that there are no readily-available and widely-accepted benchmarks that can be applied.

BC229 The Boards considered whether there might be a need for public sector-specific guidance on determining an illiquidity premium, but concluded that the issues for public sector entities are no different from those that need to be addressed by other entities applying AASB 17/PBE IFRS 17.

## **Investment Rates of Return and Discount Rate Volatility**

BC230 The Boards noted that:

- (a) most public sector entities set premiums/levies with a view to breaking even, after taking into account any relevant projected investment earnings; and
- (b) the rate of projected investment returns assumed is typically above the time value of money rate applied to measure liabilities for incurred claims.

Accordingly, public sector entities ordinarily recognise unexpired risk liabilities (onerous contract losses) due to the 'gap' between the rates.

BC231 The Boards also noted that, for many public sector entities, the liability for incurred claims is by far the largest liability and small changes in discount rates can create liability changes from period to period that create the largest expense or revenue item in the income statement. In recent years, yields on government bonds that are typically used to determine risk-free rates have been at historical lows, and small changes in rates have been having a larger than usual impact.

BC232 The Boards noted that, based on stakeholder outreach conducted in 2020-21, there is a widespread awareness that:

- (a) the gap between discount rates leads to up-front loss recognition;
- (b) changes in discount rates lead to volatility; and
- (c) some stakeholders find the up-front loss recognition and volatility potentially misleading.

BC233 The Boards noted some stakeholders consider that long-run investment rates of return should be applied to discount cash flows in measuring liabilities for incurred claims, which may generally remove the up-front loss recognition and mitigate the volatility in liabilities for incurred claims.

BC234 The Boards considered whether there might be a need for public sector-specific guidance or modifications in respect of the discount rate requirements in AASB 17/PBE IFRS 17 (such as in AASB 17/PBE IFRS 17.36 and 56) on the basis that:

- (a) for-profit private sector insurers typically have a profit 'buffer' that (in most cases) avoids the need to recognise an up-front loss relating to the impact of the gap between risk-free and investment rates; and
- (b) the gap between the risk-free and investment rates can be larger for public sector entities relative to their regulated private sector counterparts. This is because regulated private sector insurers typically hold investments with an overall lower risk/return profile than their public sector counterparts, which do not face the same regulatory disincentives to investing in higher risk/return asset classes.

## **Rates in Other Standards**

BC235 The Boards noted that some Australian public sector entities have arrangements that give rise to claims settled over long periods and these arrangements are currently accounted for as provisions by applying AASB 137. They noted that discount rates required for measuring provisions reflect current market assessments of the time value of money and the risks specific to the liability.

BC236 The Boards noted that, based on stakeholder outreach conducted in 2020-21, there are differing views on the rates required by AASB 137/PBE IPSAS 19.

- (a) Some stakeholders interpret the AASB 137/PBE IPSAS 19 requirements as being the same or similar to the discounting requirements in AASB 1023/PBE IFRS 4 and AASB 17/PBE IFRS 17.
- (b) Some stakeholders regard the AASB 137/PBE IPSAS 19 requirements as being different from the discounting requirements in AASB 1023/PBE IFRS 4 and AASB 17/PBE IFRS 17. They see a key potential difference being the focus of AASB 1023/PBE IFRS 4 (and AASB 17/PBE IFRS 17) on an entity perspective because an insurer is expected to fulfil its insurance liabilities. In contrast, they see the focus of AASB 137/PBE IPSAS 19 as being on settlement, which could be with a third party and be measured at more or less than 'face value'.

## Presentation

BC237 The Boards observed that:

- (a) under AASB 1023/PBE IFRS 4, both the initial and subsequent impacts of discounting and inflating fulfilment cash flows are presented within the ‘underwriting result’; however.
- (b) under AASB 17/PBE IFRS 17:
  - (i) only the initial impacts of discounting fulfilment cash flows are presented within the ‘insurance service result’;
  - (ii) the impacts of subsequent discount rate changes are presented in ‘insurance finance income and expenses’, including the impact on insurance liabilities of the unwinding of the discount as time passes and the impact of discount rate changes; and
  - (iii) some of the subsequent impacts of inflation rate changes are presented in ‘insurance service result’ and others in ‘insurance finance income and expenses’ under AASB 17/PBE IFRS 17.B128.

BC238 The Boards noted that at least some of the volatility currently presented as a part of the underwriting result would be separately presented under AASB 17/PBE IFRS 17 as finance income or expense, which may help facilitate explaining the impacts of changing discount rates to users of the financial statements.

BC239 The Boards also noted that the distinction between the subsequent impacts of inflation rate changes that are presented in ‘insurance service result’ versus ‘insurance finance income and expenses’ has yet to be clarified in practice, but the issues are the same for both private and public sector entities. Accordingly, the Boards expect that an industry practice will emerge that public sector entities could apply.

## Conclusions

BC240 The Boards considered whether there might be a need for public sector-specific modifications to the discount rate requirements of AASB 17/PBE IFRS 17 to address concerns about up-front loss recognition and volatility.

BC241 The Boards concluded that they would not propose any modifications on discounting fulfilment cash flows for the following reasons.

- (a) The same discounting issues which arise for public sector entities also arise for private sector entities, while acknowledging those issues can have a more significant impact for public sector entities.
- (b) The issues of volatility of liabilities due to discount rate changes from period to period are also a feature of the discount rate requirements in other Standards (such as AASB 119/PBE IPSAS 39 *Employee Benefits*), and that any efforts to address these issues would need to involve a broad-based project that goes beyond a project on insurance arrangements in the public sector.
- (c) Any project on discount rates might involve a broader consideration of measurement issues more generally.

BC242 Specifically in relation to the possible application of long-run investment returns as the basis for discount rates, the Boards noted that, 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. Accordingly, the Boards concluded that any consideration of overturning long-standing conventions of this nature would need to involve a review of principles that go beyond a project on insurance arrangements in the public sector.

## Measurement of Investments Backing Insurance Liabilities

BC243 When it is feasible under Accounting Standards to measure an investment that backs insurance liabilities at fair value through profit or loss, AASB 1023/PBE IFRS 4 requires an entity to apply fair value through profit or loss accounting. This includes applying accounting policy choices/designations within accounting standards to use fair value through profit or loss accounting for: financial instruments; investment property; and, in relation to separate financial statements, investments in subsidiaries, joint ventures and associates.

- BC244 The Boards acknowledged that the AASB 1023/PBE IFRS 4 requirements were based on a view that fair value accounting for investments would provide the greatest level of balance sheet and income statement consistency with the measurement of insurance liabilities, which is largely a current value basis.
- BC245 The Boards noted that, in respect of public sector entities, AASB 17/PBE IFRS 17 should not mandate fair value through profit or loss accounting for investments backing insurance liabilities. The Boards took this approach because, unlike AASB 1023/PBE IFRS 4, IFRS 17 is a global Standard, and asset measurement and reporting practices (other than fair value through profit or loss) may emerge within the insurance industry globally, which Australian and New Zealand insurers should be able to follow.
- BC246 The Boards noted that, in stakeholder consultation conducted for this project in 2020-21, the following themes emerged.
- (a) Most public sector entities do not determine their own accounting policies, particularly in relation to policies for transactions that are common across the public sector – those policies are determined by the Treasury office of their jurisdiction.
  - (b) The established practice is to apply fair value through profit or loss accounting to assets when feasible and this shows no sign of changing.
  - (c) Many public sector entity investments are managed separately by a specialist public sector funds management entity. Those funds management entities ordinarily hold assets for trading and apply fair value through profit or loss accounting. Most funds management entities typically only supply fair value information to their unitholders.

### **Conclusions**

BC247 The Boards considered that:

- (a) in practical terms, there are strong existing incentives for public sector entities to apply fair value through profit or loss accounting;
- (b) in broad terms, the general application of fair value through profit or loss accounting to investments backing insurance liabilities is probably the most useful approach to meet the needs of public sector users of the financial statements; and
- (c) all the relevant public sector entities are likely to voluntarily continue applying fair value through profit or loss accounting.

BC248 The Boards concluded that there is no need to carry forward into AASB 17/PBE IFRS 17 the modifications on investment measurement from AASB 1023/PBE IFRS 4 for public sector entities.

### **Risk Mitigation Program and Other Similar Costs**

BC249 The Boards noted that most entities that conduct insurance business undertake risk mitigation activities, which are not directly related to particular insurance arrangements. They could include, for example:

- (a) risk assessments of a customer's premises that are to be insured; and/or
- (b) education programs among policyholders regarding safe work practices.

BC250 The Boards observed that, for private sector for-profit insurers, these activities would be expected to typically be closely associated with underwriting or claims management and to be attributable to particular contracts or groups of contracts.

BC251 The Boards also observed that the same types of activities are conducted by public sector entities; however, they would often have a broader community focus, including for example:

- (a) road safety campaigns;
- (b) research into medical practices in public hospitals; and/or
- (c) research into rehabilitation techniques to improve return to work experience.

BC252 The Boards noted that, compared with AASB 1023/PBE IFRS 4, AASB 17/PBE IFRS 17 has more specific requirements around the types of costs that are to be accounted for as a part of insurance contract liabilities and more specific presentation requirements around the income statement line items that make

up the ‘insurance service result’. In particular, they noted that costs which might currently be accounted for as a part of the ‘underwriting result’ under AASB 1023/PBE IFRS 4 may not be sufficiently attributable to the fulfilment of particular groups of contracts to be accounted for within the ‘insurance service result’ under AASB 17/PBE IFRS 17.

BC253 This led the Boards to consider whether there is a need for public sector specific modifications in respect of costs associated with risk mitigation activities that might not be attributable to particular groups of contracts. This is particularly since these costs may be more significant in a public sector context (compared with private sector for-profit entities).

BC254 The Boards noted the following feedback received from stakeholder outreach conducted in 2020-21.

- (a) Some public sector entities that provide risk coverage for policyholders also have a separate (sometimes legislated) objective of educating communities about safety or investing in infrastructure that promotes safe outcomes.
- (b) Public sector entities are typically separately accountable for costs associated with risk mitigation and they are usually readily identifiable.

### Conclusions

BC255 Based on the above considerations, the Boards concluded that there is no need to propose any public sector modifications in respect of risk mitigation program and other similar costs.

BC256 The Boards considered that:

- (a) public sector entities would have little difficulty identifying risk mitigation program costs and classifying them in accordance with AASB 17/PBE IFRS 17; and
- (b) presenting these costs separately from the insurance service result would be useful in a public sector context since they usually relate to a separate and identifiable organisational objective.

## Summary of Project History 2017 to 2020

### AASB

BC257 The table below outlines a brief history of the AASB’s project between 2017–2020.

<i>Time</i>	<i>Milestone</i>	<i>Remarks</i>
July 2017	AASB makes <a href="#">AASB 17 Insurance Contracts</a> , which incorporates IFRS 17 <i>Insurance Contracts</i> (May 2017) applicable to annual reporting periods beginning on or after 2021	The AASB’s Basis for Conclusions notes: AusBC27 ... the AASB was aware of key concerns from the NFP public sector in particular that need further consideration before a decision is made about whether those entities should be subject to AASB 17 without amendment. Chiefly among those concerns was AASB 17 applicability to statutory obligations such as Medicare, the National Disability Insurance Scheme or worker’s compensation insurance.  AusBC28 The AASB acknowledged those concerns and decided to temporarily exclude NFP public sector entities from the scope of AASB 17 pending the outcome of its separate project to address these issues. Until such time as the NFP public sector issues are addressed, those affected entities continue to be subject to AASB 4, AASB 1023 and AASB 1038 (and, potentially, Interpretation 1047).
Nov 2017	<a href="#">Discussion Paper Australian-specific Insurance Issues – Regulatory Disclosures</a>	For comment by 28 February 2018 The DP notes in the introduction: The AASB’s view is that although AASB 17 applies only to contracts, the <i>Framework for the Preparation and Presentation of Financial Statements</i> (Conceptual

<i>Time</i>	<i>Milestone</i>	<i>Remarks</i>
	<a href="#">and Public Sector Entities</a>	<p>Framework) does not limit liability recognition to that arising from contracts, and specifically indicates that obligations may arise from statute. In applying its principle of transaction neutrality, the AASB considers that public sector entities with insurance risk created by statute, that are in substance similar to public and private sector entities with insurance risk created by contracts, should account for insurance risk in the same way.</p> <p>The DP specifically sought feedback on:</p> <ul style="list-style-type: none"> <li>• applying AASB 17 to ‘insurance-like’ arrangements in the public sector</li> <li>• applying the requirements for a risk adjustment (to insurance liabilities)</li> <li>• determining the contract boundary</li> <li>• captive insurance arrangements</li> </ul>
Sep 2018	AASB considers a summary of constituent feedback on the Discussion Paper	<p>The <a href="#">minutes</a> record the Board decided to:</p> <ol style="list-style-type: none"> <li>conduct further field testing of the ‘insurance-like’ criteria</li> <li>based on the field testing, consider whether clarifications of the ‘insurance-like’ criteria are required, particularly the ‘funding’ criteria</li> <li>consider the assumptions used in determining discount rates for public sector entities</li> <li>consider the assumptions used in determining risk margins for public sector entities.</li> </ol> <p>Six formal responses to the DP were received (including from HoTARAC and ACAG).</p>
Jun 2019	<a href="#">Exposure Draft of proposed amendments to AASB 17</a>	<p>AASB ED 292 incorporated amendments to IFRS 17 proposed by the IASB.</p> <p>For comment to AASB by 30 August 2019 and to the IASB by 25 September 2019</p>
Jul 2020	AASB makes <a href="#">AASB 2020-5 Amendments to Australian Accounting Standards – Insurance Contracts</a>	<p>AASB 2020-5 amends AASB 17 to be in line with an amended IFRS 17 issued by the IASB in June 2020.</p> <p>Key amendments to AASB 17 and IFRS 17 are:</p> <ul style="list-style-type: none"> <li>• a revised mandatory application date of annual reporting periods beginning on or after 1 January 2023</li> <li>• requiring separate presentation of insurance assets and liabilities by ‘portfolio’ rather than ‘group of contracts’</li> <li>• permitting the recognition of a separate acquisition costs asset in particular circumstances</li> <li>• recognising reinsurance contract held gains relating to onerous underlying contract losses in particular circumstances</li> <li>• entities preparing interim financial statements can choose to apply the ‘year-to-date’ measurement principle in AASB 134 / IAS 34 <i>Interim Financial Reporting</i></li> </ul>

## NZASB

BC258 The table below outlines a brief history of the NZASB's project between 2017–2020.

<i>Time</i>	<i>Milestone</i>	<i>Remarks</i>
Aug 2017	NZASB issues <a href="#">NZ IFRS 17 Insurance Contracts</a> , which incorporates IFRS 17 <i>Insurance Contracts</i> (May 2017) applicable to annual reporting periods beginning on or after 2021	NZ IFRS 17 applies only to for-profit entities.
Feb 2018	NZASB agrees to develop a PBE Standard based on IFRS 17	
Dec 2018	<a href="#">NZASB ED 2018-7 PBE IFRS 17 Insurance Contracts</a>	<p>For comment by 17 May 2019</p> <p>NZASB ED 2018-7 proposed amending the scope of PBE IFRS 17 to capture schemes that are eligible to apply the insurance approach under IPSAS 42 <i>Social Benefits</i> (i.e. intended to be fully funded from contributions and levies; and there is evidence the entity manages the scheme in the same way as an issuer of insurance contracts, including assessing the financial performance and financial position of the arrangement on a regular basis).</p> <p>NZASB ED 2018-7 sought feedback on</p> <ul style="list-style-type: none"> <li>• appropriateness of a risk adjustment for certain PBEs</li> <li>• whether the 'contract boundary' is clear for entities funded through levies</li> <li>• whether 'portfolios' and 'onerous contract groups' are appropriate for PBEs</li> <li>• relevant discount rates for PBEs.</li> </ul>
June 2019	NZASB considers constituent feedback on NZASB ED 2018-7	<p>Six formal responses to the ED were received.</p> <p>The Board:</p> <p>(a) NOTED the feedback received on NZASB ED 2018-7 PBE IFRS 17 <i>Insurance Contracts</i>; and</p> <p>(b) AGREED to:</p> <p>(i) add a public sector-specific PBE insurance project to its workplan to consider the public sector-specific issues raised by respondents; and</p> <p>(ii) proceed to issue PBE IFRS 17 <i>Insurance Contracts</i> with a proposed scope modification to limit its application to Tier 1 and Tier 2 not-for-profit PBEs.</p>
Aug 2019	<a href="#">NZASB ED 2019-3 Proposed amendments to PBE IFRS 17</a>	<p>NZASB ED 2019-3 proposed to incorporate into PBE IFRS 17 the amendments to IFRS 17 proposed by the IASB in June 2019.</p> <p>Comments were due to the NZASB by 19 November 2019.</p>
Aug 2020	NZASB issues <a href="#">Amendments to NZ IFRS 17 and Amendments to PBE IFRS 17</a>	<p>Key amendments to NZ IFRS 17, PBE IFRS 17 and IFRS 17 are:</p> <ul style="list-style-type: none"> <li>• a revised mandatory application date of annual reporting periods beginning on or after 1 January 2023</li> </ul>



<i>Time</i>	<i>Milestone</i>	<i>Remarks</i>
		<ul style="list-style-type: none"> <li>• requiring separate presentation of insurance assets and liabilities by ‘portfolio’ rather than ‘group of contracts’</li> <li>• permitting the recognition of a separate acquisition costs asset in particular circumstances</li> <li>• recognising reinsurance contract held gains relating to onerous underlying contract losses in particular circumstances</li> <li>• entities preparing interim financial statements can choose to apply the ‘year-to-date’ measurement principle in AASB 134/IAS 34 <i>Interim Financial Reporting</i></li> </ul>

## **Part D – Effective Date**

This Standard shall be applied for annual financial statements covering periods beginning on or after [1 January 2025]. Earlier application is permitted.



*Te Kāwai Ārahi Pūrongo Mōwaho*  
**EXTERNAL REPORTING BOARD**

**This Invitation to Comment is work-in-progress. We are seeking feedback on the questions that will accompany the ED (see pages 6–8).**

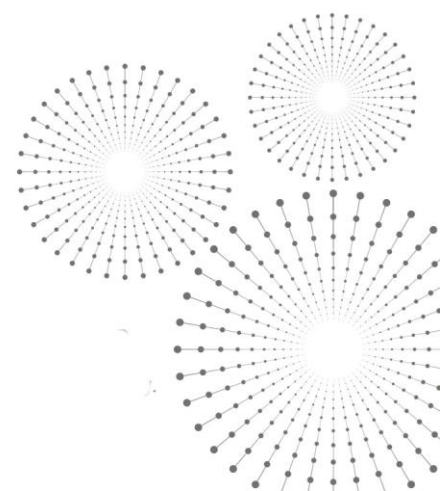
## **NZASB Exposure Draft 2022-1**

# **Accounting for Insurance Contracts in the Public Sector**

**(NZASB ED 2022-1)**

## **Invitation to Comment**

**Month 2022**



Draft

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Draft

## Information for respondents

### Invitation to Comment

The New Zealand Accounting Standards Board (NZASB)<sup>1</sup> is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising the proposals for application by public sector entities that issue insurance contracts.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to comment on only those questions, or issues that are relevant to you.

Comments should be submitted electronically using our 'Open for comment' page at: <https://www.xrb.govt.nz/accounting-standards/standards-in-development/open-for-comment/>.

Please include *NZASB ED 2022-1 Accounting for Insurance Contracts in the Public Sector* in the subject line and indicate whether the comments are made on your own behalf, or on behalf of a group of people, or an entity.

The closing date for submissions is **XX Month 2022**.

### Working with Australia

The NZASB and the Australian Accounting Standards Board (AASB) have worked together in developing these proposals. Although this ITC refers to the proposals of both Boards, each Board has issued its own exposure draft.

### Publication of submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

---

<sup>1</sup> The NZASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting accounting standards.

## List of abbreviations

The following abbreviations are used in this Invitation to Comment.

AASB	Australian Accounting Standards Board
ED	Exposure Draft
IASB	International Accounting Standards Board
ITC	Invitation to Comment
NZ IFRS	New Zealand equivalents to International Financial Reporting Standards
NZASB	New Zealand Accounting Standards Board, a sub-Board of the External Reporting Board
PBE	Public benefit entity

## Questions for respondents

Paragraphs

- 1     **Effective date**
- Do you agree with the proposed mandatory application date for public sector entities of annual periods beginning on or after 1 January 2025, with early application permitted? If not, what alternative application date would you suggest? Please provide your reasons.     xx
- 2     **Scope**
- The Boards propose that the public sector arrangements to which AASB 17/PBE IFRS 17 should apply would be identified based on a collective assessment of the following proposed indicators [paragraphs AG16.1-AG16.25]:
- (a) similarity of risks covered and benefits provided;
  - (b) identifiable coverage;
  - (c) enforceable nature of arrangement;
  - (d) source and extent of funding;     xx
  - (e) assets held to pay benefits; and
  - (f) management practices and assessing financial performance.
- Do you agree with these proposed indicators? If you disagree with the proposed indicators:
- (a) which of them would you exclude, if any?
  - (b) do you have suggested alternative indicators? If so, please outline those indicators and provide supporting reasoning.
- 3     **Captive insurers**
- Do you agree that:
- (a) no specific exemption be provided from applying AASB 17/PBE IFRS 17 for public sector captive insurers in their separate financial statements, and
  - (b) each jurisdiction would determine whether an entity should prepare general purpose financial statements (for example, through legislation or Finance/Treasury instructions) and, therefore, when an entity with the relevant types of arrangements would fall within the scope of AASB 17/PBE IFRS 17?     xx-xx
- If you disagree, please provide your reasons.
- 4     **Sub-grouping of contracts**
- Do you agree with the Boards' proposal to not require the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition in a public sector context? Please provide your reasons.     xx-xx

- 5 Do you agree with the Boards' proposal to not require the sub-grouping of contracts based on whether they are issued more than a year apart in a public sector context? Please provide your reasons.
- 6 **Initial recognition when contracts are onerous**
- Do you agree with the Boards' proposal to amend the AASB 17/PBE IFRS 17 initial recognition requirements in a public sector context to not depend on when contracts become onerous? Please provide your reasons. xx
- 7 **Risk adjustment** xx
- The NZASB is proposing to require a risk adjustment that reflects an amount that is estimated to achieve a 75 per cent confidence level for a liability for incurred claims, which can be rebutted.
- The AASB is proposing no modifications to the AASB 17 requirement for a risk adjustment that reflects the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.
- (a) Which of these approaches do you support and why?
- (b) Do you have a suggested alternative approach? If so, please outline the approach and provide supporting reasoning.
- 8 **Determining contract boundaries, coverage periods and eligibility for the premium allocation approach (PAA)** xx
- Do you agree with the Boards' proposed guidance on coverage periods, which would impact on applying the eligibility criteria for using the premium allocation approach (PAA) in a public sector context? In particular, do you agree with the Boards' proposals to provide guidance that:
- (a) assessing a public sector entity's practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits;
- (b) a public sector entity's monopoly position in providing coverage for risks in a particular community, of itself, would not affect the entity's practical ability to fully price for risks or benefits;
- (c) any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits;
- (d) arrangements would not be regarded as failing to meet the criterion in AASB 17/PBE IFRS 17.34(b)(ii) simply because premium pricing for coverage up to the date when the risks are reassessed takes into account:
- (i) risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits using a medium to long term view; and/or



- (ii) a broad government policy framework that includes considering general economic circumstances and community needs.

Please provide your reasons.

9 Do you agree with the Boards' proposals to:

- (a) require disclosure of information about the manner in which pricing/benefits are determined, including for example, the timeframes over which they are typically determined; and
- (b) permit the disclosure to be located in the financial statements or elsewhere with a relevant cross-reference in the financial statements to an authoritative source?

xx

Please provide your reasons.

10 **Other modifications**

xx

Do you consider there should be any further modifications to AASB 17/PBE IFRS 17 in respect of public sector arrangements? If so, what modifications would you suggest and on what basis would you justify them?

Please provide your reasons.

Please note that the Boards considered, but rejected, proposing modifications to AASB 17/PBE IFRS 17 in respect of public sector arrangements on the following topics:

- (a) discounting and inflating requirements applied in measuring insurance liabilities [paragraphs BC220 to BC242];
- (b) the measurement of investments backing insurance liabilities [paragraphs BC243 to BC248]; and
- (c) classification and presentation of risk mitigation program and other similar costs [paragraphs BC249 to BC256].

11 Do you agree with the proposed effective date of 1 January 2025, with early adoption permitted? If you disagree, please explain why

xx

12 Do you have any other comments on the ED?

xx

## 1. Introduction

### 1.1 Background

1. The New Zealand Accounting Standards Board (NZASB) issued PBE IFRS 17 *Insurance Contracts* in July 2019 and subsequently amended it in August 2020 to maintain alignment with NZ IFRS 17 *Insurance Contracts*. The requirements in PBE IFRS 17 are identical to the requirements in IFRS 17 *Insurance Contracts* and NZ IFRS 17. At present PBE IFRS 17 applies only to not-for-profit public benefit entities (PBEs). The NZASB decided to undertake a separate project to consider public sector-specific issues.
2. In 2020 the Australian Accounting Standards Board (AASB) and the NZASB decided to work jointly to consider whether any amendments are needed to the requirements in AASB 17 *Insurance Contracts* and PBE IFRS 17 for their application by public sector entities in Australia and New Zealand.
3. In developing these proposals, the Boards consulted with external parties that might be affected by the proposals. The Boards considered feedback from these parties in identifying appropriate modifications to AASB 17/PBE IFRS 17. Throughout the course of 2021 the Boards deliberated on the issues outlined in section 2.2 below.
4. To the extent feasible, the Boards will endeavour to achieve a consistent accounting outcome across both jurisdictions.

### 1.2 Purpose of this Invitation to Comment

5. The purpose of this ITC and associated Exposure Draft (the ED) is to seek comments on proposed amendments to PBE IFRS 17 for public sector PBEs.
6. When finalised, the proposals will amend PBE IFRS 17 by broadening the scope to include public sector PBEs and introducing some public sector specific requirements.

### 1.3 Timeline and next steps

7. Submissions on NZASB ED 2022-1 are due by **[date 2022]**. Information on how to make submissions is provided on page 2 of this Invitation to Comment.
8. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue the amendments.

## 2. Overview of Invitation to Comment and ED

### 2.1 Summary

10. This Invitation to Comment seeks feedback on proposed modifications to PBE IFRS 17. The proposals are set out in NZASB ED 2022-1 *Accounting for Insurance Contracts in the Public Sector*. The proposals are:
- (a) to include indicators for identifying the transactions to which AASB 17/PBE IFRS 17 should apply in a public sector context (Australia and New Zealand);
  - (b) to include an exemption from sub-grouping onerous versus non-onerous contracts at initial recognition (Australia and New Zealand);
  - (c) to include an exemption from sub-grouping contracts issued no more than a year apart (Australia and New Zealand);
  - (d) to amend the initial recognition requirements so that they do not depend on when contracts become onerous (Australia and New Zealand);
  - (e) to require risk adjustments to be measured at a rebuttable 75% confidence level (New Zealand – Australia is proposing no change); and
  - (f) to add guidance on coverage periods, which has consequences for assessing eligibility for the premium allocation approach in a public sector context (Australia and New Zealand).
11. The issues discussed by the Boards and their rationale for proposing modifications, or making no modification, are detailed in the Basis for Conclusions which accompanies the ED.

### 2.2 Proposed modifications

#### Effective date

12. The proposed effective date of the modifications is annual financial statements covering periods beginning on or after 1 January 2025, with early application permitted.

#### Question for respondents

1. Do you agree with the proposed mandatory application date for public sector entities of annual periods beginning on or after 1 January 2025, with early application permitted? If not, what alternative application date would you suggest? Please provide your reasons.

#### Scope

13. The Boards have identified a range of indicators for identifying which arrangements in the public sector should be accounted for as insurance contracts. The indicators are to be considered collectively, along with related guidance. The indicators were identified taking into consideration the definitions and guidance on 'insurance contracts', 'insurance contract services' and 'insurance risk' in AASB 17/PBE IFRS 17.

14. Paragraphs AG16.1–AG16.25 provide guidance on the indicators for identifying arrangements that should be accounted for as insurance contracts. These indicators are:
- (a) similarity of risks covered and benefits provided (see paragraphs AG16.4–AG16.9 and paragraphs BC38–BC43);
  - (b) identifiable coverage (see paragraphs AG16.10–AG16.12 and paragraphs BC61–BC63);
  - (c) enforceable nature of arrangement (see paragraphs AG16.13–AG16.16 and paragraphs BC44–BC60);
  - (d) source and extent of funding (see paragraphs AG16.17–AG16.21 and paragraphs BC52–BC65);
  - (e) assets held to pay benefits (see paragraphs AG16.23–AG16.25 and paragraphs BC66–BC70); and
  - (f) management practices and assessing financial performance (see paragraph AG16.22 and paragraphs BC71–BC95).

**Question for respondents**

2. The Boards propose that the public sector arrangements to which AASB 17/PBE IFRS 17 should apply would be identified based on a collective assessment of the following proposed indicators [paragraphs AG 16.1–AG16.25]:

- (a) similarity of risks covered and benefits provided;
- (b) identifiable coverage;
- (c) enforceable nature of arrangement;
- (d) source and extent of funding;
- (e) assets held to pay benefits; and
- (f) management practices and assessing financial performance.

Do you agree with these proposed indicators? If you disagree with the proposed indicators:

- (a) which of them would you exclude, if any?
- (b) do you have suggested alternative indicators? If so, please outline those indicators and provide supporting reasoning.

**Captive insurers**

15. The Boards discussed whether public sector captive insurers should be explicitly scoped out of applying AASB 17/PBE IFRS 17 (see paragraphs BC108–BC116).
16. The Boards considered that the issues surrounding captive insurers are essentially reporting entity issues rather than issues of particular relevance to the insurance project. The Boards therefore concluded that it is not relevant to specifically exempt public sector captive insurers from applying AASB 17/PBE IFRS 17 in their separate financial statements.

**Question for respondents**

3. Do you agree that:
- (a) no specific exemption be provided from applying AASB 17/PBE IFRS 17 for public sector captive insurers in their separate financial statements, and
  - (b) each jurisdiction would determine whether an entity should prepare general purpose financial statements (for example, through legislation or Finance/Treasury instructions) and, therefore, when an entity with the relevant types of arrangements would fall within the scope of AASB 17/PBE IFRS 17?

If you disagree, please provide your reasons.

**Sub-grouping of contracts***Onerous versus non-onerous contracts*

17. Paragraph 16 of AASB 17/PBE IFRS 17 requires insurance contracts within each portfolio to be sub-grouped as follows at initial recognition:
- (a) contracts that are onerous at initial recognition, if any;
  - (b) contracts that have no significant possibility of becoming onerous subsequently, if any; and
  - (c) other (non-onerous) contracts.
18. Based on their deliberations, the Boards concluded that they would propose an exemption for all public sector entities from applying the requirements in paragraph 16 of AASB 17/PBE IFRS 17 (see paragraph 16.1 of the ED).
19. The practical impact of this proposed exemption is that public sector entities would have a basic unit of account that is a portfolio. Accordingly, their liabilities for remaining coverage and liabilities for incurred claims would be measured for each portfolio as a whole (and, for those entities with only one portfolio, effectively at the whole of entity level).
20. Paragraphs BC119–BC135 explain the Boards' discussions and conclusions on this matter.

*Contracts issued more than one year apart*

21. Paragraph 22 of AASB 17/PBE IFRS 17 requires entities to divide each portfolio of contracts into sub-groups of contracts issued no more than a year apart. The Boards noted that the IASB considers annual grouping by the underwriting year to be important to ensure trends in the profitability of a portfolio of contracts are reflected in the financial statements on a timely basis (paragraph BC136 of IFRS 17).
22. The Boards noted that some of the responses to NZASB ED 2018-7 *PBE IFRS 17 Insurance Contracts* argued that a public sector modification is needed because the requirement in paragraph 22 is not relevant to the circumstances of some public sector insurers that take a long view on pricing. That is, grouping by annual cohort is irrelevant when the insured risk is

for highly uncertain and infrequent events where the entity is a monopoly provider (and cannot withdraw from the market).

23. Based on their deliberations, the Boards concluded that they would propose an exemption for all public sector entities from applying the requirements in paragraph 22 of AASB 17/PBE IFRS 17 (see paragraph 22.1 of the ED). Paragraphs BC136–BC143 explain the Boards' discussions and conclusions on this matter.

#### Questions for respondents

4. Do you agree with the Boards' proposal to not require the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition in a public sector context? Please provide your reasons.
5. Do you agree with the Boards' proposal to not require the sub-grouping of contracts based on whether they are issued more than a year apart in a public sector context? Please provide your reasons.

#### Initial recognition when contracts are onerous

24. Paragraph 25 of AASB 17/PBE IFRS 17 requires a group of insurance contracts an entity issues to be recognised from the earliest of the following:
- the beginning of the coverage period of the group of contracts;
  - the date when the first payment from a policyholder in the group becomes due; and
  - for a group of onerous contracts, when the group becomes onerous.
25. The Boards noted that, for an entity that has binding arrangements in the weeks before year end for the following 1 July to 30 June coverage period, applying paragraph 25(c) of AASB 17/PBE IFRS 17 would mean all of the onerous contract losses associated with the next year's arrangements would need to be included in the current year's results. While this may not have a major impact year-on-year, the Boards thought it would be a counter-intuitive outcome.
26. Based on their deliberations, the Boards concluded that it would be appropriate to propose an exemption for all public sector entities from applying the requirements in paragraph 25(c) of AASB 17/PBE IFRS 17 (see paragraph 25.1 of the ED). Paragraphs BC144–BC148 explain the Boards' discussions and conclusions on this matter.

#### Question for respondents

6. Do you agree with the Board's proposal to amend the AASB 17/PBE IFRS 17 initial recognition requirements in a public sector context to not depend on when contracts become onerous? Please provide your reasons.

### Risk adjustments

27. The Boards noted:
- (a) that a risk adjustment under AASB 17/PBE IFRS 17 (the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risks as the entity fulfils insurance contracts) differs from a risk margin under AASB 1023 *General Insurance Contracts*/ PBE IFRS 4 *Insurance Contracts* (the inherent uncertainty in the central estimate of the present value of the expected future payments);
  - (b) that there is a presumption that for-profit private sector entities would need to be compensated for bearing risk and, as risk is released, that revenue would be recognised;
  - (c) that public sector entities may have a different perspective and not need to be compensated for bearing risk on the basis that (i) they are often monopolies and there may be the opportunity to increase premiums/levies to meet future claims; and (ii) they have explicit or implicit government guarantees of financial support; and
  - (d) the comments from respondents to NZASB ED 2018-7 and feedback received from stakeholder outreach conducted in 2020 and 2021.
28. The Board considered the following possible approaches regarding the risk adjustment requirements:
- (a) Approach 1: require public sector entities to apply AASB 17/PBE IFRS 17 with no modifications or guidance;
  - (b) Approach 2: require public sector entities to have a zero risk adjustment; and
  - (c) Approach 3: require a particular confidence level for determining risk adjustment for liabilities for incurred claims for all public sector entities.
29. Based on their deliberations, the Boards reached different conclusions. The AASB has proposed Approach 1 (no modification to AASB 17) while the NZASB has proposed Approach 3 (75% confidence level) (see paragraph 37.1 of the ED).
30. Paragraphs BC149–BC185 explain the Boards’ discussions and conclusions on this matter.

#### Question for respondents

7. The NZASB is proposing to require a risk adjustment that reflects an amount that is estimated to achieve a 75 per cent confidence level for a liability for incurred claims, which can be rebutted.

The AASB is proposing no modifications to the AASB 17 requirement for a risk adjustment that reflects the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

- (a) Which of these approaches do you support and why?

- (b) Do you have a suggested alternative approach? If so, please outline the approach and provide supporting reasoning.

**Determining contract boundaries, coverage periods and eligibility for the premium allocation approach (PAA)**

31. AASB 17/PBE IFRS 17 includes two approaches to measuring liabilities for remaining coverage:
- (a) a general measurement model that involves discounting fulfilment cash flows and, when relevant, recognising a 'contractual service margin' (deferred profit/loss); and
  - (b) the premium allocation approach (PAA), which is a 'simplified approach' and typically much less burdensome to apply than the general measurement model.
32. The Boards noted that identifying contract boundaries and coverage periods under AASB 17/PBE IFRS 17 is crucial for two main reasons:
- (a) identifying the cash flows used to measure liabilities for remaining coverage for in-force arrangements; and
  - (b) determining whether liabilities for remaining coverage for in-force arrangements are eligible to be measured applying the PAA.
33. The Boards observed that, for most public sector entities currently applying AASB 1023/PBE IFRS 4, the liability for incurred claims is typically much larger than the liability for remaining coverage. Nonetheless, the liability for remaining coverage would be expected to be a material amount for most public sector entities with arrangements that would be scoped into AASB 17/PBE IFRS 17. Accordingly, eligibility to apply the PAA is a key issue for public sector stakeholders.
34. Under AASB 17/PBE IFRS 17 the 'coverage period' might be different from the stated period in a contract or arrangement because it is determined, in large part, based on identifying the cash flows that are within the 'contract boundary'. In that context, the Boards noted that cash flows are regarded as being within the boundary of an insurance contract to the extent that the entity can compel the policyholder to pay premiums or the entity has a substantive obligation to provide the policyholder with insurance contract services (see paragraph 34 of AASB 17/PBE IFRS 17).
35. Based on their deliberations, the Boards concluded that:
- (a) for the avoidance of doubt, it would be appropriate to propose guidance to the effect that an entity's practical ability to fully price for risks/benefits also includes the ability of its controlling government (including any relevant Minister(s) and/or regulatory supervisor) under existing and/or substantively enacted legislation to decide on pricing and benefits;
  - (b) for the avoidance of doubt, it would be appropriate to propose guidance to the effect that an entity's monopoly status (and the possible inference that there is a legislative obligation to stand-ready to insure future policyholders), of itself, does not affect an



entity's practical ability to fully price for risks/benefits and, therefore, would not affect the coverage period;

- (c) for the avoidance of doubt, it would be appropriate to propose guidance that a public sector entity would not fail to meet the criterion that pricing up to the date when the risks are reassessed does not take into account risks for periods after the reassessment date simply because it has a deliberate policy of setting prices and benefits based on a medium to long term view; and
- (d) they would require the disclosure of information about the manner in which pricing/benefits are determined.

36. Paragraphs 34.1–34.3 and AG64.1 of the ED for the proposed amendments. Paragraphs BC186–BC219 explain the Boards' discussions and conclusions on this matter.

**Questions for respondents**

8. Do you agree with the Boards' proposed guidance on coverage periods, which would impact on applying the eligibility criteria for using the premium allocation approach (PAA) in a public sector context? In particular, do you agree with the Boards' proposals to provide guidance that:
- (a) assessing a public sector entity's practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits;
  - (b) a public sector entity's monopoly position in providing coverage for risks in a particular community, of itself, would not affect the entity's practical ability to fully price for risks or benefits;
  - (c) any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits;
  - (d) arrangements would not be regarded as failing to meet the criterion in AASB 17/ PBE IFRS 17.34(b)(ii) simply because premium pricing for coverage up to the date when the risks are reassessed takes into account:
    - (i) risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits using a medium to long term view; and/or
    - (ii) a broad government policy framework that includes considering general economic circumstances and community needs.

Please provide your reasons.

9. Do you agree with the Boards' proposals to:
- (a) require disclosure of information about the manner in which pricing/benefits are determined, including for example, the timeframes over which they are typically determined; and

- (b) permit the disclosure to be located in the financial statements or elsewhere with a relevant cross-reference in the financial statements to an authoritative source?

Please provide your reasons.

### Other modifications

37. The Boards considered, but rejected, proposing modifications on the topics of:
- (a) discounting and inflating requirements applied in measuring insurance liabilities;
  - (b) the measurement of investments backing insurance liabilities; and
  - (c) classification and presentation of risk mitigation program and other similar costs.

### Question for respondents

10. Do you consider there should be any further modifications to AASB 17/PBE IFRS 17 in respect of public sector arrangements? If so, what modifications would you suggest and on what basis would you justify them?

Please provide your reasons.

Please note that the Boards considered, but rejected, proposing modifications to AASB 17/PBE IFRS 17 in respect of public sector arrangements on the following topics:

- (a) discounting and inflating requirements applied in measuring insurance liabilities [paragraphs BC220 to BC242];
- (b) the measurement of investments backing insurance liabilities [paragraphs BC243 to BC248]; and
- (c) classification and presentation of risk mitigation program and other similar costs [paragraphs BC249 to BC256].

### 2.3 Effective date and other comments

38. The proposed effective date in the ED is 1 January 2025, with early adoption permitted. This date is tentative and would be reviewed prior to issuing any amendments.

### Questions for respondents

11. Do you agree with the proposed effective date of 1 January 2025, with early adoption permitted? If you disagree, please explain why.
12. Do you have any other comments on the ED?

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**Date:** 3 December 2021

**To:** NZASB Members

**From:** Joanne Scott and Anthony Heffernan

**Subject:** Auditor remuneration

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### Purpose<sup>1</sup>

1. This memo asks the Board if it wishes to propose changes to audit fee<sup>2</sup> disclosures in NZ IFRS and PBE Standards now or wait and propose changes at the same time as the Australian Accounting Standards Board (AASB). It sets out the relevant background to this question and matters to consider.

### Recommendations

2. The Board is asked to PROVIDE FEEDBACK on whether there is a need to change the audit fee disclosures in NZ IFRS and PBE Standards, the best timing for this, and its views on possible changes to the categories required to be disclosed.

### Background

3. The discussion of audit fee disclosures in accounting standards needs to be considered in the context of recent changes to auditing and assurance, and professional standards, and calls by regulators and public bodies to enhance actual or perceived auditor independence.
4. Both the NZASB and the AASB have been contemplating changes to audit fee disclosures for some time. The AASB has agreed to propose changes to the disclosures, but is waiting on other events before finalising those proposals. The NZASB and NZAuASB have also discussed this topic at the last two joint meetings. There are therefore international, trans-Tasman and domestic considerations.
5. The Appendix to this memo sets out a comprehensive list of events, discussions and documents, organised by date. Although this memo repeats some of the information in the Appendix, the memo has less detail and discusses related matters together.

### Structure of this memo

6. The remainder of this memo is set out as follows.
  - (a) Audit fee disclosures in New Zealand
  - (b) Rationale for audit fee disclosures

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<sup>1</sup> 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).

<sup>2</sup> The term 'audit fees' is used here to mean any fees paid to the audit firm or individual audit practitioner for audit services, assurance services, and any other types of services.

- (c) Changes to auditing, assurance and professional standards
- (d) Australian background
- (e) Matters for the Board to consider.

**Audit fee disclosures in New Zealand**

7. The audit fee disclosures in accounting standards and the Companies Act are shown below. The accounting standards refer to ‘all other services’ without specifying any further level of detail. FMA guidance<sup>3</sup> has shaped practice. The categories suggested by the FMA are:
- Audit and review of financial statements
  - Other services
    - Regulatory audit work
    - Other assurance services
    - Tax services
    - Other services.
8. There have been calls to require disclosure of more detailed fee categories in accounting standards.

**Table 1 Current audit fee disclosure requirements**

<b>FRS-44 New Zealand Additional Disclosures</b>	
*8.1	An entity shall disclose fees to each auditor or reviewer, including any network firm, separately for: <ul style="list-style-type: none"> <li>(a) the audit or review of the financial statements; and</li> <li>(b) all other services performed during the reporting period.</li> </ul>
*8.2	For 8.1 (b) above, an entity shall describe the nature of other services.
<b>PBE IPSAS 1 Presentation of Financial Statements</b>	
*116.1	<b>An entity shall disclose fees to each auditor or reviewer, including any network firm,<sup>1</sup> separately for:</b> <ul style="list-style-type: none"> <li>(a) the audit or review of the financial statements; and</li> <li>(b) all other services performed during the reporting period.</li> </ul>
*116.2	<b>To comply with paragraph 116.1 above, an entity shall describe the nature of other services.</b>
	<sup>1</sup> Network firm is discussed in Professional and Ethical Standard (PES) 1 (Revised) <i>Ethical Standards for Assurance Practitioners</i> .
<b>Companies Act 2013</b>	
<b>211</b>	<b>Contents of annual report</b>
(1)	Every annual report for a company must be in writing and be dated and, subject to subsection (3), must—
	...

<sup>3</sup> Disclosure of fees paid to auditors by listed issuers (FMA, April 2014)

- (j) state the amounts payable by the company to the person or firm holding office as auditor of the company as audit fees and, as a separate item, fees payable by the company for other services provided by that person or firm; and
- (2) A company that is required to include group financial statements in its annual report must include, in relation to its subsidiaries, the information specified in paragraphs (e) to (j) of subsection (1).
- (3) The annual report of a company need not comply with any of paragraphs (a), and (e) to (j) of subsection (1), and subsection (2) if shareholders who together hold at least 95% of the voting shares (within the meaning of section 198) agree that the report need not do so.

9. The Australian and New Zealand audit fee disclosures for **Tier 1** entities are currently harmonised, but the AASB is working on proposals to require more detailed disclosure. The AASB's work is discussed later in this memo (see '[Australian background](#)').
10. The Australian and New Zealand audit fee disclosures for **Tier 2** entities have been harmonised at various points in the past, but are not currently harmonised. Some key points follow.
  - (a) Prior to 2012 all New Zealand entities, including those that qualified for differential reporting or RDR concessions, were required to disclose the audit fee information required by accounting standards.
  - (b) In 2012 a Tier 2 RDR concession for audit fee disclosures was introduced to align with Australian RDR concessions at that time. There are still RDR concessions in FRS-44 and PBE IPSAS 1.
  - (c) In March 2020 the AASB issued AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*. AASB 1060 required that Tier 2 entities make the same audit fee disclosures as Tier 1 entities.
  - (d) Although there have been some suggestions that the Tier 2 RDR concessions for audit fee disclosures be withdrawn, this issue would probably be better addressed when the Board reconsiders the RDR more generally. The Board plans to review the Tier 2 RDR concessions once the IASB has completed its project on subsidiaries without public accountability.

#### **Rationale for audit fee disclosures**

11. Auditor independence is necessary to maintain investor confidence in audits of financial statements and other assurance of information. Audit fee disclosures help stakeholders make judgements and assessment about auditor independence. They also give stakeholders information about the cost of audit and assurance.
12. Regulators argue that mandatory disclosure of auditor fees and the types of services provided allows investors and other financial statement users to evaluate potential conflicts of interest that could compromise auditor objectivity.<sup>4</sup> The disclosure in the financial statements, together with disclosures in the auditor's report about any relationship with the client other than as auditor, informs the user's evaluation of independence.

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<sup>4</sup> Similar views have been expressed by New Zealand investors in interviews with XRB staff.

13. Fee disclosure is only one of the mechanisms used to ensure auditor independence and transparency around that independence. A recent [briefing paper](#) by Accountancy Europe (November 2021) gives a good overview of mechanisms in Europe, many of which are also relevant in New Zealand. These include:
  - (a) prohibitions on auditors from providing many non-audit services. Prohibitions may be legal or ethical, including those in *The International Code of Ethics*;
  - (b) oversight of the audit profession by independent public authorities;
  - (c) scrutiny by boards and audit committees of non-audit services;
  - (d) audit firm policies regarding independence; and
  - (e) disclosure of fee-related information.
14. The briefing paper also explains why auditors are sometimes asked or required to provide other services to audit clients and notes that there can be a public interest aspect to such involvement. It describes three main types of non-audit services:
  - (a) services closely related to the audit itself and which may be considered as an extension of the financial statements audit;
  - (b) services required by legislation to be performed by an independent provider; and
  - (c) services demanded by third parties who need reliable information and receive comfort from the independent auditor's involvement.
15. Interestingly it notes that the distinction between these types of services is not always clear, and an assurance service may exhibit more than one of these characteristics. Hence the document does not make a categorical classification of such services.
16. The purpose of the paper seems to have been to document the existing situation and encourage European policymakers to establish frameworks that specify each party's responsibilities when they create broader reporting requirements. For example, should independent assurance of corporate-societal impacts be required, and who should provide such assurance?

#### **Changes to auditing, assurance and professional standards**

17. Over recent years there has been a push to enhance auditor independence and perceptions of independence by prohibiting or limiting the ability of auditors to perform non-assurance services and requiring more information about the performance of non-audit services.
18. Table 2 summarises international requirements and recent changes. It also notes which changes have since been considered in New Zealand and Australia and the jurisdiction-specific changes that are being proposed within those projects.

**Table 2 International changes and flow on effects in Australia and New Zealand**

<b>International Auditing and Assurance Standards Board (IAASB)</b>
The IAASB sets high-quality international standards for auditing, assurance, and quality control that strengthen public confidence in the global profession. The NZAuASB develops and issues Auditing & Assurance Standards based on IAASB standards.
<p><b>ISA (NZ) 260 <i>Communication with Those Charged with Governance (Revised)</i></b></p> <ul style="list-style-type: none"> <li>Requires auditors to communicate with those charged with governance (TCWG) total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity.</li> <li>As part of this communication, ISA (NZ) 260 paragraph 17(a)(i)–(ii) requires that the fees be allocated to categories that are appropriate to assist TCWG in assessing the effect of services on the independence of the auditor.</li> </ul>
<p><b>ISA (NZ) 700 <i>Forming an Opinion and Reporting on Financial Statements</i></b></p> <ul style="list-style-type: none"> <li>Paragraph NZ 33.1, requires that the external auditor make a statement in the audit report as to the existence of any relationship (other than that of auditor) which the auditor has with, or any interests which the auditor has in, the entity being audited.</li> </ul>
<b>International Ethics Standards Board for Accountants (IESBA)</b>
The IESBA sets high-quality, internationally appropriate ethics standards for professional accountants, including auditor independence requirements. The NZAuASB develops and issues Auditing & Assurance Standards based on IESBA standards.
<p><b>IESBA Project on non-assurance services</b></p> <ul style="list-style-type: none"> <li>April 2021: IESBA issues <i>Revisions to the Non-Assurance Services Provisions of the Code</i>. These changes include stricter prohibitions on the types of non-assurance service (NAS) which firms and network firms may or may not provide to an audit or assurance client. The revised provisions expressly prohibit firms and network firms from providing NAS to their audit clients that are public interest entities (PIES) <i>where that service might create a self-review threat</i>. More detail about these changes is available in the Appendix to this memo.</li> </ul> <p><u>New Zealand</u></p> <ul style="list-style-type: none"> <li>July 2021: NZAuASB issues ED<sup>5</sup> which proposes to: <ul style="list-style-type: none"> <li>adopt the IESBA non-assurance changes to the Code;</li> <li>prohibit the provision of tax advisory and tax planning services to an audit client and modify the IESBA Code discussion of self-review threat from providing tax advisory and tax planning services to an audit client;</li> <li>provide guidance on the types of audit-related services that a firm is often best placed to perform. The guidance is the form of application material acknowledging that additional work performed by the firm that is related to, or that enhances the quality of, an audit engagement will generally not create a self-review threat to independence. The ED gives examples.</li> </ul> </li> <li>Time of writing: NZAuASB still deliberating on feedback received. Feedback received to date indicates the importance of audit fee disclosures as part of the increased focus on non-assurance services.</li> <li>Extracts from the NZAuASB ITC and ED (re services and self-review threat) follow.</li> </ul> <p><u>NZAuASB ITC extracts</u></p> <p>41. The proposed guidance is in the form of application material acknowledging that additional work performed by the firm that is related to, or that enhances the quality of, an audit engagement will generally not create a self-review threat to independence. Examples of audit-related engagements include:</p>

<sup>5</sup> ED 2021-4 *Amendments to Professional and Ethical Standard 1: Non-Assurance Services*

- Engagements required by law or regulation to be performed by the auditor or assurance practitioner.
- Engagements that involve the formal expression of an assurance opinion or conclusion.
- Engagements to perform agreed-upon procedures. (Refer NZ600 14 A1)

42. Agreed-upon procedures engagements that the firm might perform in its role as auditor of the entity that generally will not create a self-review threat to independence include, for example, as scrutineer of votes at an annual general meeting or procedures in relation to grant funding the audit client has received from a government department.

NZAuASB ED extracts

NZ600.14 A1 Additional work performed by the firm will not generally create a self-review threat to independence when such work is related to the audit or review engagement. Examples of audit or review related engagements include:

- Engagements required by law or regulation to be performed by the auditor or assurance practitioner.
- Engagements that involve the formal expression of an assurance opinion or conclusion.
- Engagements to perform agreed-upon procedures.

However, providing such additional services might create one or more other threats, as noted in paragraph 120.6 A4. In such circumstances, the firm is required to apply the conceptual framework to identify, evaluate and address the threats to independence

Australia

The Accounting Professional & Ethical Standards Board Limited (APESB) has not yet issued an ED to adopt the IESBA non-assurance changes to the Code.

**IESBA Project on fees**

April 2021: IESBA issues *Revisions to the Fee-related Provisions of the Code*.

The revisions to the fee-related provisions of the Code include:

- a prohibition on firms allowing the audit fee to be influenced by the provision of services other than audit to the audit client;
- in the case of PIEs, a requirement to cease to act as auditor if fee dependency on the audit client continues beyond a specified period;
- communication of fee-related information to those charged with governance of an entity and to the public to assist their judgments about auditor independence. The Code requires that auditors talk to PIE clients about the benefits of disclosing fee information and notes that some jurisdictions require fee disclosure and disaggregation. If a PIE does not disclose information about fees to stakeholders, the Code requires that the audit firm publicly disclose fee information;<sup>6</sup> and
- enhanced guidance on identifying, evaluating and addressing threats to independence.

More detail is available in the Appendix to this memo. Also, the next section of this memo contains more information on the categories of fees referred to.

New Zealand

- The NZAuASB exposed the IESBA ED at the time as the IESBA. The ITC that accompanied the NZAuASB NAS ED (ED 2021-4, issued in July 2021) stated that the NZAuASB expects to adopt the revised IESBA fee provisions in New Zealand at a later date, “with a cross-reference to the New Zealand disclosure requirements.”

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<sup>6</sup> This requirement in the Code does not have any impact in the New Zealand context, because the accounting standards require disclosure of information about fees.



<p><u>Australia</u></p> <ul style="list-style-type: none"> <li>• May 2021: APESB issues ED<sup>7</sup> to incorporate IESBA changes to the fee-related provisions in the Code. The ED also includes Australian-specific proposals to address the PJC’s fee-related recommendations. Comments due to APESB: 31 August 2021.</li> <li>• Time of writing: The APESB is still deliberating on feedback received.</li> </ul>
<p><b>IESBA Project on definitions of listed entity and public interest entity</b></p> <ul style="list-style-type: none"> <li>• January 2021: IESBA issues ED proposing changes to broaden the definition of a PIE. PIEs are subject to more stringent independence requirements and audit fee disclosure requirements. Comments due to IESBA: 3 May 2021.</li> <li>• Time of writing: IESBA still deliberating on feedback received. It is expected to finalise the PIE definition shortly.</li> </ul>

**Australian background**

19. The AASB is currently working on proposals to amend the audit fee disclosures in AASB 1054 *Australian Additional Disclosures*. The AASB’s work is largely in response to the Australia Parliamentary Joint Committee (PJC) report, *Regulation of Auditing in Australia* (November 2020) but will also be informed by:
  - (a) AASB Research Report 15 *Review of Auditor Remuneration Disclosure Requirements* (December 2020);
  - (b) the views of the Australian Securities and Investment Commission; and
  - (c) recent changes, or proposals to change, the auditor independence and disclosure requirements in other standards.
  
20. The PJC report highlighted two main issues of relevance to auditor independence: the perceived closeness of the auditor with the audited entity, and the provision of non-audit services. The report contained 10 recommendations, three of which related to auditor tenure and auditor remuneration (see below).

**Table 3 PJC recommendations**

<p><b>Recommendation 3 Disclose auditor remuneration</b></p> <p>The committee recommended that the Financial Reporting Council, in partnership with ASIC, by the end of the 2020–21 financial year, oversee consultation, development and introduction under Australian standards of:</p> <ul style="list-style-type: none"> <li>• defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and</li> <li>• a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.</li> </ul>
<p><b>Recommendation 6 Disclose auditor tenure</b></p> <p>The committee recommended that the FRC, by the end of the 2020–21 financial year, oversee the revision and implementation of Australian standards to require audited entities to disclose auditor tenure in annual financial reports. Such disclosures should include both the length of tenure of the entity’s external auditor, and of the lead audit partner.</p>

<sup>7</sup> ED 03/21 *Proposed Amendments to Fee-related provisions of APES 110 Code of Ethics for Professional Accountants (including Independence Standards)*

<b>Recommendation 7 Disclose why no public tender</b>
Audited entities that have not undertaken a public tender process in the last 10 years should explain why this has not occurred.

21. In February this year the AASB directed staff to begin work on drafting revised auditor remuneration disclosures based on the work presented in AASB Research Report 15 and other outreach and research activities. The AASB indicated that it would consider the timing of the ED once (i) IESBA has finalised its projects on fees and non-assurance services and (ii) the Australian federal Government has responded to the PJC recommendations. At the time of writing it is not clear when or if the Australian federal Government will formally respond to the PJC recommendations.
22. In June this year the AASB discussed options for disclosing audit tenure and auditor remuneration. The AASB noted the audit and non-audit service categories recommended by AASB Research Report 15 (AASB RR 15) and those proposed in the APESB ED (May 2021). As shown below, there are no significant differences between the two.

**Table 4 AASB RR 15 vs APESB ED categories**

AASB RR 15	APESB ED <sup>8</sup>
Audit services (with these being defined)	Fees for audit services
Audit-related services	Fees for audit-related services (based on UK Ethical Standards 2019)
Other assurance services	Fees for other assurance services (based on UK Ethical Standards 2019)
Taxation services	Fees for tax services (adapted from APES 220 <i>Taxation Services</i> )
All other non-audit services, together with a description of the nature of services in each category	Fees for other services

23. The AASB acknowledged that the APESB ED defines the services within each category, but noted that APES 110 provides *guidance* rather than mandatory requirements. The AASB decided that AASB 1054 should define the services included in each category. The AASB also decided to comment on the APESB ED and to liaise with the APESB in developing the disclosure proposals.
24. The AASB indicated its intention to wait for the government response to the PJC Inquiry recommendations before issuing an ED on fee disclosure. In the interim, the AASB plans to continue deliberating the proposals to amend AASB 1054.

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<sup>8</sup> There is more information about the APESB ED in the next section of this memo.

**Matters for the Board to consider**

25. As the previous sections in this memo show, in discussing potential changes to audit fee disclosures we need to be mindful of the context. In the remainder of this memo we invite the Board to consider **whether** it should consider more detailed audit fee disclosures, **what** more detailed disclosures might look like, and **when** it would be best to do this.

*Whether to consider more detailed audit fee disclosures*

26. This section begins with a table summarising factors suggesting change is needed, and other factors suggesting that change may not be required, or may not be urgent. It then goes on to explain why, from an auditing and assurance perspective, more detailed audit fee disclosures in accounting standards are important.

**Table 5 The case for more detailed audit fee disclosures in accounting standards**

Case for changing	Is change required / urgent?
International reviews of auditor independence and oversight in response to corporate failures <ul style="list-style-type: none"> <li>• IESBA changes to Code to limit or prohibit NAS</li> <li>• IESBA changes to Code require more information about fees, including fees for NAS.</li> </ul>	There is a relatively low level of NAS in New Zealand – around 16% of fees charged by audit firms. <sup>9</sup>  This is due in part to the prohibitions and limitations on the provision of NAS by:
Fee disclosures have been under the spotlight in Australia with the PJC’s recommendation for more detailed fee disclosure, the Australian-specific proposed fee categories in the APESB ED and the AASB’s plans to issue an ED proposing changes to AASB 1054.  The Board is required to consider harmonisation with the AASB. <sup>11</sup>	<ul style="list-style-type: none"> <li>• the Code</li> <li>• the Auditor General’s Code of Ethics</li> <li>• audit firms’ policies</li> <li>• the policies of individual entities/ views of audit committees</li> </ul> Tier 1 entities are already required to disclose and describe fees for ‘other services’.
The NZAuASB would like to refer to audit fee disclosure requirements accounting standards when it adopts the IESBA Code fee changes.  The Australian-specific proposed fee categories in the APESB ED raises harmonisation issues for the NZAuASB.	There is a relatively good level of compliance with the disclosure requirements in FRS-44. <sup>10</sup>
The FMA is likely to support enhanced fee disclosure.	Nevertheless, in the absence of an outright ban on NAS, investors will continue to see auditors providing some NAS. In order to have confidence in the financial statements, investors need to understand why those services do not detract from independence.

27. The project to revise the NAS provisions in the Code is responsive to public interest concerns about the perceived lack of independence when firms provide NAS to their audit clients. The

<sup>9</sup> FMA Audit Quality Monitoring Report 2020

<sup>10</sup> FMA (June 2015) *Disclosure of fees paid to auditors by listed issuers*. Of the sample reviewed, 84% were found to meet the disclosure requirements of FRS-44.

<sup>11</sup> The Board is required by the Accounting Standards Framework and the 2019 Joint Ministerial Statement to consider harmonisation of for-profit requirements.

revisions are significantly more robust, but do not go as far as to ban the auditor from performing any other services.

28. Independence in appearance is a critical factor for a firm to consider before agreeing to provide a NAS to any audit client. A lack of independence in appearance undermines public confidence and impacts confidence in financial reporting, the audit, and the audit function. The perception of a lack of independence can arise from within the audit client and from investors, users or others.
29. The NZAuASB has debated at length whether the revisions will go far enough to address a perceived (or actual) lack of independence when firms provide NAS, and even considered whether the New Zealand standards should go as far as to ban all NAS. It received feedback from XRAP, particularly from the governance members of the panel that, while external perceptions are important, it is also important not to exclude the possibility of the entity deriving benefit from additional services that are best provided by the auditor without compromising the firm's independence. The NZAuASB agrees that, in some cases, there may be benefits to an entity (in terms of both efficiency and audit quality) in the auditor performing certain limited services in addition to the audit engagement. The NZAuASB determined that it would be inappropriate to go as far as to ban all NAS.
30. This view was confirmed from various perspectives at a recent XRB panel discussion.
31. While there is general consensus that there is a balance at play i.e., there is benefit in the auditor performing limited services, there is not consensus on what those services should be. One example is tax advisory and planning services. The IESBA Code does not include a blanket prohibition for tax advisory and tax planning services, although there are some who consider this should be banned. This is what the NZAuASB exposure draft sought views on. Feedback demonstrates that there are mixed views on whether there is a need to ban tax advisory and tax planning services. In addition to tax advisory and planning, some respondents are of the view that the XRB ethical requirements should go even further (i.e. that the prohibition if there might be a self-review threat does not go far enough). The debate as to which services should be expressly prohibited is likely to continue, with various parties, having very different views.
32. Regardless of whether the NZAuASB decides to expressly ban tax advisory services or not, it is likely that the level of NAS will continue to drop as the new requirements are adopted. But it is also likely that audit firms will continue to perform some other services that are permitted under the rules. While auditors are permitted to continue to perform some NAS, the importance of clear, informative disclosures about what those services are and the level of fees earned relative to audit fees is an integral part of maintaining trust.
33. Separating the fees earned into additional categories of services will provide more detailed information to users (to assist them to evaluate whether the auditors and indeed TCWG have appropriately exercised their judgement as to whether those other services impair auditor independence) and to regulators and ethical standard setters to gather data on the nature and extent of other services that continue to be provided under the tighter rules. The importance

of this disclosure was highlighted by investors at a recent XRB panel discussion and by practitioners in written submissions to the XRB.

34. The issue that needs to be explored in more detail, is what the categories of disclosure should be in light of the new ethical requirements, that tighten the rules but do not outright ban NAS. The FMA guidance on this adds weight to the need for additional categories of disclosure than what is currently required by the accounting standards. The ongoing work in Australia and the PJC recommendations also highlights that there is a need for enhancements to the current disclosure requirements.

*What more detailed disclosures might look like*

35. We have begun by looking at the categories used in the APESB ED. This is because the Board would normally look to harmonise disclosures with Australian Accounting Standards and the AASB is already considering the APESB categories. These categories were mentioned earlier but Table 6 below has more detail.

**Table 6 Fee categories in APESB ED (May 2021)**

IESBA Fee-related provisions (April 2021) / APESB ED Fee-related provisions (May 2021)
<p><u>International requirements re fee-related information</u></p> <p>In keeping with the international changes to the Code, the APESB ED proposes to require communication of fee-related information to <i>those charged with governance</i>. The two categories for that disclosure are:</p> <ul style="list-style-type: none"> <li>• fees for the audit of the financial statements</li> <li>• fees for other services. The IESBA Code and APESB ED give examples of categories that might be used in providing background and context about fees to enable those charged with governance to consider the independence of the firm. These suggestions are: <ul style="list-style-type: none"> <li>○ the amount of fees for other services that are required by law or regulation;</li> <li>○ the nature of other services provided and their associated fees;</li> <li>○ information on the nature of the services provided under a general policy approved by those charged with governance and associated fees; and</li> <li>○ the proportion of fees referred to in paragraph R410.25(a) to the aggregate of the fees charged by the firm and network firms for the audit of the financial statements on which the firm expresses an opinion.</li> </ul> </li> </ul> <p>The international Code (and the APESB ED) also note that public disclosure of fee information to stakeholders is beneficial. If a PIE does not disclose fee information to stakeholders, the Code (and APESB ED) require that the auditor publicly disclose fee information for the following categories (paraphrased):</p> <ul style="list-style-type: none"> <li>• fees for the audit of the financial statements (on which the firm expresses an opinion)</li> <li>• fees charged to entities consolidated within the statements on which the auditor expresses an opinion)</li> <li>• other fees charged to related entities that are relevant to the evaluation of the firm’s independence.</li> </ul>
<p><u>Description of Australian-specific fee disclosure proposals in the APESB ED</u></p> <p>The APESB ED (paragraph AUST 410.29.1 A1) includes some Australian-specific material which says firms should consider the following categories in making disclosures in relation to fees received or receivable for professional services provided to audit clients. These categories are similar to those proposed by ASIC in 2019.</p> <ul style="list-style-type: none"> <li>• Fees for audit services</li> <li>• Fees for audit-related services (based on UK Ethical Standards 2019)</li> </ul>

- Fees for other assurance services (based on UK Ethical Standards 2019)
- Fees for tax services (adapted from APES 220 Taxation Services)
- Fees for other services

The new row in this table shows the actual text of AUST 410.29.1 A1.

APESB ED paragraph AUST 410.29.1 A1

Paragraph 410.3 A3 is shown for context.

410.3 A3. For the purposes of this section, audit fees comprise fees or other types of remuneration for an audit or review of Financial Statements. Where reference is made to the fee for the audit of the Financial Statements, this does not include any fee for an audit of Special Purpose Financial Statements or a review of Financial Statements.

...

AUST 410.29.1 A1 Firms should consider the following categories of services for making disclosures in relation to fees received or receivable for Professional Services provided to Audit Clients:

- (a) **Audit services** – which includes:
  - Audit Engagements and audits of Related Entities for Audit Clients that are Public Interest Entities;
  - Audit Engagements and audits of Related Entities for which the Audit Client has direct or indirect control; and
  - Review Engagements in accordance with ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*.
- (b) **Audit-related services** – which are services provided by members of the Audit Team that is closely related to work performed for audit services in (a) above, such as:
  - Reporting required to be provided by the external auditor by laws or regulations;
  - Reviews of interim financial information;
  - Reporting on regulatory returns (for example, reporting to the Australian Prudential Regulation Authority, or the auditor’s report to ASIC on an Australian Financial Services licensee using Form FS 71);
  - Reporting to a regulator on client assets;
  - Reporting on government grants;
  - Reporting on internal financial controls when required by law or regulation; and
  - Additional audits or reviews performed on financial information and/or financial controls that have been authorised by Those Charged with Governance.
- (c) **Other assurance services** – comprise all Assurance Engagements other than (a) and (b) above. For example:
  - audit and other services relating to public reporting as a reporting or investigating accountant on financial or other information of the audited entity in an investment circular or prospectus;
  - services, including private reporting that are customarily performed by the reporting or investigating accountant to support statements and disclosures made by the directors, in a prospectus or investment circular or, to support confirmations provided by the sponsor or nominated advisor; and
  - audit and other assurance services relating to public reporting on other information issued by the entity, such as reports on information in the front of annual reports not covered by the auditor’s report on the financial statements.
- (d) **Taxation Services** – which comprises any Professional Activities performed by a Member relating to ascertaining a client’s tax liabilities or entitlements or satisfying their obligations under taxation law, provided under circumstances where they can reasonably expect to rely on the Professional Activities. This includes:
  - (i) preparation of a return, notice, statement, application or other document for lodgement with a revenue authority, and responding on behalf of a client to the revenue authority’s requests for further information;

<ul style="list-style-type: none"> <li>(ii) Subject to the prohibition in paragraph R604.10, preparation of tax calculations to be used as the basis for the accounting entries in the financial statements;</li> <li>(iii) provision of tax planning and other tax advisory services; and</li> <li>(iv) assisting a client in the resolution of tax disputes; and</li> <li>(e) <b>Other services</b> – which comprise any service not covered in (a) – (d) above.</li> </ul>
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36. The category ‘fees for audit-related services’ may be the one where there is some disagreement about the name of the category (should it be called ‘audit-related’ or ‘assurance-related’) and what should be included (for example, should it focus on services that do not generally give rise to threats to independence)?
37. The APESB categories are not the only categories that the Board could consider. Table 7 shows some other options.

**Table 7 Other options for fee categories**

Options	Staff comments
FMA 2014 suggestions <sup>12</sup> Audit of financial statements <ul style="list-style-type: none"> <li>• Audit and review of financial statements</li> </ul> Other services <ul style="list-style-type: none"> <li>• Regulatory audit work</li> <li>• Other assurance services</li> <li>• Tax services</li> <li>• Other services</li> </ul>	This is one way of providing more detail about the ‘other services’ required by FRS-44. It is useful to contrast these suggestions with more recent requirements and proposals.
Categories considered at NZASB/NZAuASB joint meeting February 2020 <ul style="list-style-type: none"> <li>• Assurance with a distinction between audit, review and other assurance</li> <li>• Audit-related services</li> <li>• Non-assurance services</li> </ul>	Still relevant. Recent Australian proposals have more categories, but the question is whether they give a sufficiently clear distinction between assurance and non-assurance services. NZAuASB ED (July 2021) gives examples of services that may not create a self-review threat.

*Timing – when would be best?*

38. If the Board decides to propose changes to audit fee disclosures, it will need to consider when the project work should begin and when to issue proposals. There is no easy answer to this.
39. On one hand the NZAuASB would like revised audit fee disclosures to be effective at the same time as the as the Revised NAS (and fees requirements) in the Code. The Code changes are effective for periods beginning on or after 1 December 2022. This would suggest an urgent need for consultation on changes to audit fee disclosures. However, if we issue an ED ahead of the AASB, there is a risk that the two sets of proposals will not be the same. This could lead to a permanent trans-Tasman difference or another exposure draft at some point.

<sup>12</sup> The 2014 FMA report highlighted concerns about the quality of disclosure of audit and non-audit fees and the lack of consistency and comparability between entities. The FMA was looking for a clearer breakdown of the ‘other services’ required by FRS-44.

40. On the other hand, the Board has requirements to consider trans-Tasman harmonisation<sup>13</sup> and would generally look to align domestic disclosure proposals with Australian proposals. The AASB is waiting for the federal Government response to the PJC recommendations before it issues an ED. At this stage there is no indication when or if the federal Government will respond to the PJC recommendations.
41. The AASB will also be interested in feedback on the APESB fee disclosure proposals (which responded to PJC recommendation 3 for the FRC/AASB to introduce defined categories and associated fee disclosure requirements in relation to audit and non-audit services). If we wait for the AASB to issue an exposure draft the NZAuASB would either have to proceed to align with the IESBA fee-related changes without being able to refer to revised disclosure requirements in accounting standards, or it could wait for the Board to undertake due process on any changes to accounting standards.
42. Trans-Tasman harmonisation is more likely to be achieved if the NZASB and AASB consult on the same proposals at the same time. However, harmonisation is not assured, as the NZASB and AASB could receive different feedback from constituents and might need to consider different matters.
43. The expected changes to the assurance standards to reduce NAS that might create a self-review threat will arguably reduce the need for improved audit fee disclosures, because there will be fewer instances of auditors providing 'other services'. These restrictions are more stringent in relation to PIEs. However, accounting standards are also applied by entities that are not PIEs.
44. If the Board decides to propose changes to audit fee disclosures, staff will draft a project plan to reflect the Board's preferred timing. The following factors could affect the resources and time required.
  - (a) The NZAuASB's interest in revised audit fee disclosures being effective at the same time as the as the Revised NAS (and fees requirements) in the Code.
  - (b) AASB RR 2015 (December 2020) identified 11 issues that should be considered when developing definitions for audit and non-audit services fee disclosure requirements. These issues would need to be considered. For example, should disclosure of auditor remuneration for audit related services be further disaggregated into remuneration for: (1) audit related services that are impractical to be provided (or prohibited from being provided) by another auditor; and (2) audit-related services that could be reasonably performed by another auditor, with a description of the nature of the services?
  - (c) The level of agreement within Australia and New Zealand on the proposed categories.

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<sup>13</sup> The *Joint Statement of Intent: Single Economic Market Outcomes Framework* (August 2009) included an agreed trans-Tasman outcome "For -profit entities are able to use a single set of accounting standards and prepare only one set of financial statements."

The *Accounting Standards Framework* (Updated December 2015) says that the Tier 1 and Tier 2 Accounting Requirements will be harmonised with Australia as appropriate. However, the requirement to harmonise Tier 2 disclosures has been put on hold following the issuance of AASB 1060 which established new requirements for Tier 2 entities in Australia.



Questions for the Board

- Q1. Should we commence a domestic project to propose amendments to the disclosure of audit fees in NZ IFRS and PBE Standards?  
(i.e. Is there a need to change the existing audit fee disclosures?)
- Q2. What is the best timing for this work and/or consulting on proposals?
- Should we wait for the AASB to issue an ED proposing amendments to AASB 1054?
  - Should we wait for the NZAuASB to complete its project on non-assurance services?<sup>14</sup>
- Q3. If you agree that we should commence a domestic project to propose amendments to the disclosure of audit fees, should these disclosures be aligned with the AASB/APESB proposals as outlined in [paragraph 22](#)?

**Next steps**

45. The next steps depend on what the Board wants and how quickly it wishes to proceed with developing any proposals.

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<sup>14</sup> ED 2021-4 – *Amendments to Professional and Ethical Standard 1: Non-Assurance Services*, closed for comment 31 October 2022. The NZAuASB is currently analysing submissions and considering next steps.

## Appendix A Background information

This Appendix contains background information about audit fee disclosures, including discussions by standard-setting boards, EDs and changes to standards and codes.

Date	Discussion/event/document
1978–2003	<p><b>Accounting standards prior to adoption of NZ IFRS</b></p> <p>Audit fee disclosures in standards were based on the requirements in the Companies Act 1993 – which are the same as the Companies Act 2013. See <b>FRS-9: Information to be Disclosed in Financial Statements</b> (issued March 1995)</p> <p>6.13 The following items of expense shall be disclosed separately:</p> <p>...</p> <p>(e) fees paid to auditors, disclosing separately fees paid to:</p> <ul style="list-style-type: none"> <li>* (i) each (if more than one) auditor of the parent entity for the audit of the financial report;</li> <li>* (ii) any other auditor(s) of entities in the group (not including the parent entity) for the audit of the financial report(s);</li> <li>* (iii) the auditor(s) of the parent entity for other services provided to group entities by the auditor(s) or entities related to the auditor(s); ...</li> </ul>
2004	<p><b>Adoption of NZ IFRS</b></p> <p>There are no specific audit fee disclosure requirements in IFRS Standards so New Zealand-specific requirements were added to NZ IAS 1 <i>Presentation of Financial Statements</i>.</p> <p>The FRSB's initial proposals for audit fee disclosures were almost identical to those in FRS-9 and the Companies Act 1993.</p> <p>However, the audit fee disclosure requirements finally included in NZ IAS 1 (shown below) were more detailed than the proposals. The final requirements were influenced by (i) disclosures required by United States Securities and Exchange Commission (SEC) as a consequence of the Sarbanes-Oxley Act 2002 and (ii) the proposals in AASB 101 <i>Presentation of Financial Statements</i> (which at that time, was pending final approval).</p> <p>Feedback when FRS-44 <i>New Zealand Additional Disclosures</i> was developed in 2010/2011 indicated that some felt the requirements in NZ IAS 1 were too complex.</p> <p><b>NZ IAS 1 (2004)</b></p> <p>NZ 94.1. An entity shall disclose, either on the face of the income statement or in the notes, fees to auditors, disclosing separately fees to:</p> <ul style="list-style-type: none"> <li>(a) each (if more than one) auditor of the parent entity for: <ul style="list-style-type: none"> <li>(i) audit fees being fees for the audit of the financial statements;</li> <li>(ii) audit related fees being fees for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements and are not reported under paragraph (a)(i). An entity shall describe the nature of the services comprising the fees disclosed under this category;</li> <li>(iii) tax fees being fees for tax compliance, tax advice, and tax planning services. An entity shall describe the nature of the services comprising the fees disclosed under this category; and</li> <li>(iv) all other fees being fees for services other than those reported in paragraphs (a)(i) through (a)(iii). An entity shall describe the nature of the services comprising the fees disclosed under this category; and</li> </ul> </li> <li>(b) any other auditor(s) of entities in the group (not including the parent entity) for audit fees being fees for the audit of the financial statements.</li> </ul>

Date	Discussion/event/document																														
2011	<p><b>FRS-44 issued</b></p> <p>Audit fee disclosures for for-profit entities were removed from NZ IAS 1 and included in FRS-44 <i>New Zealand Additional Disclosures</i>. The new requirements (shown below) were less detailed.</p> <p>*8.1 An entity shall disclose fees to each auditor or reviewer, including any network firm, separately for:</p> <p style="padding-left: 40px;">(a) the audit or review of the financial statements; and</p> <p style="padding-left: 40px;">(b) all other services performed during the reporting period.</p> <p>*8.2 For 8.1 (b) above, an entity shall describe the nature of other services.</p>																														
2013	<p>PBE Standards issued. Audit fee disclosure requirements in PBE IPSAS 1 <i>Presentation of Financial Statements</i> are almost identical to those in FRS-44.</p>																														
April 2014	<p><b>FMA report: <i>Disclosure of fees paid to auditors by listed issuers.</i></b></p> <p>This report highlighted concerns about the quality of disclosure of audit and non-audit fees and the lack of consistency and comparability between entities. The FMA found that the disclosure of fees paid to the external auditor was often unclear and not always in line with the requirements of FRS-44. The FMA expressed the view that in some cases the financial statements of issuers paying high fees for non-audit services would benefit from clearer disclosures regarding the other services provided. The FMA also commented on the usefulness of disclosures by certain entities in their annual reports which explained the process the audit committee followed in managing the relationship with the auditor.</p> <p>The FMA indicated that it expected to be able to analyse audit fees disclosed in accordance with FRS-44 into the following categories. It acknowledged that other ways of disclosing this information could achieve the same objective.</p> <table border="1" data-bbox="400 1104 1332 1505" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;">Fees paid to auditor:</th> <th style="text-align: center;">Year</th> <th style="text-align: center;">Year</th> </tr> </thead> <tbody> <tr> <td colspan="3"><b>Audit of financial statements</b></td> </tr> <tr> <td>Audit and review of financial statements (note x)</td> <td style="text-align: center;">xxx</td> <td style="text-align: center;">xxx</td> </tr> <tr> <td colspan="3"><b>Other services</b></td> </tr> <tr> <td>Regulatory audit work (note x)</td> <td style="text-align: center;">xx</td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Other assurance services (note x)</td> <td style="text-align: center;">xx</td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Tax services (note x)</td> <td style="text-align: center;">xx</td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Other services (note x)</td> <td style="text-align: center;">xx</td> <td style="text-align: center;">xx</td> </tr> <tr> <td>Total other services</td> <td style="text-align: center;">xxx</td> <td style="text-align: center;">xxx</td> </tr> <tr> <td>Total fees paid to auditor</td> <td style="text-align: center;">xxx</td> <td style="text-align: center;">xxx</td> </tr> </tbody> </table>	Fees paid to auditor:	Year	Year	<b>Audit of financial statements</b>			Audit and review of financial statements (note x)	xxx	xxx	<b>Other services</b>			Regulatory audit work (note x)	xx	xx	Other assurance services (note x)	xx	xx	Tax services (note x)	xx	xx	Other services (note x)	xx	xx	Total other services	xxx	xxx	Total fees paid to auditor	xxx	xxx
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Regulatory audit work (note x)	xx	xx																													
Other assurance services (note x)	xx	xx																													
Tax services (note x)	xx	xx																													
Other services (note x)	xx	xx																													
Total other services	xxx	xxx																													
Total fees paid to auditor	xxx	xxx																													
June 2015	<p><b>FMA report: <i>Disclosure of fees paid to auditors by listed issuers</i></b></p> <p>The FMA observed a marked improvement in the quality of disclosure of fees paid to the external auditor. Of the sample reviewed, 84% were found to meet the disclosure requirements of FRS-44.</p>																														

Date	Discussion/event/document
2018	<p><b>2018 International Code of Ethics for Professional Accountants</b></p> <p>This Code, which is issued by IESBA, has been adopted in New Zealand.</p> <p>The Code itself does not establish public disclosure requirements. Rather, the accounting standard setters establish the disclosure requirements for the preparer and the International Auditing and Assurance Standards Board establishes what is disclosed in the auditor's report.</p> <p>The Code includes a conceptual framework and revised examples of actions that might be safeguards to threats to compliance with the fundamental principles and to independence in the context of provision of NAS to an audit client and fee-related matters. The provision of other assurance services is not seen to threaten the auditor's independence.</p> <p>The Code:</p> <ul style="list-style-type: none"> <li>• requires a firm or network firm to identify whether providing a NAS to an audit client might create a threat to independence, then to evaluate the level of the threat created and how to address the threat before accepting an engagement to provide such a service.</li> <li>• provides guidance on considering the combined effect of threats created by providing multiple NAS to an audit client.</li> <li>• prohibits an audit firm from assuming a management responsibility for an audit client.</li> <li>• prevents certain types of NAS from being provided to <b>public interest entities</b> (in New Zealand, these are entities that must report using Tier 1 accounting standards).</li> <li>• requires that audit firms consider the size of the total fee from an audit client relative to the proportion of the total fee of any one particular partner or the office of the firm.</li> </ul>
2018	<p><b>FMA: Corporate governance in New Zealand: Principles and guidelines</b></p> <p>The handbook (for directors, executives and advisers) expects that Boards will report on categories of audit work. See extracts from Principle 7 Auditors (page 23).</p> <p>7.5 Boards must prepare and file financial reports as required under relevant legislation. They should report to shareholders and stakeholders, once a year, on the fees paid to their audit firm. This report should differentiate between audit fees and fees for individually identified non-audit work (for example, separating each category of non-audit work, and disclosing the fees for this).</p> <p>7.6 Fee negotiations should be managed by the directors and/or the audit committee. They should not be delegated to the entity's management.</p> <p>7.7 Boards should explain in their annual report the non-audit work their audit firm carried out, and why the work did not compromise auditor objectivity and independence. They should also explain:</p> <ul style="list-style-type: none"> <li>• how they satisfied themselves about auditor quality and effectiveness of the audit</li> <li>• their approach to tenure and reappointment of auditors</li> <li>• any threats to auditor independence and how those threats were mitigated.</li> </ul>
September 2019	<p><b>CA ANZ submission</b> to the inquiry into the regulation of audit in Australia</p> <p>Suggested four categories of fee disclosures</p> <ul style="list-style-type: none"> <li>• audit</li> <li>• assurance</li> <li>• audit related; and</li> <li>• non-audit related services.</li> </ul>

Date	Discussion/event/document
September 2019	<p><b>EY's submission</b> to the inquiry into the regulation of audit in Australia contained proposals for disclosure of audit and non-audit services</p> <ul style="list-style-type: none"> <li>• <b>Statutory audit fees</b> Fees paid relating to the statutory financial statement audit and half-year review of any entity within the group, local and international.</li> <li>• <b>Audit-related services</b> Other audits or reporting that auditors are either required to undertake or are best placed to undertake under legislation, regulation or contract. These services are typically provided by the same audit partner and staff, and include regulatory audits, compliance plan audits, grant audits, covenant reporting to banks and associated entity audits.</li> <li>• <b>Other assurance services</b> This would include audits conducted in accordance with the assurance framework contained in Australian Auditing Standards (such as ISARs, sustainability reporting and agreed-upon procedures report) as well as other areas of assurance).</li> <li>• <b>Non-audit-related (other) services</b> Tax compliance services, consulting and other services permitted under the Corporations Act, APES 110, and Australian Auditing Standards.</li> </ul>
November 2019	<p><b>FMA report: <i>Audit Quality Monitoring Report 2019</i></b></p> <p>The report included a section on auditor independence. The report suggested that directors and auditors should take perceived threats to independence into account when deciding whether or not to perform non-assurance services.</p>
2019	<p><b>ASIC guidance</b></p> <p>In 2019 Australian Securities and Investments Commission (ASIC) released guidance to audit firms to encourage ASX listed entities to disclose auditor remuneration in accordance with specific categories. ASIC said it would like to see auditors' remuneration disclosure split into the following categories:</p> <ol style="list-style-type: none"> <li>a. Fees to the group auditor for:             <ol style="list-style-type: none"> <li>i. auditing the statutory financial report of the parent covering the group</li> <li>ii. auditing the statutory financial report of any controlled entities</li> </ol> </li> <li>b. Fees for assurance services required by legislation to be provided by the auditor (e.g. for certain reporting to the Australian Prudential Regulation Authority, or for the auditor's report to ASIC on an Australian Financial services licensee using Form FS 71)</li> <li>c. Fees for other assurance services and agreed-upon procedures services under other legislation or contractual arrangements (e.g. assurance on revenue information relating to contingent rental in a lease agreement) where there is discretion as to whether the service is provided by the auditor or another firm, and</li> <li>d. Fees for other services (e.g. tax advice, tax compliance, consulting, etc.).</li> </ol>
January 2020	<p><b>IESBA issued Fees ED</b></p> <p><i>Proposed revisions to the Fee-related Provisions of the Code</i></p> <p>Comments due 4 May 2020 (extended to 4 June 2020)</p> <p>The proposed revisions to the fee-related provisions of the code included:</p> <ul style="list-style-type: none"> <li>• A prohibition on firms allowing the audit fee to be influenced by the provision of services other than audit to the audit client;</li> <li>• In the case of PIEs, a requirement to cease to act as auditor if fee dependency on the audit client continues beyond a specified period; and</li> <li>• Communication of fee-related information to TCWG and to the public to assist their judgments about auditor independence.</li> </ul>

Date	Discussion/event/document
	<p>The Fees ED also included enhanced guidance on identifying, evaluating and addressing threats to independence in relation to other fee-related matters, including the proportion of fees for services other than audit to the audit fee.</p> <p><i>These proposals were finalised in April 2021.</i></p>
<p>January 2020</p>	<p><b>IESBA issued NAS ED</b>  <i>Proposed Revisions to the Non-Assurance Services Provisions of the Code</i>  Comments due 4 May 2020 (extended to 4 June 2020)</p> <p>The proposed revisions to the non-assurance services provisions of the code include:</p> <ul style="list-style-type: none"> <li>• A prohibition on providing NAS to an audit client that is a public interest entity (PIE) if a self-review threat to independence will be created;</li> <li>• Further tightening of the circumstances in which materiality may be considered in determining the permissibility of a NAS;</li> <li>• Strengthened provisions regarding auditor communication with TCWG, including, for PIEs, a requirement for NAS pre-approval by TCWG; and</li> <li>• Stricter requirements regarding the provision of some NAS, including certain tax and corporate finance advice.</li> </ul> <p>The NAS ED also includes enhanced guidance to assist firms in evaluating the level of threats to independence when providing NAS to audit clients.</p> <p><i>These proposals were finalised in April 2021.</i></p>
<p>February 2020</p>	<p><b>Joint NZASB and NZAuASB meeting</b>  Item 4.1</p> <ul style="list-style-type: none"> <li>• The purpose of the item was to explore the need for information related to fees paid to the auditor and whether and/how to improve consistency and transparency of information regarding fees paid to the auditor in the current environment.</li> <li>• Staff suggested that the following fee categories could place more emphasis on assurance versus non-assurance services. <ul style="list-style-type: none"> <li>○ Assurance with a distinction between audit, review and other assurance</li> <li>○ Audit-related services</li> <li>○ Non-assurance services</li> </ul> </li> <li>• The Boards generally supported the need to clarify and improve the current disclosure requirements of fees paid for audit services, assurance services, and other services <ul style="list-style-type: none"> <li>○ To align with terminology in the assurance standards</li> <li>○ To clarify the distinction between the various services provided by audit firms</li> <li>○ To promote best practice disclosure in New Zealand</li> <li>○ To address the definitional issues identified (e.g. audit related services)</li> </ul> </li> <li>• The Boards also noted the consideration of this issue in Australia and note the importance of the AASB and NZASB working together to reach a solution.</li> </ul>
<p>February 2020</p>	<p><b>PJC Interim Report</b>  Parliamentary Joint Committee on Corporations and Financial Services (PJC) issued <i>Regulation of Auditing in Australia: Interim Report</i>. <a href="#">link</a></p> <p>The report examined two main issues persistently identified as threats to auditor independence, being:</p> <ul style="list-style-type: none"> <li>• the provision of non-audit services; and</li> <li>• the perceived closeness of the auditor with the audited entity.</li> </ul> <p>To address these issues, the report recommended improving transparency of the remuneration received by auditors for non-audit services.</p>

Date	Discussion/event/document
	<p>Paragraphs 4.92 and 4.117 of the report noted the following concerns in relation to audit fee disclosures:</p> <ul style="list-style-type: none"> <li>• there are no industry-wide definitions of the <b>non-audit services</b> an auditor may perform. Entities therefore develop their own criteria as to what constitutes the different categories of services (for example, audit-related or other assurance services), which has led to inconsistencies in reporting; and</li> <li>• whether longer individual auditor or <b>audit firm tenure</b> could lead to an over-familiarity and, in turn, an erosion of professional scepticism necessary to perform high-quality audits.</li> </ul> <p>Industry stakeholders were of the broad view that the market would benefit from clearly and consistently defined categories and associated fee disclosure of non-audit services.</p> <p>The PJC recommendations were finalised in November 2020 (shown below).</p>
March 2020	<p><b>AASB 1060 – Tier 2 entities must disclose audit fees</b></p> <p>AASB issued AASB 1060 <i>General Purpose Financial Statements –Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities</i>.</p> <p>It requires that Tier 2 entities comply with the same audit fee disclosures as Tier 1 entities. By contrast, FRS-44 and PBE IPSAS 1 have an RDR concession for audit fees.</p>
March 2020	<p><b>Auditor General’s revised Code of Ethics</b></p> <p>The Code sets limits on the provision of additional work, over and above the work that is required or permitted to be carried out on behalf of the Auditor-General. Such work is limited to “work of an assurance nature”. That is said to include:</p> <ul style="list-style-type: none"> <li>• engagements that involve the formal expression of an opinion;</li> <li>• agreed-upon procedures engagements;</li> <li>• real-time independent quality assurance;</li> <li>• probity engagements; and</li> <li>• activities involving the examination, investigation or inquiry into matters of concern.</li> </ul> <p>All other types of NAS engagement are effectively prohibited.</p>
June 2020	<p><b>NZAuASB comments on IESBA Fees ED</b></p> <p><i>Extracts from the NZAuASB’s comment letter follow</i></p> <p>In general, the NZAuASB supports the proposals, however, while the NZAuASB is supportive of the objective of transparency of fee-related information, it is concerned that the proposal to require fee-related disclosures other than by the professional accountant is beyond the mandate of the IESBA. In this regard, the NZAuASB encourages the IESBA to pursue a solution through the International Accounting Standards Board. It is the view of the NZAuASB that disclosure of financial information is management’s responsibility and should not be imposed on the auditor through the Code.</p> <p><i>Comments on Question 11</i></p> <p><b>11. Do you support the proposed requirement in paragraph R410.25 regarding public disclosure of fee-related information for a PIE audit client? In particular, having regard to the objective of the requirement and taking into account the related application material, do you have views about the operability of the proposal?</b></p> <p>Response:</p> <p>While the NZAuASB supports public disclosure of fee-related information, the NZAuASB has a number of concerns about the proposed requirement in paragraph R410.25.</p> <p>The NZAuASB is concerned that a requirement to disclose fee related information extends beyond the mandate of the IESBA. Disclosure of financial information is the responsibility of the preparer of financial statements, not the auditor. In New Zealand, FRS 44 requires disclosure of the audit or review fee, and fees for all other services performed during the reporting period. In addition, the entity is required to describe the nature of other services.</p>

Date	Discussion/event/document
	<p>We urge the IESBA to work with the International Accounting Standards Board to enhance the transparency of fee-related information through enhanced disclosure by the entity.</p> <p>The requirement is for the firm to be satisfied that the information is publicly disclosed in a timely and accessible manner. There is no consistent location for this information to be disclosed. The guidance indicates, if the information is disclosed by the entity, it could be in the financial statements, annual report or proxy statement. If disclosed by the firm, such information might be disclosed by the firm in a manner deemed appropriate for the circumstances. Not having the information available in a consistent location, for example, the entity's financial statements, will make it difficult for users to find, and consequently, reduce its usefulness.</p> <p>Further, if there is a conflict between the requirements of the financial reporting framework and the requirements in R410.25, which will prevail? It is not desirable for the auditor to be required to disclose information that the entity itself is not required to disclose in accordance with the applicable financial reporting framework.</p> <p>The objective of providing fee-related disclosures is so that the users of the information can make their own determinations about the independence of the auditor. The ability to make good decisions depends on the decision usefulness of the information presented. The NZAuASB considers that more granular disclosures are necessary. Comparing the audit fee to all fees from the client does not give a clear picture as the auditor often provides additional services, that require independence and an audit level of knowledge, for example, the audit of regulatory reports required by the regulator. These "audit related" services need to be considered separately from other services. Additionally, it may also be useful to disclose fees paid to other professional accountants for both assurance and non-assurance services.</p> <p>Such information would then give a fuller picture of the total spend by the entity for assurance and non-assurance services and where any other close relationships might be.</p> <p><i>Comments on Question 12</i></p> <p><b>12. Do you have views or suggestions as to what the IESBA should consider as:</b></p> <ul style="list-style-type: none"> <li><b>a) Possible other ways to achieve transparency of fee-related information for PIE audit clients; and</b></li> <li><b>b) Information to be disclosed to TCWG and to the public to assist them in their judgements and assessments about the firm's independence?</b></li> </ul> <p>Response:</p> <p>Public transparency of fee-related information is important as it allows users to form their own conclusions as to independence. However, as noted in response to the preceding question, the NZAuASB considers that it is important to distinguish between fees for audit/assurance and related services from fees for other services, as well as fees paid to other firms for assurance and non-assurances services.</p> <p>The ability of users to make decisions depends on the "decision usefulness" of the information presented. Fuller disclosures provide for better decision making.</p> <p>It is good governance practice for those charged with governance to be aware of the services the auditor performs for the entity. The NZAuASB is also of the view that it is the responsibility of management, rather than the auditor, to provide such information to those charged with governance.</p>



Date	Discussion/event/document
July 2020	<p><b>AASB’s User Advisory Committee survey</b></p> <p>The UAC completed an AASB staff survey about what information relating to audit remuneration users would find useful and why.</p> <p>Key points</p> <ul style="list-style-type: none"> <li>• 87.5% of UAC members agreed there is need for an increase in transparency regarding total remuneration paid to auditors, while 12.5% disagreed.</li> <li>• 42.86% of UAC members preferred the most extensive level of disclosures of auditor remuneration.</li> <li>• 50% of UAC members were of the view that only for-profit entities should be required to disclose this level of auditor remuneration.</li> <li>• 87.5% of UAC members agreed information regarding auditor tenure and firm rotation would be beneficial, while 12.5% disagreed.</li> </ul>
November 2020	<p><b>FMA Audit Quality Monitoring Report 2020</b></p> <p>The section on auditor independence included the following comments.</p> <ul style="list-style-type: none"> <li>• ...the level of non-assurance services compared to audit services is relatively low, and the proportion of fees charged by audit firms related to non-assurance services, remained at 16%.</li> <li>• We will continue to review independence for each audit file and extend our research into the level of non-assurance services audit firms provide to their clients. We will also increase our engagement with FMC reporting entities about concerns of auditor non-compliance with independence requirements, and areas where directors could help improve this compliance.</li> </ul>
November 2020	<p><b>PJC Final Report</b></p> <p>The Australia Parliamentary Joint Committee (PJC) issued its report, <i>Regulation of Auditing in Australia</i>. The report highlighted two main issues of relevance to auditor independence:</p> <ul style="list-style-type: none"> <li>• the perceived closeness of the auditor with the audited entity; and</li> <li>• the provision of non-audit services.</li> </ul> <p>The report contained 10 recommendations, three of which related to auditor tenure and auditor remuneration (see below). The federal Government may formally respond to the PJC recommendations but, as at the time of writing (November 2021), it has not done so.</p> <p><b>Recommendation 3 (disclose auditor remuneration)</b></p> <p>The committee recommended that the Financial Reporting Council, in partnership with ASIC, by the end of the 2020–21 financial year, oversee consultation, development and introduction under Australian standards of:</p> <ul style="list-style-type: none"> <li>• defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and</li> <li>• a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.</li> </ul> <p><b>Recommendation 6 (disclose tenure)</b></p> <p>The committee recommended that the FRC, by the end of the 2020–21 financial year, oversee the revision and implementation of Australian standards to require audited entities to disclose auditor tenure in annual financial reports. Such disclosures should include both the length of tenure of the entity’s external auditor, and of the lead audit partner.</p> <p><b>Recommendation 7 (disclose why no public tender)</b></p> <p>Audited entities that have not undertaken a public tender process in the last 10 years should explain why this has not occurred.</p>

Date	Discussion/event/document
December 2020	<p><b>AASB Research Report 15</b> <i>Review of Auditor Remuneration Disclosure Requirements</i></p> <p>The report compared Australian and selected overseas jurisdictions' auditor remuneration disclosure requirements and identified factors that could be considered in implementing the PJC's recommendations on the audit and [allowed] non-audit services fee disclosure requirements. The report was intended to form the basis for the AASB working collaboratively with regulators, other standard setters, users, preparers and other stakeholders to reach a clear, effective, broadly accepted and improved framework for financial reporting (and assurance) in Australia in respect of auditor remuneration disclosures.</p> <p>The jurisdictions considered included Canada, Germany, Hong Kong, New Zealand, Singapore, South Africa, the United Kingdom (UK) and the United States (US).</p> <p>Without reaching a conclusion, AASB Research Report 15 suggested:</p> <ul style="list-style-type: none"> <li>• Continue requiring disclosure of remuneration for 'audit services' in financial statements, and provide a definition thereof; and</li> <li>• Specify categories of the allowed 'non-audit services' and related remuneration that are required to be separately disclosed in financial statements, particularly by larger entities, namely: <ul style="list-style-type: none"> <li>- audit-related services plus a description of the nature of the services (no further breakdown proposed unless shown to be cost beneficial);</li> <li>- taxation services (possibly with further breakdown into tax compliance and other tax services);</li> <li>- other assurance services plus a description of the nature of the services (no further breakdown proposed unless shown to be cost beneficial);</li> <li>- all other non-audit services plus a description of the nature of the significant services.</li> </ul> </li> </ul> <p>The report also identified <b>11 issues</b> that should be considered when developing definitions for audit and non-audit services fee disclosure requirements.</p> <ol style="list-style-type: none"> <li>1. Given the AASB's deliberations on auditor remuneration requirements in 2010 (and the 2003 Corporate Law Economic Reform Program that resulted in auditor remuneration requirements in the Corporations Act), is it timely to review them now with the prospect of making them more prescriptive by, for example, requiring separate disclosure of the nature and amount of remuneration for specified categories of allowed non-audit services provided by the auditor?</li> <li>2. Should a definition (or a defined scope) be developed for 'audit services'?</li> <li>3. Should there be different Australian auditor remuneration disclosure requirements applicable to different types of entities? If so, how should the different types of entities be distinguished?</li> <li>4. Should the scope of audit-related services be clarified and should auditor remuneration for audit-related services be required to be separately disclosed together with a description of the nature of the services?</li> <li>5. Should disclosure of auditor remuneration for audit related services be further disaggregated into remuneration for: (1) audit related services that are impractical to be provided (or prohibited from being provided) by another auditor; and (2) audit-related services that could be reasonably performed by another auditor, with a description of the nature of the services?</li> <li>6. Should auditor remuneration for taxation services be required to be separately disclosed with a description of the nature of the services?</li> <li>7. Should disclosure of auditor remuneration for taxation services be further disaggregated into remuneration for (1) 'tax compliance services' (i.e. tax return preparation) and (2) 'other tax services' with a description of the nature of the services?</li> </ol>

Date	Discussion/event/document
	<p>8. Should auditor remuneration for other assurance services be required to be separately disclosed with a description of the nature of the services?</p> <p>9. Should disclosure of remuneration for other assurance services be further disaggregated into remuneration for: (1) other assurance services performed due to a regulatory or contractual obligation; and (2) other assurance services performed at the discretion of the entity with a description of the nature of the services?</p> <p>10. Should auditor remuneration for internal audit services be required to be separately disclosed with a description of the nature of the services?</p> <p>11. Should auditor remuneration for each of the other non-audit services not considered above be required to be separately disclosed, together with a description of their nature?</p>
January 2021	<p><b>IESBA issues ED on Definitions Listed Entity and PIE</b></p> <p>Comments due 3 May 2021</p> <p>The IESBA proposes to broaden the definition of a PIE. The definition of a PIE has implications for the scope of permissible NAS.</p> <p>Among other matters, the proposed revisions:</p> <ul style="list-style-type: none"> <li>• Introduce an overarching objective for additional requirements to enhance confidence in the audit of financial statements of PIEs.</li> <li>• Provide guidance on factors to consider when determining the level of public interest in an entity.</li> <li>• Broaden the definition of PIE to additional categories of entities.</li> <li>• Replace the term 'listed entity' with the term 'publicly traded entity' and redefine that PIE category.</li> <li>• Introduce new requirements for firms to determine if additional entities should be treated as PIEs for independence purposes and to publicly disclose if an audit client was treated as a PIE.</li> <li>• Recognise and encourage local regulators to refine PIE categories in regard to national conditions.</li> </ul>
February 2021	<p><b>AASB Meeting: Item 11 Auditor Remuneration Disclosures</b></p> <p>Meeting held 24–25 February.</p> <p>Note: This topic was considered again in <b>June</b>. In June the AASB agreed to wait for the government response to the PJC Inquiry recommendations before issuing an ED.</p> <p>The February memo:</p> <ul style="list-style-type: none"> <li>• noted the PJC report (November 2020)</li> <li>• noted the AASB's Research Report 15 <i>Auditor Remuneration</i> (December 2020)</li> <li>• noted ASIC's 2019 views</li> <li>• noted that many larger audit firms have already encouraged the categorisation suggested by ASIC or suggested changes to address PJC concerns.</li> <li>• sought the AASB's views on a project to review auditor remuneration disclosures in AASB 1054 as well as other options for influencing the IASB.</li> </ul> <p>The AASB directed staff to begin work on drafting revised auditor remuneration disclosures based on the categories proposed in AASB Research Report 15, subject to consideration of APESB proposals and other outreach and research activities. The timing of the ED will be considered once the International Ethics Standards Board for Accountants (IESBA) finalises its projects on fees and non-assurance services and the Australian federal Government responds to the PJC recommendations.</p> <p>Staff agreed to undertake further research on disclosures about auditor tenure and consult with the Auditing and Assurance Standards Board (AUASB) as to whether such disclosures would be better addressed in auditing standards.</p>
February 2021	<p><b>Joint NZASB/NZAuASB meeting</b></p>

Date	Discussion/event/document
	<p><b>Agenda Item 4: Non-assurance Services</b></p> <p>Audit and assurance staff presented on the IESBA’s changes to the international Code of Ethics on non-assurance services to public interest entities, which include a prohibition on services where a self-review threat exists, but also the importance of considering other threats such as familiarity and advocacy.</p> <p>The Joint Boards discussed the implications of these changes for disclosure, and commented, in particular, on costs, the role of the regulator and more education needed on this topic.</p> <p><b>Agenda Item 5: Audit Fee Disclosure</b></p> <p>The joint Boards received an update on the ongoing projects in Australia and New Zealand to improve the disclosure of audit fees.</p> <p>The Boards received an overview of:</p> <ul style="list-style-type: none"> <li>• the Australian Parliamentary Joint Committee Report (PJC) <i>Regulation of Auditing in Australia</i>; and</li> <li>• AASB Research Report 15 <i>Review of Auditor Remuneration Disclosures</i></li> </ul> <p>The Boards noted the IESBA’s recent decisions on changes to the Code of Ethics regarding fee dependency and fee disclosure by firms.</p> <p>The Boards were asked to discuss:</p> <ul style="list-style-type: none"> <li>• the categories proposed in AASB Research Report 15;</li> <li>• how well the distinction between ‘audit services’, ‘audit-related services’, and ‘other assurance services’ is understood in New Zealand;</li> <li>• whether any definitions and/or guidance would be needed to ensure the consistent use of these proposed categories; and</li> <li>• whether to keep the Tier 2 RDR concession for disclosure of audit fees until a detailed review of RDR is undertaken.<sup>15</sup></li> </ul> <p>The Boards noted that the distinction between categories of services provided by audit firms is unclear.</p> <p>The Boards agreed that the NZASB should continue working closely with the AASB.</p>
April 2021	<p><b>IESBA issues Revisions to the Non-Assurance Services Provisions of the Code</b></p> <p>The revised NAS provisions contain substantive revisions that will enhance the International Independence Standards by clarifying and addressing the circumstances in which firms and network firms may or may not provide a NAS to an audit or assurance client. The revised provisions expressly prohibit firms and network firms from providing certain types of NAS to their audit clients, especially when they are public interest entities (PIEs).</p> <p>Key elements of the revised NAS provisions include:</p> <ul style="list-style-type: none"> <li>• A prohibition on the provision of a NAS to an audit client that is a PIE* where that service <i>might</i> create a self-review threat to the firm’s independence) even if there is only a mere possibility of a self-review threat occurring).</li> <li>• New provisions to strengthen and improve the quality of firm communication with those charged with governance about NAS-related matters, including the firm’s independence.</li> <li>• Strengthened provisions to assist firms in addressing threats to independence that are created by the provision of NAS to audit clients that are not PIEs, including new application material in relation to situations where a safeguard is not available.</li> <li>• Enhanced guidance to explain that materiality is not relevant in evaluating whether a self-review threat might be created.</li> </ul> <p>Firms and network firms can continue providing NAS to audit clients that are non-PIEs provided that any identified self-review threat is reduced to an acceptable level in accordance with the conceptual framework.</p>

<sup>15</sup> No decision on the Tier 2 RDR concession was made at this time.

Date	Discussion/event/document
	<p>* For the purposes of Professional and Ethical Standard (PES) 1, a public interest entity is defined as any entity that meets the Tier 1 criteria in accordance with XRB A1 <i>Application of the Accounting Standards Framework</i> and is not eligible to report in accordance with the accounting requirements of another tier.</p>
<p>April 2021</p>	<p><b>IESBA issues Revisions to the Fee-related Provisions of the Code</b></p> <p>The revisions to the fee-related provisions of the Code include:</p> <ul style="list-style-type: none"> <li>• a prohibition on firms allowing the audit fee to be influenced by the provision of services other than audit to the audit client;</li> <li>• in the case of PIEs, a requirement to cease to act as auditor if fee dependency on the audit client continues beyond a specified period;</li> <li>• communication of fee-related information to those charged with governance of an entity and to the public to assist their judgments about auditor independence; and</li> <li>• enhanced guidance on identifying, evaluating and addressing threats to independence.</li> </ul> <p>With respect to fees for audit clients that are PIEs, the pronouncement requires (NB: this is summarised):</p> <ul style="list-style-type: none"> <li>• disclosure of information <i>to those charged with governance</i> about audit fees, fees for other services, and fee dependency</li> <li>• in the absence of specific requirements to disclose fee information to <i>stakeholders</i>, that the firm discuss with the PIE the benefits of such disclosure and the information that might enhance the users’ understanding of the fees paid or payable and their impact on the firm’s independence</li> <li>• if a <i>PIE</i> doesn’t disclose information about fees to stakeholders, that the <i>audit firm</i> publicly disclose: <ul style="list-style-type: none"> <li>(a) Fees paid or payable to the firm and network firms for the audit of the financial statements on which the firm expresses an opinion;</li> <li>(b) Fees, other than those disclosed under (a), charged to the client for the provision of services by the firm or a network firm during the period covered by the financial statements on which the firm expresses an opinion. For this purpose, such fees shall only include fees charged to the client and its related entities over which the client has direct or indirect control that are consolidated in the financial statements on which the firm will express an opinion;</li> <li>(c) Any fees, other than those disclosed under (a) and (b), charged to any other related entities over which the audit client has direct or indirect control for the provision of services by the firm or a network firm when the firm knows, or has reason to believe, that such fees are relevant to the evaluation of the firm’s independence; and</li> <li>(d) If applicable, the fact that the total fees received by the firm from the audit client represent, or are likely to represent, more than 15% of the total fees received by the firm for two consecutive years, and the year that this situation first arose.</li> </ul> </li> </ul> <p>The auditor decides <i>where</i> to disclose such information. Suggestions include on a website, in a transparency report, in an audit quality report, in targeted communication to stakeholders or in the auditor’s report.</p>
<p>April 2021</p>	<p><b>XRB survey</b></p> <p>XRB staff undertook a survey in April 2021, to gain a better understanding of the impact of the provision of NAS on users’ perceptions of the auditor’s independence. The survey results indicated that the provision of NAS by the auditor to their client has some negative effect for nearly all types of NAS provided. Tax-related NAS tend to have an especially negative effect on users’ perceptions.</p> <p>The NZAuASB also consulted the XRB’s advisory panel (the External Reporting Advisory Panel). It received feedback, particularly from the governance members of the panel that, while external perceptions are important, it is also important not to exclude the possibility of the</p>

Date	Discussion/event/document
	entity deriving benefit from additional services that are best provided by the auditor without compromising the firm's independence.
May 2021	<p><b>APESB ED proposes changes to fee-related provisions in the Code</b> (<a href="#">link</a>)</p> <p>Exposure Draft ED 03/21: <i>Proposed Amendments to Fee-related provisions of APES 110 Code of Ethics for Professional Accountants</i> (including Independence Standards)</p> <p>Issued: May 2021.</p> <p>Comments due: 31 August 2021</p> <p>The ED proposed to:</p> <ul style="list-style-type: none"> <li>• incorporate the changes made by IESBA to the <i>International Code of Ethics for Professional Accountants</i> (including International Independence Standards). These amendments seek to enhance the fee-related provisions of the Code; and</li> <li>• address key recommendation from the PJC Inquiry by: <ul style="list-style-type: none"> <li>○ providing information on the different categories of services that may be provided by an auditor (which will assist in determining disclosures required under Australian Accounting Standards suggested in recommendation 3 of the PJC Inquiry); and</li> <li>○ broadening the extant prohibition on audit partners being incentivised, either directly or indirectly for selling non-assurance services to their audit clients to now prohibit incentivisation for sales of non-assurance services to all audit clients of the Firm (as per recommendation 5 of the PJC Inquiry).</li> </ul> </li> </ul> <p>The <b>fee categories proposed in the APESB ED</b> (shown below) are similar to those proposed by ASIC in 2019. Paragraph 410.3 A3 is shown for context.</p> <p>410.3 A3. For the purposes of this section, audit fees comprise fees or other types of remuneration for an audit or review of Financial Statements. Where reference is made to the fee for the audit of the Financial Statements, this does not include any fee for an audit of Special Purpose Financial Statements or a review of Financial Statements.</p> <p>...</p> <p>AUST 410.29.1 A1 Firms should consider the following categories of services for making disclosures in relation to fees received or receivable for Professional Services provided to Audit Clients:</p> <p>(a) <b>Audit services</b> – which includes:</p> <ul style="list-style-type: none"> <li>• Audit Engagements and audits of Related Entities for Audit Clients that are Public Interest Entities;</li> <li>• Audit Engagements and audits of Related Entities for which the Audit Client has direct or indirect control; and</li> <li>• Review Engagements in accordance with ASRE 2410 <i>Review of a Financial Report Performed by the Independent Auditor of the Entity</i>.</li> </ul> <p>(b) <b>Audit-related services</b> – which are services provided by members of the Audit Team that is closely related to work performed for audit services in (a) above, such as:</p> <ul style="list-style-type: none"> <li>• Reporting required to be provided by the external auditor by laws or regulations;</li> <li>• Reviews of interim financial information;</li> <li>• Reporting on regulatory returns (for example, reporting to the Australian Prudential Regulation Authority, or the auditor's report to ASIC on an Australian Financial Services licensee using Form FS 71);</li> <li>• Reporting to a regulator on client assets;</li> <li>• Reporting on government grants;</li> <li>• Reporting on internal financial controls when required by law or regulation; and</li> </ul>

Date	Discussion/event/document
	<ul style="list-style-type: none"> <li>• Additional audits or reviews performed on financial information and/or financial controls that have been authorised by Those Charged with Governance.</li> </ul> <p>(c) <b>Other assurance services</b> – comprise all Assurance Engagements other than (a) and (b) above. For example:</p> <ul style="list-style-type: none"> <li>• audit and other services relating to public reporting as a reporting or investigating accountant on financial or other information of the audited entity in an investment circular or prospectus;</li> <li>• services, including private reporting that are customarily performed by the reporting or investigating accountant to support statements and disclosures made by the directors, in a prospectus or investment circular or, to support confirmations provided by the sponsor or nominated advisor; and</li> <li>• audit and other assurance services relating to public reporting on other information issued by the entity, such as reports on information in the front of annual reports not covered by the auditor’s report on the financial statements.</li> </ul> <p>(d) <b>Taxation Services</b> – which comprises any Professional Activities performed by a Member relating to ascertaining a client’s tax liabilities or entitlements or satisfying their obligations under taxation law, provided under circumstances where they can reasonably expect to rely on the Professional Activities. This includes:</p> <ul style="list-style-type: none"> <li>(i) preparation of a return, notice, statement, application or other document for lodgement with a revenue authority, and responding on behalf of a client to the revenue authority’s requests for further information;</li> <li>(ii) Subject to the prohibition in paragraph R604.10, preparation of tax calculations to be used as the basis for the accounting entries in the financial statements;</li> <li>(iii) provision of tax planning and other tax advisory services; and</li> <li>(iv) assisting a client in the resolution of tax disputes; and</li> </ul> <p>(e) <b>Other services</b> – which comprise any service not covered in (a) – (d) above.</p>
June 2021	<p><b>AASB Item 9 Audit Engagement-related Disclosures</b></p> <p>The AASB (21–22 June) received an update on related projects and discussions, including recent meetings with the AUASB, ASIC, CA ANZ, CPA, Australian Institute of Company Directors and APESB.</p> <p>The AASB discussed options for disclosing audit tenure (PJC recommendation 6) and auditor remuneration (PJC recommendation 3).</p> <p><b>Re audit tenure</b></p> <p>The papers contained an analysis of:</p> <ul style="list-style-type: none"> <li>• where the auditor tenure information would be disclosed [the options were the financial statements or the directors’ report]</li> <li>• which entities would be required to disclose the information [options included entities required to prepared financial statements in accordance with Australian Accounting Standards, entities required to prepare financial reports under Chapter 2M.3 of the Corporations Act 2001, listed entities and <i>large</i> listed entities]; and</li> <li>• potential timing for implementation of proposed amendments [changes to legislation would take longer than developing requirements for accounting standards].</li> </ul> <p>The AASB noted that that the Australian Institute of Company Directors (AICD) plans to develop voluntary guidance for directors on disclosing information about audit tenure. It also</p>

<b>Date</b>	<b>Discussion/event/document</b>
	<p>noted that the AICD intends to seek incorporation of the guidance into the ASX Corporate Governance Principles at a later date.</p> <p>After considering the options available and the work undertaken by other bodies, the AASB decided not to propose amendments to Australian Accounting Standards to require auditor tenure disclosure at this stage but to continue to monitor the work being carried out by the AICD in respect of listed entities.</p> <p><b>Re auditor remuneration</b></p> <p>The AASB considered a comparison of audit and non-audit service categories recommended by AASB Research Report 15 with those suggested by ASIC and those proposed in the APESB ED (issued May 2021).</p> <p>The AASB acknowledged that the APESB May 2021 ED on fee-related provisions defines the services within each category, but noted that APES 110 (the Code of Ethics) <i>provides guidance</i> rather than mandatory requirements. The AASB decided that AASB 1054 should define the services included in each category. The AASB also decided to comment on the APESB ED and to liaise with the APESB in developing the disclosure proposals.</p> <p>The AASB indicated that it intends to wait for the government response to the PJC Inquiry recommendations before issuing an ED. In the interim, the AASB will continue deliberating the proposals to amend AASB 1054.</p>



Date	Discussion/event/document																																																																		
June 2021	<p><b>KPMG (Australia) Reporting Update</b></p> <p><b>Auditor Tenure and Auditor Fee Disclosures</b></p> <ul style="list-style-type: none"> <li>Discusses the recommendations in the PJC report (issued November 2020)</li> <li>Discusses possible/expected responses to the PJC recommendations <ul style="list-style-type: none"> <li>The Australian Institute of Company Directors plans to issue guidance in 2022 for directors on (voluntarily) disclosing information on audit tenure</li> <li>Notes the APESB ED (issued May 2021)</li> <li>Notes that the AASB plans to develop an ED to enhance auditor remuneration disclosures</li> </ul> </li> <li>Notes current Australian requirements: legislation, auditing standards and the APES 110 Code of Ethics</li> </ul> <p><b>Re auditor tenure</b></p> <ul style="list-style-type: none"> <li>Expresses the view that it would be logical to disclose information about auditor tenure in the directors' report</li> <li>Contains example illustrative disclosures of auditor tenure</li> </ul> <p><b>Re auditor fee disclosures</b></p> <ul style="list-style-type: none"> <li>Notes Australian legislative requirements <ul style="list-style-type: none"> <li>for auditors to make a statutory declaration about independence, which is then appended to the directors' report</li> <li>for directors to make disclosures/ statements about audit fees and non-audit services <i>in the directors' report</i></li> </ul> </li> <li>Notes fee disclosure requirements in AASB 1054</li> <li>Notes that in 2019 ASIC released guidance to audit firms to encourage entities to disclose auditor remuneration in accordance with specific categories. The KPMG Example Public Company Limited Financial Report (see extract below) illustrates ASIC's categorisation.</li> </ul> <p>Appendix 1 – Auditor fee illustrative disclosures</p> <table border="1" data-bbox="513 1205 1326 1827"> <thead> <tr> <th colspan="3" data-bbox="521 1216 1318 1279">Notes to the consolidated financial statements (continued)</th> </tr> <tr> <th data-bbox="521 1279 1070 1308"><b>48. Auditors' remuneration<sup>a, b, c</sup></b></th> <th data-bbox="1070 1279 1161 1308">2021</th> <th data-bbox="1161 1279 1318 1308">2020</th> </tr> </thead> <tbody> <tr> <td data-bbox="521 1308 1070 1337"><i>In dollars</i></td> <td data-bbox="1070 1308 1161 1337"></td> <td data-bbox="1161 1308 1318 1337"></td> </tr> <tr> <td data-bbox="521 1337 1070 1366"><b>Audit and review services<sup>d</sup></b></td> <td data-bbox="1070 1337 1161 1366"></td> <td data-bbox="1161 1337 1318 1366"></td> </tr> <tr> <td data-bbox="521 1366 1070 1395">Auditors of the Group – KPMG</td> <td data-bbox="1070 1366 1161 1395"></td> <td data-bbox="1161 1366 1318 1395"></td> </tr> <tr> <td data-bbox="521 1395 1070 1424">    Audit and review of financial statements – Group<sup>e</sup></td> <td data-bbox="1070 1395 1161 1424">658,900</td> <td data-bbox="1161 1395 1318 1424">524,360</td> </tr> <tr> <td data-bbox="521 1424 1070 1453">    Audit and review of financial statements – controlled entities<sup>e</sup></td> <td data-bbox="1070 1424 1161 1453">1,049,600</td> <td data-bbox="1161 1424 1318 1453">689,890</td> </tr> <tr> <td data-bbox="521 1453 1070 1482"></td> <td data-bbox="1070 1453 1161 1482">1,708,500</td> <td data-bbox="1161 1453 1318 1482">1,214,250</td> </tr> <tr> <td data-bbox="521 1482 1070 1512">Other auditors</td> <td data-bbox="1070 1482 1161 1512"></td> <td data-bbox="1161 1482 1318 1512"></td> </tr> <tr> <td data-bbox="521 1512 1070 1541">    Audit and review of financial statements</td> <td data-bbox="1070 1512 1161 1541">12,260</td> <td data-bbox="1161 1512 1318 1541">11,310</td> </tr> <tr> <td data-bbox="521 1541 1070 1570"><b>Assurance services<sup>f</sup></b></td> <td data-bbox="1070 1541 1161 1570"></td> <td data-bbox="1161 1541 1318 1570"></td> </tr> <tr> <td data-bbox="521 1570 1070 1599">Auditors of the Group – KPMG</td> <td data-bbox="1070 1570 1161 1599"></td> <td data-bbox="1161 1570 1318 1599"></td> </tr> <tr> <td data-bbox="521 1599 1070 1628">    Regulatory assurance services<sup>f, g</sup></td> <td data-bbox="1070 1599 1161 1628">43,410</td> <td data-bbox="1161 1599 1318 1628">30,860</td> </tr> <tr> <td data-bbox="521 1628 1070 1657">    Other assurance services<sup>f, h</sup></td> <td data-bbox="1070 1628 1161 1657">460,510</td> <td data-bbox="1161 1628 1318 1657">491,370</td> </tr> <tr> <td data-bbox="521 1657 1070 1686"></td> <td data-bbox="1070 1657 1161 1686">503,920</td> <td data-bbox="1161 1657 1318 1686">522,230</td> </tr> <tr> <td data-bbox="521 1686 1070 1715">Other auditors</td> <td data-bbox="1070 1686 1161 1715"></td> <td data-bbox="1161 1686 1318 1715"></td> </tr> <tr> <td data-bbox="521 1715 1070 1744">    Other assurance services<sup>f, h</sup></td> <td data-bbox="1070 1715 1161 1744">2,000</td> <td data-bbox="1161 1715 1318 1744">2,000</td> </tr> <tr> <td data-bbox="521 1744 1070 1774"><b>Other services<sup>f, i</sup></b></td> <td data-bbox="1070 1744 1161 1774"></td> <td data-bbox="1161 1744 1318 1774"></td> </tr> <tr> <td data-bbox="521 1774 1070 1803">Auditors of the Group – KPMG</td> <td data-bbox="1070 1774 1161 1803"></td> <td data-bbox="1161 1774 1318 1803"></td> </tr> <tr> <td data-bbox="521 1803 1070 1832">    Taxation advice and tax compliance services</td> <td data-bbox="1070 1803 1161 1832">114,320</td> <td data-bbox="1161 1803 1318 1832">96,350</td> </tr> <tr> <td data-bbox="521 1832 1070 1861">Other auditors</td> <td data-bbox="1070 1832 1161 1861"></td> <td data-bbox="1161 1832 1318 1861"></td> </tr> <tr> <td data-bbox="521 1861 1070 1890">    Valuation services</td> <td data-bbox="1070 1861 1161 1890">25,000</td> <td data-bbox="1161 1861 1318 1890">23,000</td> </tr> </tbody> </table>	Notes to the consolidated financial statements (continued)			<b>48. Auditors' remuneration<sup>a, b, c</sup></b>	2021	2020	<i>In dollars</i>			<b>Audit and review services<sup>d</sup></b>			Auditors of the Group – KPMG			Audit and review of financial statements – Group <sup>e</sup>	658,900	524,360	Audit and review of financial statements – controlled entities <sup>e</sup>	1,049,600	689,890		1,708,500	1,214,250	Other auditors			Audit and review of financial statements	12,260	11,310	<b>Assurance services<sup>f</sup></b>			Auditors of the Group – KPMG			Regulatory assurance services <sup>f, g</sup>	43,410	30,860	Other assurance services <sup>f, h</sup>	460,510	491,370		503,920	522,230	Other auditors			Other assurance services <sup>f, h</sup>	2,000	2,000	<b>Other services<sup>f, i</sup></b>			Auditors of the Group – KPMG			Taxation advice and tax compliance services	114,320	96,350	Other auditors			Valuation services	25,000	23,000
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July 2021	<p><b>NZAuASB issues ED 2021-4 on NAS</b></p> <p>Comments on the ED closed on 31 October 2021</p> <p>The ED <i>Amendments to Professional and Ethical Standard 1: Non-Assurance Services</i> proposed to adopt the revised IESBA provisions (issued April 2021) regarding the prohibition of NAS to PIEs.</p> <p>In addition, the ED proposed other changes including:</p> <ul style="list-style-type: none"> <li>• prohibiting the provision of tax advisory and tax planning services to an audit client that is a PIE and modifying/ strengthening the IESBA Code discussion of self-review threat from tax advisory and tax planning services.</li> <li>• application material to acknowledge that some services do not generally create a self-review threat to independence, although they may create other threats that need to be considered (see extract below).</li> </ul> <p>The ITC stated that the NZAuASB expects to adopt the revised IESBA fee provisions in New Zealand at a later date, with a cross reference to the New Zealand disclosure requirements.</p> <p><b>Extract from ED</b></p> <p>NZ600.14 A1 Additional work performed by the firm will not generally create a self-review threat to independence when such work is related to the audit or review engagement. Examples of audit or review related engagements include:</p> <ul style="list-style-type: none"> <li>• Engagements required by law or regulation to be performed by the auditor or assurance practitioner.</li> <li>• Engagements that involve the formal expression of an assurance opinion or conclusion.</li> <li>• Engagements to perform agreed-upon procedures.</li> </ul> <p>However, providing such additional services might create one or more other threats, as noted in paragraph 120.6 A4. In such circumstances, the firm is required to apply the conceptual framework to identify, evaluate and address the threats to independence.</p>
November 2021	<p><b>FMA Audit Quality Monitoring Report 2021</b></p> <p>No specific comments on audit fee disclosures.</p>
November 2021	<p><b>Accountancy Europe briefing paper <a href="#">(link)</a></b></p> <p><i>Non-audit services and auditor's independence</i></p> <p>The briefing paper provides an overview of the measures that ensure auditors' independence while providing other assurance services to the companies they audit.</p> <p>The paper is intended to contribute to the ongoing debate at both European and national levels (about auditors providing other services to audit clients). Specifically, it:</p> <ul style="list-style-type: none"> <li>• communicates the strict measures already in place to ensure that auditors do not provide any service that compromises their independence</li> <li>• describes the reasons why auditors are requested or required to provide other assurance services</li> <li>• provides examples of services for which there is a public interest (i.e., benefits to shareholders and other stakeholders) in an auditor's involvement.</li> </ul> <p>It details how auditor's independence is maintained through:</p> <ul style="list-style-type: none"> <li>• legal restrictions and ethical requirements</li> <li>• public oversight and audit committee scrutiny</li> <li>• transparency of fee-related information.</li> </ul> <p><b>Extracts from contents of the paper</b></p> <p><b>Measures in place to ensure auditor's independence</b></p> <p>Auditors are already prohibited from providing many non-audit services Independent public authorities oversee the audit profession Audit committees scrutinise auditor's independence</p>

Date	Discussion/event/document
	<p>Audit firms have comprehensive policies around independence</p> <p><b>Auditors and other assurance services</b></p> <p>Fee-related information is transparently disclosed</p> <ol style="list-style-type: none"><li>1. Why are auditors the ones to provide other assurance services to their audit clients? The service is closely linked to the financial statements audit</li><li>2. An independent service provider's involvement is required by legislation</li><li>3. Stakeholders take comfort in auditor's involvement</li></ol>

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**Date:** 13 December 2021

**To:** NZASB Members

**From:** Vanessa Sealy-Fisher

**Subject:** *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*

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### Recommendations<sup>1</sup>

1. We recommend that the Board:
  - (a) APPROVES for issue *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*, which amends NZ IFRS 17 *Insurance Contracts*; and
  - (b) APPROVES the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board requesting approval to issue *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*.
2. *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information* is identical to *Initial Application of IFRS 17 and IFRS 9—Comparative Information* issued by the IASB except for the New Zealand-specific introduction and a scope paragraph limiting the application of the amending standard to Tier 1 and Tier 2 for-profit entities.

### Background

3. The International Accounting Standards Board (IASB) issued Exposure Draft ED/2021/8 *Initial Application of IFRS 17 and IFRS 9—Comparative Information* (ED/2021/8) in July 2021.
4. The NZASB issued the ED for comment in New Zealand around the same time. Constituents were asked to comment directly to the IASB and send a copy of their comments to the NZASB. Comments were due to the IASB by 27 September 2021.
5. The NZASB did not comment on ED/2021/8 and did not receive any comment letters from New Zealand constituents. The IASB received 46 comment letters from its world-wide constituents, none of which were from New Zealand (or Australian) constituents.
6. The IASB issued *Initial Application of IFRS 17 and IFRS 9—Comparative Information* in December 2021. The amendments are applicable when an entity first applies IFRS 17 *Insurance Contracts*. The amendments create a transition option which is referred to as the ‘classification overlay’.
7. We expect the amendments to have limited impact in New Zealand for the following reasons.
  - (a) Entities applying Appendix C *Life Insurance Entities* and Appendix D *Financial Reporting of Insurance Activities* of NZ IFRS 4 *Insurance Contracts* were required to apply NZ IFRS 9

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<sup>1</sup> 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).

*Financial Instruments* when NZ IFRS 17 became effective, which is annual periods beginning on or after 1 January 2018. These entities were not permitted to apply the temporary exemption from applying NZ IFRS 9 (*Applying NZ IFRS 9 Financial Instruments with NZ IFRS 4 Insurance Contracts (Amendments to NZ IFRS 4)*). For entities that have already applied NZ IFRS 9 the classification overlay relates only to the redesignation of financial assets derecognised in the comparative period.

- (b) It is possible that there are some entities that have been applying NZ IFRS 4 to insurance contracts, but which are not general insurers or life insurers within the scope of Appendices C and D of NZ IFRS 4. If such entities deferred the application of NZ IFRS 17 and chose to restate comparative information applying NZ IFRS 9, they could apply the classification overlay to financial assets derecognised in the comparative period (and to which NZ IFRS 9 is not applied). If they deferred the application of NZ IFRS 9 and chose not to restate comparative information applying NZ IFRS 9 they could apply the classification overlay to any financial asset in the comparative period.

### **Reasons for amendments**

- 8. The amendments issued by the IASB address a concern raised internationally by some insurers about the usefulness of the comparative information that would be presented for financial assets on initial application of IFRS 17. The concern has arisen because the transition requirements in IFRS 17 and IFRS 9 apply at different dates.
- 9. The amendments (a classification overlay) permit an entity to present comparative information for financial assets as if the classification and measurement requirements in IFRS 9 (rather than IAS 39 for entities that have applied the temporary exemption from IFRS 9) had been applied to those financial assets. This enables an entity to present comparative information about financial assets that is more consistent with the classification and measurement requirements of IFRS 9, which enables insurers to reduce potentially significant accounting mismatches between financial assets and insurance contract liabilities in the comparative period.

### **Key issues**

- 10. All respondents to ED/2021/8 supported the proposals. However, most suggested that the IASB expand the scope of the proposed amendments. Scope suggestions included allowing the proposed amendments to:
  - (a) apply to all financial assets, not just financial assets held in respect of insurance activities; and
  - (b) be used by entities that have already applied IFRS 9.

11. Respondents provided the following rationale for permitting the classification overlay to be applied to financial assets held in respect of an activity unconnected with contracts within the scope of IFRS 17.
  - (a) This would align the scope of the classification overlay with the scope of the temporary exemption from IFRS 9 for insurers (the temporary exemption from IFRS 9 was available for all financial assets).
  - (b) Both the classification overlay and the temporary exemption from IFRS 9 aim to reduce accounting mismatches between financial assets and insurance contract liabilities.
  - (c) The restricted scope would cause operational complexity with no perceived benefit. If entities could apply the classification overlay to all financial assets for which comparatives have not been restated for IFRS 9, they could prepare comparatives in the same way for all financial assets which would significantly reduce operational complexity.
  - (d) The use of the classification overlay can only improve the comparative information presented on initial application of IFRS 9 because it will result in the comparative information being more comparable to the IFRS 9 information presented for the reporting period.
12. After considering respondents' comments, the IASB concluded that the benefits of expanding the availability of the classification overlay would outweigh any perceived costs.
13. Respondents who requested that the classification overlay be made available to insurers that have already applied IFRS 9 explained that those insurers have the same concerns about accounting mismatches in the comparative period relating to derecognised financial assets as insurers that will apply IFRS 17 and IFRS 9 at the same time. Such mismatches could arise because these entities cannot apply paragraph C19 of IFRS 17 (which deals with redesignation of financial assets) to financial assets derecognised in the comparative period.
14. After considering respondents' comments, the IASB agreed to expand the scope of the amendment so that it can also be applied by entities that have applied IFRS 9 before applying IFRS 17, but only in respect of financial assets derecognised in the comparative period.
15. Table 1 summarises the IASB's decisions.

**Table 1 Availability of classification overlay**

Situation	Availability of classification overlay
Entities that apply IFRS 17 and IFRS 9 at the same time and that restate comparative information that choose to restate comparative information applying IFRS 9	Available for financial assets derecognised in the comparative period.
Entities that apply IFRS 17 and IFRS 9 at the same time and that do not restate comparative information applying IFRS 9.	Available for any financial asset in the comparative period.
Entities that have applied IFRS 9 before they apply IFRS 17.	Available for financial assets derecognised in the comparative period.

**RDR concessions**

16. The amending standard establishes a new disclosure requirement. If an entity applies the classification overlay, it is required to disclose that fact. We do not propose an RDR concession for this new disclosure requirement because there are currently no disclosure concessions in NZ IFRS 17 *Insurance Contracts* or AASB 17 *Insurance Contracts*.

**Consistency with Australian Accounting Standards**

17. The Australian Accounting Standards Board (AASB) is expected to approve the equivalent Australian Accounting Standard in February 2022.
18. In 2020 the AASB issued a stand-alone disclosure standard, AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*. Prior to this New Zealand and Australia had equivalent RDR regimes and New Zealand's Tier 1 and Tier 2 for-profit reporting requirements were aligned with those in Australia. The AASB now considers whether to add new disclosure requirements to AASB 1060 on a case-by-case basis. Paragraph BC88(b) of AASB 1060 states that "... AASB 17 *Insurance Contracts* ... is not addressed in this Standard as the majority of entities applying these Standards would have public accountability by holding assets in a fiduciary capacity."

**Due process**

19. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2021/8 and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB's October 2021 meeting.<sup>2</sup>
20. 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.
21. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the amending standard is likely to require the disclosure of personal information. In our view the amending standard does not include requirements that would result in the disclosure of personal information, and therefore no consultation with the Privacy Commissioner is required.

**Draft amending standard and signing memorandum**

22. Attached as agenda item 11.2 is a copy of *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*.
23. Attached as agenda item 11.3 is a draft signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

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<sup>2</sup> A summary of the IASB's October 2021 meeting is available at <https://www.ifs.org/news-and-events/updates/iasb/2021/iasb-update-october-2021/>

**Questions for the Board**

- Q1. Does the Board APPROVE for issue *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*, which amends NZ IFRS 17?
- Q2. Does the Board APPROVE the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board, requesting approval to issue the amending standard?

**PBE Policy Approach**

24. Agenda item 11.4 considers whether there is any need for equivalent amendments to PBE IFRS 17 *Insurance Contracts*.

**Attachments**

- Agenda item 11.2: Draft *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*.
- Agenda item 11.3: Draft signing memorandum
- Agenda item 11.4: Memo: Application of the PBE Policy Approach





## **Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information**

### **Issued January 2022**

This Standard was issued on 13 January 2022 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 2019, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 10 February 2022.

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 *Initial Application of IFRS 17 and IFRS 9—Comparative Information* issued by the International Accounting Standards Board.

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The following is available within New Zealand on the XRB website as additional material
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**APPROVAL BY THE IASB OF *INITIAL APPLICATION OF IFRS 17 AND IFRS 9—  
COMPARATIVE INFORMATION* ISSUED IN DECEMBER 2021**

**AMENDMENTS TO THE BASIS FOR CONCLUSIONS ON IFRS 17 *INSURANCE CONTRACTS***

## Part A – Introduction

This Standard sets out amendments to NZ IFRS 17 *Insurance Contracts*. The amendments will help insurers to avoid temporary accounting mismatches due to different transition requirements in NZ IFRS 17 and NZ IFRS 9 *Financial Instruments*.

Tier 2 entities are required to comply with all the requirements in this Standard.

## Part B – Scope

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

## Part C – Amendments to NZ IFRS 17 *Insurance Contracts*

Paragraphs C2A, C28A–C28E, C33A and the heading before paragraph C28A are added.

For ease of reading these paragraphs have not been underlined. Paragraph C29 is not amended, but is included in grey text for ease of reference.

## Appendix C Effective date and transition

...

### Effective date

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...

C2A *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*, issued in January 2022, added paragraphs C28A–C28E and C33A. An entity that chooses to apply paragraphs C28A–C28E and C33A shall apply them on initial application of NZ IFRS 17.

### Transition

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...

#### Comparative information

...

#### Entities that first apply NZ IFRS 17 and NZ IFRS 9 at the same time

C28A An entity that first applies NZ IFRS 17 and NZ IFRS 9 at the same time is permitted to apply paragraphs C28B–C28E (classification overlay) for the purpose of presenting comparative information about a financial asset if the comparative information for that financial asset has not been restated for NZ IFRS 9. Comparative information for a financial asset will not be restated for NZ IFRS 9 if either the entity chooses not to restate prior periods (see paragraph 7.2.15 of NZ IFRS 9), or the entity restates prior periods but the financial asset has been derecognised during those prior periods (see paragraph 7.2.1 of NZ IFRS 9).

C28B An entity applying the classification overlay to a financial asset shall present comparative information as if the classification and measurement requirements of NZ IFRS 9 had been applied to that financial asset. The entity shall use reasonable and supportable information available at the transition date (see paragraph C2(b)) to determine how the entity expects the financial asset would be classified and measured on initial application

of NZ IFRS 9 (for example, an entity might use preliminary assessments performed to prepare for the initial application of NZ IFRS 9).

- C28C In applying the classification overlay to a financial asset, an entity is not required to apply the impairment requirements in Section 5.5 of NZ IFRS 9. If, based on the classification determined applying paragraph C28B, the financial asset would be subject to the impairment requirements in Section 5.5 of NZ IFRS 9 but the entity does not apply those requirements in applying the classification overlay, the entity shall continue to present any amount recognised in respect of impairment in the prior period in accordance with NZ IAS 39 *Financial Instruments: Recognition and Measurement*. Otherwise, any such amounts shall be reversed.
- C28D Any difference between the previous carrying amount of a financial asset and the carrying amount at the transition date that results from applying paragraphs C28B–C28C shall be recognised in opening retained earnings (or other component of equity, as appropriate) at the transition date.
- C28E An entity that applies paragraphs C28B–C28D shall:
- (a) disclose qualitative information that enables users of financial statements to understand:
    - (i) the extent to which the classification overlay has been applied (for example, whether it has been applied to all financial assets derecognised in the comparative period);
    - (ii) whether and to what extent the impairment requirements in Section 5.5 of NZ IFRS 9 have been applied (see paragraph C28C);
  - (b) only apply those paragraphs to comparative information for reporting periods between the transition date to NZ IFRS 17 and the date of initial application of NZ IFRS 17 (see paragraphs C2 and C25); and
  - (c) at the date of initial application of NZ IFRS 9, apply the transition requirements in NZ IFRS 9 (see Section 7.2 of NZ IFRS 9).

## Redesignation of financial assets

- C29 At the date of initial application of NZ IFRS 17, an entity that had applied NZ IFRS 9 to annual reporting periods before the initial application of NZ IFRS 17:
- (a) may reassess whether an eligible financial asset meets the condition in paragraph 4.1.2(a) or paragraph 4.1.2A(a) of NZ IFRS 9. A financial asset is eligible only if the financial asset is not held in respect of an activity that is unconnected with contracts within the scope of NZ IFRS 17. Examples of financial assets that would not be eligible for reassessment are financial assets held in respect of banking activities or financial assets held in funds relating to investment contracts that are outside the scope of NZ IFRS 17.
  - (b) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if the condition in paragraph 4.1.5 of NZ IFRS 9 is no longer met because of the application of NZ IFRS 17.
  - (c) may designate a financial asset as measured at fair value through profit or loss if the condition in paragraph 4.1.5 of NZ IFRS 9 is met.
  - (d) may designate an investment in an equity instrument as at fair value through other comprehensive income applying paragraph 5.7.5 of NZ IFRS 9.
  - (e) may revoke its previous designation of an investment in an equity instrument as at fair value through other comprehensive income applying paragraph 5.7.5 of NZ IFRS 9.
- ...
- C33A For a financial asset derecognised between the transition date and date of initial application of NZ IFRS 17, an entity may apply paragraphs C28B–C28E (classification overlay) for the purpose of presenting comparative information as if paragraph C29 had been applied to that asset. Such an entity shall adapt the requirements of paragraphs C28B–C28E so that the classification overlay is based on how the entity expects the financial asset would be designated applying paragraph C29 at the date of initial application of NZ IFRS 17.

## Part D – Effective Date

This Standard shall be applied for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted.

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**Date:** 16 December 2021

**To:** Michele Embling, Chair External Reporting Board

**From:** Carolyn Cordery, Chair NZASB

**Subject:** *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*

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### Introduction<sup>1</sup>

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information* which amends NZ IFRS 17 *Insurance Contracts*.
2. The amendments address a concern raised internationally by some insurers about the usefulness of the comparative information that would be presented for financial assets on initial application of IFRS 17 *Insurance Contracts*. The concern has arisen because the transition requirements in IFRS 17 and IFRS 9 *Financial Instruments* apply at different dates.
3. The amendments issued by the IASB (a transition option referred to as ‘a classification overlay’) permit an entity to present comparative information for financial assets as if the classification and measurement requirements in IFRS 9 (rather than IAS 39 *Financial Instruments: Recognition and Measurement* for entities that have applied the temporary exemption from IFRS 9) had been applied to those financial assets. This enables an entity to present comparative information about financial assets that is more consistent with the classification and measurement requirements of IFRS 9, which enables insurers to reduce potentially significant accounting mismatches between financial assets and insurance contract liabilities in the comparative period.

### Benefits to New Zealand constituents

4. We expect the amendments to have limited impact in New Zealand for the following reasons.
  - (a) Entities applying Appendix C *Life Insurance Entities* and Appendix D *Financial Reporting of Insurance Activities* of NZ IFRS 4 *Insurance Contracts* were required to apply NZ IFRS 9 *Financial Instruments* when it became effective, which was annual periods beginning on or after 1 January 2018. These entities were not permitted to apply the temporary exemption from applying NZ IFRS 9 (*Applying NZ IFRS 9 Financial Instruments with NZ IFRS 4 Insurance Contracts (Amendments to NZ IFRS 4)*).
  - (b) Entities that have already applied NZ IFRS 9 *Financial Instruments* would experience less significant accounting mismatches between financial assets and insurance contract liabilities in the comparative period compared to entities that applied NZ IAS 39 *Financial Instruments: Recognition and Measurement* in the comparative period.

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- (c) It is possible that there are some entities that have been applying NZ IFRS 4 to insurance contracts, but which are not general insurers or life insurers within the scope of Appendices C and D of NZ IFRS 4. However, we are not aware of any such entities.

**Due process**

5. The International Accounting Standards Board (IASB) issued Exposure Draft ED/2021/8 *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information* (ED/2021/8) in July 2021.
6. The NZASB issued the ED for comment in New Zealand around the same time. Constituents were asked to comment directly to the IASB and send a copy of their comments to the NZASB. Comments were due to the IASB on 27 September 2021.
7. The NZASB did not comment on ED/2021/8 and received no comment letters from New Zealand constituents. The IASB received 46 comment letters from its world-wide constituents. The IASB did not receive any comments from New Zealand (or Australian) constituents.
8. All respondents to ED/2021/8 supported the proposals. However, most suggested that the IASB expand the scope of the proposed amendments. Scope suggestions included allowing the proposed amendments to:
  - (a) apply to all financial assets, not just financial assets held in respect of insurance activities; and
  - (b) be used by entities that have already applied IFRS 9.
9. expand the scope by:
  - (a) removing the scope restriction relating to whether a financial asset is held in respect of insurance activities; and
  - (b) expanding the scope to apply for entities that have already applied IFRS 9.
10. After considering respondents’ comments, the IASB agreed to expand the scope of the amendment by removing the scope restriction about financial assets held in respect of insurance activities and to permit limited application by entities that have applied IFRS 9 before applying IFRS 17.
11. Table 1 summarises the IASB’s scope decisions.

**Table 1 Availability of classification overlay**

Situation	Availability of classification overlay
Entities that apply IFRS 17 and IFRS 9 at the same time and that restate comparative information that choose to restate comparative information applying IFRS 9	Available for financial assets derecognised in the comparative period.
Entities that apply IFRS 17 and IFRS 9 at the same time and that do not restate comparative information applying IFRS 9.	Available for any financial asset in the comparative period.
Entities that have applied IFRS 9 before they apply IFRS 17.	Available for financial assets derecognised in the comparative period.



12. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2021/8 and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB's October 2021 meeting.<sup>2</sup>
13. The IASB issued *Initial Application of IFRS 17 and IFRS 9—Comparative Information* in December 2021. An entity that elects to apply the amendments applies them when it first applies IFRS 17.
14. The NZASB has approved *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*. 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.
15. 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**

16. The amending standard is a standard in its own right. The amending standard is identical to *Initial Application of IFRS 17 and IFRS 9—Comparative Information* 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.
17. The amending standard establishes a new disclosure requirement. We do not propose an RDR concession for this new disclosure requirement because there are currently no disclosure concessions in NZ IFRS 17 *Insurance Contracts* or AASB 17 *Insurance Contracts*.
18. The Australian Accounting Standards Board (AASB) is expected to approve the equivalent Australian Accounting Standard in February 2022.
19. In 2020 the AASB issued a stand-alone disclosure standard, AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*. Prior to this New Zealand and Australia had equivalent RDR regimes and New Zealand's Tier 1 and Tier 2 for-profit reporting requirements were aligned with those in Australia. The AASB now considers whether to add new disclosure requirements to AASB 1060 on a case-by-case basis. Paragraph BC88(b) of AASB 1060 states that "... AASB 17 *Insurance Contracts* ... is not addressed in this Standard as the majority of entities applying these Standards would have public accountability by holding assets in a fiduciary capacity."
20. The issue of this amending standard is consistent with all three elements of the Financial Reporting Strategy: it adopts the international standard, retains a harmonised position with

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<sup>2</sup> An update on the IASB meeting in October 2021 is available at <https://www.ifrs.org/news-and-events/updates/iasb/2021/iasb-update-october-2021/>

Australia for Tier 1 for-profit entities and is consistent with the Accounting Standards Framework.

**Effective date**

21. An entity that elects to apply the amendments shall apply them when it first applies NZ IFRS 17. NZ IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2023, with early application permitted.

**Other matters**

22. The NZASB will consider the need for equivalent amendments in PBE IFRS 17 *Insurance Contracts* and issue an exposure draft if it decides such amendments are necessary. Apart from this, there are no other matters relating to the issue of this amending standard that the NZASB considers to be pertinent or that should be drawn to your attention.

**Recommendation**

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

**Attachments**

*Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*

Certificate of determination

Carolyn Cordery  
Chair NZASB

**Date:** 13 December 2021

**To:** NZASB Members

**From:** Joanne Scott and Vanessa Sealy Fisher

**Subject:** **Application of PBE Policy Approach:  
Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information**

### Recommendation<sup>1</sup>

1. We recommend that the Board:
  - (a) CONSIDERS the application of the *Policy Approach to the Development of PBE Standards* (Policy) to *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information*; and
  - (b) AGREES to incorporate one part of these amendments into PBE IFRS 17 *Insurance Contracts* – being to permit use of the classification overlay for financial assets derecognised in the comparative period.

### Background

2. *Initial Application of NZ IFRS 17 and NZ IFRS 9—Comparative Information* amends the transition requirements in NZ IFRS 17 *Insurance Contracts* and permits entities to apply a transition option (referred to as a ‘classification overlay’). The use of the classification overlay is optional and it may be applied on an instrument-by-instrument basis.
3. The next step is to consider whether equivalent amendments should be incorporated into PBE Standards and, if so, when. Table 1 explains when for-profit entities may use the classification overlay and considers which of these situations are relevant for PBEs. It shows that one aspect of the amendments could be relevant for PBEs applying PBE IFRS 17 *Insurance Contracts*.

**Table 1**

For-profit amendments to IFRS 17/NZ IFRS 17	Relevance to PBEs and PBE IFRS 17
<p>Entities that first <b>apply IFRS 17 and IFRS 9 at the same time</b> and that choose to <b>restate</b> comparative information applying IFRS 9 may apply the classification overlay to <b>financial assets derecognised</b> in the comparative period (that is, financial assets to which IFRS 9 is not applied).</p> <p>Entities that first <b>apply IFRS 17 and IFRS 9 at the same time</b> and that <b>do not restate</b> comparative information applying IFRS 9 may apply the</p>	<p>These two uses of the classification overlay are not relevant for PBEs.</p> <p>The temporary exemption was not made available to entities applying PBE IFRS 9 <i>Financial Instruments</i> or PBE IPSAS 41 <i>Financial Instruments</i>.</p> <p>See Appendix A to this memo for more detail.</p>

<sup>1</sup> 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).

For-profit amendments to IFRS 17/NZ IFRS 17	Relevance to PBEs and PBE IFRS 17
<p>classification overlay to <b>any financial asset</b> in the comparative period.</p> <p>Few for-profit entities in New Zealand will be applying NZ IFRS 17 and NZ IFRS 9 at the same time. The temporary exemption to delay the adoption of NZ IFRS 9 was not available to entities applying Appendices C and D of NZ IFRS 4 <i>Insurance Contracts</i>.</p>	
<p>Entities that <b>have applied IFRS 9</b> before they apply IFRS 17 may apply the classification overlay to <b>financial assets derecognised</b> in the comparative period.</p> <p>Most for-profit entities applying NZ IFRS 17 will be in this situation and might want to apply the classification overlay to financial assets derecognised in the comparative period.</p>	<p>This use of the classification overlay could be relevant for PBEs applying PBE IFRS 17.</p>

4. PBE IFRS 17 becomes effective from 1 January 2023. At present the scope of PBE IFRS 17 is limited to not-for-profit entities. We are aware of a small number of not-for-profit entities that are insurers and that will apply PBE IFRS 17. There could be a few others that have insurance contracts.
5. The Board is currently working on a project to expand the scope of PBE IFRS 17 to public sector entities from 1 January 2025 onwards (see agenda item 9). We are aware of a couple of public sector entities that will be required to apply PBE IFRS 17. There could be a few others that have insurance contracts.

#### PBE Policy Approach

6. The PBE Policy Approach contains triggers that prompt consideration of whether to amend PBE Standards. The relevant triggers for this situation are in section 4 *Application of the Development Principle* of the Policy. In this case, the IASB has issued amendments to an existing IFRS Standard (NZ IFRS 17) which the NZASB has included in PBE Standards (subsection 4.2.3). There is no equivalent IPSAS.
7. Paragraphs 36–39 of the Policy set out the matters to be considered. Paragraph 38 notes that the IPSASB’s likely response to the change is less relevant where there is no equivalent IPSAS on the topic. Paragraph 39 notes that PBE Standards based on an NZ IFRS may need to be regularly updated to align with the current equivalent NZ IFRS. Table 2 sets out our thoughts on these matters.

Table 2

<p><b>Are the amendments minor?</b></p> <p>Yes, but useful and urgent for any entity that wants to apply them.</p>
<p><b>Will the IPSASB consider these amendments in an acceptable timeframe?</b></p> <p>No.</p> <p>There is no IPSAS equivalent to IFRS 17 and the IPSASB has no plans to develop a standard dealing with the accounting for insurance contracts. Any PBEs wanting to make use of the classification overlay for financial assets derecognised in the comparative period will need it to be available on adoption of PBE IFRS 17 (ie for 1 January 2023).</p>
<p><b>Will the potential development lead to higher quality financial reporting?</b></p> <p>Yes.</p> <p>Although fewer accounting mismatches are expected for entities that have already adopted the newer financial instruments standards making the classification overlay available for financial assets that have been derecognised in the comparative period could avoid such mismatches and provide more relevant information when PBE IFRS 17 is first adopted.</p>
<p><b>Will the benefits outweigh the costs?</b></p> <p>Yes.</p> <p><i>Relevant to the PBE sector as a whole?</i></p> <p>The amendments are not relevant to the PBE sector as a whole. Nor are all of the amendments relevant to PBEs applying PBE IFRS 17. However, there are strong reasons for maintaining alignment between IFRS 17 and PBE IFRS 17, to the extent possible. Although few PBEs issue insurance contracts, the transactions are similar for the PBE and the for-profit sectors.</p> <p><i>Whether the benefits will outweigh the costs</i></p> <ul style="list-style-type: none"> <li>• The amendments are optional – they do not impose costs on an entity unless it decides that it wants to make use of the classification overlay for financial assets derecognised in the comparative period.</li> <li>• The amendments would be applied only when an entity first adopts PBE IFRS 17, so there would be no ongoing costs.</li> <li>• We have spoken with some practitioners from mid-tier accounting firms who have PBE clients that issue insurance contracts. They have expressed a strong preference for keeping the for-profit and PBE standards aligned as much as possible as this enables a comparison of insurance activities across the sectors.</li> </ul> <p><i>Coherence of the suite of PBE Standards</i></p> <p>The amendments would affect only PBE IFRS 17. There are no consequential amendments to other PBE Standards so the coherence of the suite of PBE Standards would be maintained.</p> <p><i>Impact on mixed groups</i></p> <p>To the extent that PBEs can use the classification overlay this would have a positive impact on mixed groups.</p>
<p><b>RDR</b></p> <p>The amendments introduce a new disclosure requirement – if an entity has applied the amendments, it is required to disclose that fact. There are no RDR concessions in PBE IFRS 17 and, therefore, no RDR concessions for this new disclosure requirement.</p>

8. Because the amendments are relevant for so few entities we suggest issuing a separate Invitation to Comment and ED rather than combining the proposals with other proposals in the forthcoming PBE Omnibus.

**Questions for the Board**

- Q1. Does the Board AGREE to permit use of the classification overlay for financial assets derecognised in the comparative period for entities applying PBE IFRS 17?
- Q2. Does the Board AGREE that the proposals should be in a separate ITC and ED?

**Next steps**

9. If the Board agrees with our recommendation we will draft proposed amendments for approval at the February 2022 meeting.

**Appendix A**

The following table summarises the application of the PBE Policy Approach to other similar amendments accounting for insurance contracts in 2016 and 2020. It explains why those amendments were not incorporated into PBE Standards.

**Previous amendments**

<b>Amendments to NZ IFRS</b>	<b>Application of PBE Policy</b>
<p><i>Applying NZ IFRS 9 Financial Instruments with NZ IFRS 4 Insurance Contracts (Amendments to NZ IFRS 4)</i>                      Issued November 2016</p> <p>These amendments applied only to those Tier 1 and Tier 2 for-profit entities issuing insurance contracts which did not apply NZ IFRS 4 Appendix C or Appendix D.</p> <p>We were not aware of any for-profit entities that made use of this temporary exemption.</p>	<p>In December 2016, the Board agreed that no further work needed to be done on applying the PBE Policy Approach to <i>Applying NZ IFRS 9 with NZ IFRS 4</i>. The reasons given at that time were:</p> <ul style="list-style-type: none"> <li>(a) If a PBE does not early adopt PBE IFRS 9, neither the deferral approach nor the overlay approach in <i>Applying NZ IFRS 9 with NZ IFRS 4</i> are relevant.</li> <li>(b) If a PBE early adopts PBE IFRS 9, the deferral approach in <i>Applying NZ IFRS 9 with NZ IFRS 4</i> is not relevant.</li> <li>(c) If a PBE early adopts PBE IFRS 9, the overlay approach in <i>Applying NZ IFRS 9 with NZ IFRS 4</i> would be relevant only if we expected to develop a new insurance standard for PBEs in the next couple of years.</li> <li>(d) In any case, few PBEs would be expected to be able to make use of amendments equivalent to those in <i>Applying NZ IFRS 9 with NZ IFRS 4</i>.</li> </ul>
<p><i>Extension of the Temporary Exemption from Applying NZ IFRS 9</i>                      Issued August 2020</p>	<p>In August 2020 the Board AGREED that <i>Extension of the Exemption from Applying NZ IFRS 9</i> should not be incorporated into PBE Standards.</p> <p>The reasons given in the memo at that time were:</p> <ul style="list-style-type: none"> <li>(a) The four not-for-profit licensed insurers in New Zealand would be applying either Appendix C or Appendix D of PBE IFRS 4 <i>Insurance Contracts</i>, so the temporary exemption would not be available to them.</li> <li>(b) Staff were unaware of any not-for-profit entities that would be able to apply the temporary exemption. The temporary exemption would be relevant only if an entity (i) issued insurance contracts but did not apply PBE IFRS 4 Appendices C and D and (ii) had early adopted the newer financial instrument standards.</li> <li>(c) As noted by the IASB, applying IFRS 9 results in the reporting of better financial information than using the exemption.</li> </ul>

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**Date:** 3 December 2021  
**To:** NZASB Members  
**From:** Joanne Scott  
**Subject:** Editorial corrections

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## Recommendation

1. We recommend that the Board:
  - (a) APPROVES editorial corrections to NZ IFRS (see agenda item 12.2);
  - (b) APPROVES editorial corrections to PBE Standards (see agenda item 12.3); and
  - (c) APPROVES editorial corrections to NZASB documents to reflect changes to legislative size thresholds (see agenda item 12.4).

## Background

2. Each year we check whether any editorial corrections are required to standards issued by the NZASB. Editorial corrections are approved by the Board and notified on the website.

## NZ IFRS

3. The IASB has issued one editorial correction this year. In October 2021 the IASB issued an editorial correction to paragraph 5 of IAS 34 *Interim Financial Reporting*. That paragraph was recently amended by *Disclosure of Accounting Policies*. The word ‘comprising’ was inadvertently deleted and has now been added back. We need to make the following editorial correction to NZ IAS 34 *Interim Financial Reporting*).

## Content of an interim financial report

5. NZ IAS 1 defines a complete set of financial statements as including the following components:
  - (a) ...
  - (e) notes, comprising material accounting policy information and other explanatory information;
  - (ea) ....
4. The editorial corrections also add footnotes to two standards to help constituents understand why some paragraphs differ from the equivalent paragraphs in the Red Book of IFRS Standards. The two standards are NZ IFRS 10 *Consolidated Financial Statements* and NZ IAS 28 *Investments in Associates and Joint Ventures*.
5. The reason for the differences stems from an amending standard issued in 2014 – *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28). The IASB subsequently deferred these amendments indefinitely. The NZASB issued those amendments in 2014 but has since deferred the effective date until



1 January 2025. The IASB has compiled the amendments in the Red Book but the amendments are not shown in the versions of NZ IFRS 10 and NZ IAS 28 on the XRB website. The standards already include an explanation about the deferral of the amendments but we think more signposting from the affected paragraphs to the explanation would be helpful.

**Question for the Board**

Q1 Does the Board APPROVE the editorial corrections to NZ IFRS (see agenda item 12.2)?

**PBE Standards**

6. Staff considered the following when drafting the editorial corrections to PBE Standards.
  - (a) IPSASB Handbook editorial corrections (issued February 2020). A number of these corrections are relevant for PBE Standards. These were inadvertently omitted from the February 2021 PBE editorial corrections. This was because we had intended to address them at the same time as some other IPSASB amendments which were subsequently delayed.
  - (b) IPSASB Handbook editorial corrections (issued August 2020). These did not require any change at this time. There are a couple which we have noted as needing to be picked up when we develop a PBE Standard based on IPSAS 42 *Social Benefits*.
  - (c) IPSASB Handbook editorials (issued March 2021). These did not require any change at this time. There is one item to be considered when we develop a PBE Standard based on IPSAS 42 *Social Benefits*.
  - (d) New-Zealand specific corrections identified by constituents and staff.
7. The editorial corrections to PBE Standards are set out in agenda item 12.3.

**Question for the Board**

Q2 Does the Board APPROVE the editorial corrections to PBE Standards (see agenda item 12.3)?

**Financial Reporting (Inflation Adjustments) Regulations 2021**

8. The Government recently updated various legislative size thresholds which determine financial reporting and assurance requirements. *Financial Reporting (Inflation Adjustments) Regulations 2021* ([link](#)) was issued in October 2021 and takes effect from 1 January 2022. Appendix 1 to this memo outlines the changes and how those thresholds are used. Appendix 2 shows the text of the amended enactments.
9. Three documents issued by the **XRB Board** refer to these size thresholds. We are seeking approval from the XRB Board of editorial corrections to the following.
  - (a) XRB A1 *Application of the Accounting Standards Framework*
  - (b) XRB A2 *Meaning of Specified Statutory Size Thresholds*
  - (c) EG A1 *Guide to Application of the Accounting Standards Framework*

10. Three explanatory guides issued by the **NZASB** refer to these size thresholds. We are seeking approval from the NZASB of editorial corrections to the following.
  - (a) EG A4 *Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Cash (Public Sector)*
  - (b) EG A6 *Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Cash (Not-for-profit)*
  - (c) EG A8 *Financial Reporting by Not-for-profit Entities: The Reporting Entity*
11. Staff are also reviewing standards and explanatory guides issued by the **NZAuASB** and will advise the NZAuASB accordingly. Minor changes to some guides are expected.

*Size criteria established by the XRB Board*

12. The XRB Board has also established other size-based criteria which determine financial reporting requirements. Some of these were established after considering the \$30 million criterion referred to in section 45 of the Financial Reporting Act 2013.
  - (a) A for-profit public sector entity is required to report in accordance with the Tier 1 For-profit Accounting Requirements if it has public accountability *or is large*. Large is defined as total expenses over \$30 million.
  - (b) A PBE is required to report in accordance with the Tier 1 PBE Accounting Requirements if it has public accountability *or is large*. Large is defined as total expenses over \$30 million.
  - (c) A PBE may elect to report in accordance with the Tier 2 PBE Accounting Requirements if its total expenses are less than or equal to \$30 million.
  - (d) A PBE may elect to report in accordance with the Tier 3 PBE Accounting Requirements if its total expenses are less than or equal to \$2 million.
13. The Basis for Conclusions on XRB A1 (paragraph BC33) states that the Board will “keep under review all size-based tier criteria and adjust the size thresholds for inflation periodically.”
14. The Financial Reporting Act 2013 (sections 29 to 33) specifies requirements for varying the strategy for tiers of financial reporting. Any changes to the tier criteria established by the XRB Board would require formal due process, including an exposure draft. The XRB Board may wish to initiate a project to review these size criteria. The timing of any such review is for the XRB Board to decide.

**Question for the Board**

- Q3 Does the NZASB APPROVE the editorial corrections to documents issued by the NZASB for recent changes to legislative size thresholds (see Table 2 of agenda item 12.4)?

### Next steps

15. We will put a copy of the corrections on the website and update the documents concerned. The revised documents, including the editorial corrections, will be reloaded in February 2022.

### *Next PBE omnibus project*

16. This section is for the Board's information.
17. Relatively minor issues are often collated into an omnibus ED. Staff intend to bring the following minor PBE issues to the Board early next year and seek approval to issue an ED.
  - (a) *Improvements to IPSAS, 2021* (expected to be published early 2022).
  - (b) Amendments to Appendix A of PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* which deals with changes in existing decommissioning, restoration and similar liabilities. The amendments would clarify that the Appendix applies to related assets *that are property, plant and equipment* and align the revaluation requirements for such assets with PBE IPSAS 17. This issue was raised by a constituent.
  - (c) Amendments to PBE IAS 12 to incorporate amendments equivalent to *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* (issued by the IASB in May 2021).
  - (d) Amendments to PBE IPSAS 5 *Borrowing Costs* to incorporate amendments equivalent to *Amendments to IPSAS 5, Borrowing Costs – Non-Authoritative Guidance* (issued by the IPSASB in November 2021).

### Attachments

- 12.2 Editorial corrections to NZ IFRS
- 12.3 Editorial corrections to PBE Standards
- 12.4 Editorial corrections: *Financial Reporting (Inflation Adjustments) Regulations 2021*

**Appendix 1**

This Appendix outlines changes to legislative size thresholds and how those thresholds are used.<sup>1 2</sup>

Financial Reporting Act 2013	As at 2021	Adjusted
<p><b>S45 Meaning of large</b></p> <p>Section 45(1) of the Financial Reporting Act 1993 defines the meaning of large for an entity (other than an overseas company or a subsidiary of an overseas company) for the purposes of enactments that refer to that section. The section defines large by reference to the total assets and total revenue of the entity and its subsidiaries.</p> <p>We have identified the following enactments that refer to section 45(1).</p> <ul style="list-style-type: none"> <li>• Section 198 of the Companies Act 1993 defines a <i>large company</i>. Sections 200–202 of that Act establish financial reporting requirements for large companies. Sections 206 and 207 of that Act establish audit requirements for large companies.</li> <li>• Section 8C of the Industrial and Provident Societies Act 1908 defines a <i>large registered society</i>. Section 8D of that Act establishes financial reporting requirements for large registered societies. Section 8K of that Act permits certain societies which are not large to opt out of preparation and audit requirements. Section 8L of that Act permits certain large societies to opt out of audit requirements.</li> <li>• Section 58 of the Partnership Law Act 2019 defines a <i>large partnership</i>. Sections 59–61 of that Act establish financial reporting and audit requirements for large partnerships and section 64 of that Act permits certain large partnerships to opt out of audit requirements.</li> <li>• Section 75 of the Limited Partnerships Act 2008 defines a <i>large limited partnership</i>. Sections 75–75C of that Act establish financial reporting and audit requirements for large limited partnerships. Section 75G of that Act permits certain large limited partnerships to opt out of audit requirements.</li> <li>• The Incorporated Societies Bill (clause 98) proposes to establish audit requirements by reference to the definition of large in section 45.</li> </ul>	<p>\$60 million assets \$30 million revenue</p>	<p>\$66 million assets \$33 million revenue</p>
<p>Section 45(2) of the Financial Reporting Act 1993 defines the meaning of large for an overseas company or a subsidiary of an overseas company for the purposes of enactments that refer to that section. The section defines large by reference to the total assets and total revenue of the entity and its subsidiaries.</p> <p>We have identified the following enactment that refers to section 45(2).</p> <ul style="list-style-type: none"> <li>• Section 198 of the Companies Act 1993 defines a <i>large overseas company</i>. Sections 206 and 207 of that Act establish audit requirements for large overseas companies. Section 340A of that</li> </ul>	<p>\$20 million assets \$10 million revenue</p>	<p>\$22 million assets \$11 million revenue</p>

<sup>1</sup> There may be other enactments that refer to sections 45 and 46 of the Financial Reporting Act 2013. There may also be other requirements (such as filing requirements) which are based on these size thresholds.

<sup>2</sup> The Te Ture Whenua Māori Act 1993 also includes a size threshold for large Māori Incorporations (total revenue > \$10 million). The Regulations do not change that size threshold.

<p>Act establishes financial reporting requirements for large overseas companies.</p>		
<p><b>S46 Meaning of specified not-for-profit entity</b></p> <p>Section 46 of the Financial Reporting Act 1993 defines the meaning of a specified not-for-profit entity for the purposes of enactments that refer to that section. It defines such entities by reference to the total operating payments of the entity.</p> <p>We have identified the following enactments that refer to the definition of specified not-for-profit entity in section 46.</p> <ul style="list-style-type: none"> <li>• Section 42A of the Charities Act 2005 defines a specified not-for-profit entity. Section 42A of that Act establishes financial reporting requirements for entities that are, and are not, specified not-for-profit entities. The total operating payments criterion effectively creates the cut-off point between Tiers 3 and 4. Specified not-for-profit entities cannot apply Tier 4.</li> <li>• Sections 62 of the Friendly Societies and Credit Unions Act 1982 defines a specified not-for-profit entity. Section 63 of that Act establishes financial reporting requirements for entities that are, and are not, specified not-for-profit entities. Section 64A of that Act establishes obligations for the appointment of auditors which differentiate between entities that are, and are not, specified not-for-profit entities.</li> <li>• Section 12 of the Agricultural and Pastoral Societies Act 1908 defines a specified not-for-profit entity. Section 12 of that Act also establishes financial reporting requirements for entities that are, and are not, specified not-for-profit entities.</li> <li>• Section 2 of the Burial and Cremation Act 1964 defines a specified not-for-profit entity. Section 29A of that Act establishes financial reporting requirements for entities that are, and are not, specified not-for-profit entities.</li> <li>• Section 6 of the Māori Purposes Fund Act 1934–35 defines a specified not-for-profit entity. Section 6 of that Act also establishes financial reporting requirements for entities that are, and are not, specified not-for-profit entities.</li> <li>• Section 2 of the Patriotic and Canteen Funds Act 1947 defines a specified not-for-profit entity. Section 40A of that Act establishes financial reporting requirements for entities that are, and are not, specified not-for-profit entities.</li> <li>• Section 2 of the Reserves Act 1977 defines a specified not-for-profit entity. Sections 39B and 88 of that Act establish financial reporting requirements for entities that are, and are not, specified not-for-profit entities.</li> <li>• Section 10 of the Reserves and Other Lands Disposal Act 1995 defines a specified not-for-profit entity. Section 10 also establishes financial reporting requirements for Ngati Whakaue Education Endowment Trust Board if it is, or is not, a specified not-for-profit entity.</li> <li>• The Incorporated Societies Bill (clause 96) proposed to define a specified not-for-profit entity. Clause 95 proposed to establish financial reporting requirements for entities that are, and are not, specified not-for-profit entities.</li> </ul>	<p>\$125,000 total operating payments</p>	<p>\$140,000 total operating payments</p>

<b>Charities Act 2005</b>	<b>As at 2021</b>	<b>Adjusted</b>
<p><b>42D Meaning of large and medium size</b></p> <p>Section 42D of the Charities Act 2005 defines the meaning of large and medium size charitable entities for the purposes of section 42C of that Act. Section 42C of that Act specifies when financial statements must be audited or reviewed.</p> <p>At present, charitable entities that have operating expenditure between \$500,000 to \$1 million can choose between an audit or a review. Charitable entities that have operating expenditure below \$500,000 do not have any assurance requirements.</p>	<p>\$500,000</p> <p>\$1 million</p> <p>total operating expenditure</p>	<p>\$550,000</p> <p>\$1.1 million</p> <p>total operating expenditure</p>
<b>Companies Act 1993</b>	<b>As at 2021</b>	<b>Adjusted</b>
<p><b>204 Financial statements for overseas company must include financial statements for large New Zealand business</b></p> <p>Section 204 establishes requirements for overseas companies to prepare financial statements or group financial statements for a large New Zealand business.</p> <p>The section defines large by reference to the total assets and total revenue of the New Zealand business.</p>	<p>\$20 million</p> <p>assets</p> <p>\$10 million</p> <p>revenue</p>	<p>\$22 million</p> <p>assets</p> <p>\$11 million</p> <p>revenue</p>
<b>Friendly Societies and Credit Unions Act 1982</b>	<b>As at 2021</b>	<b>Adjusted</b>
<p><b>64 Registered society or branch may opt out</b></p> <p>Section 64 permits certain registered societies or branches with operating expenditure below a certain amount to opt out of compliance with section 63 (which establishes requirements to prepare financial statements).</p>	<p>\$30 million</p> <p>total operating expenditure</p>	<p>\$33 million</p> <p>total operating expenditure</p>

## Appendix 2

This Appendix shows the sections amended by the *Financial Reporting (Inflation Adjustments) Regulations 2021*.

### Financial Reporting Act 2013

#### 45 Meaning of large

- (1) For the purposes of an enactment that refers to this section, an entity (other than an overseas company or a subsidiary of an overseas company) is **large** in respect of an accounting period if at least 1 of the following paragraphs applies:
- (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed \$66 million ~~\$60 million~~;
  - (b) in each of the 2 preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds \$33 million ~~\$30 million~~.

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#### Example

ABC Limited has an accounting period of 1 April 2014 to 31 March 2015.

The balance dates of the 2 preceding periods are 31 March 2013 and 31 March 2014. As at 31 March 2013, ABC Limited and its subsidiaries had total assets of \$50 million. As at 31 March 2014, those total assets were \$55 million.

During the period 1 April 2012 to 31 March 2013, ABC Limited and its subsidiaries had total revenue of \$25 million. During the period 1 April 2013 to 31 March 2014, that total revenue was \$35 million. Given that the \$33 million ~~\$30 million~~ threshold in paragraph (b) is crossed in only 1 of those preceding periods, paragraph (b) is not satisfied.

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ABC Limited is not a large company in relation to the accounting period of 1 April 2014 to 31 March 2015.

- (2) For the purposes of an enactment that refers to this section, an overseas company or a subsidiary of an overseas company is **large** in respect of an accounting period if at least 1 of the following paragraphs applies:
- (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed \$22 million ~~\$20 million~~;
  - (b) in each of the 2 preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds \$11 million ~~\$10 million~~.
- (3) Despite subsections (1) and (2), an entity is not large in respect of an accounting period (**period A**) if—
- (a) the entity was an inactive entity in respect of period A; and
  - (b) the entity, within 5 months after the end of period A, delivers to the Registrar a declaration, in the prescribed form, stating that it was an inactive entity in respect of period A.
- (4) In subsection (3), an entity is an **inactive entity** in respect of an accounting period if,—
- (a) during that period, the entity—
    - (i) has not derived, or been deemed to have derived, any income; and
    - (ii) has no expenses; and
    - (iii) has not disposed of, or been deemed to have disposed of, any assets; and
  - (b) at the end of that period, the entity has no subsidiaries or all of its subsidiaries are inactive entities in respect of that period.
- (5) In determining whether an entity is an inactive entity, no account may be taken of any—
- (a) statutory company filing fees or associated accounting or other costs; or

- (b) bank charges or other minimal administration costs totalling not more than \$50 in the accounting period; or
- (c) interest earned on any bank account during the accounting period, to the extent that the total interest does not exceed the total of any charges or costs incurred by the entity to which paragraph (b) applies.

**46 Meaning of specified not-for-profit entity**

For the purposes of an enactment that refers to this section, an entity is a **specified not-for-profit entity** in respect of an accounting period if, in each of the 2 preceding accounting periods of the entity, the total operating payments of the entity are \$140,000 ~~\$125,000~~ or more.

**Charities Act 2005**

**42D Meaning of large and medium size**

- (1) In section 42C,—
  - (a) a charitable entity is **large** in respect of an accounting period if, in each of the 2 preceding accounting periods of the entity, the total operating expenditure of the entity and all entities it controls (if any) is \$1.1 million ~~\$1 million~~ or more:
  - (b) a charitable entity is of **medium size** in respect of an accounting period if—
    - (i) it is not large under paragraph (a); and
    - (ii) in each of the 2 preceding accounting periods of the entity, the total operating expenditure of the entity and all entities it controls (if any) is \$550,000 ~~\$500,000~~ or more:
  - (c) **qualified auditor** has the same meaning as in section 35 of the Financial Reporting Act 2013.
- (2) A financial reporting standard (within the meaning of the Financial Reporting Act 2013), or a part of such a standard, that is expressed as applying for the purposes of subsection (1)(a) or (b) must be applied in determining whether that provision applies (for example, the standard may define operating expenditure or control).

**Companies Act 1993**

**204 Financial statements for overseas company must include financial statements for large New Zealand business**

- (1) If an overseas company is required to prepare financial statements under section 201 and its New Zealand business is large, the financial statements that are prepared must include, in addition to the financial statements of the overseas company, financial statements for its New Zealand business prepared as if that business were conducted by a company formed and registered in New Zealand.
- (2) If an overseas company is required to prepare group financial statements under section 202 and the group's New Zealand business is large, the group financial statements that are prepared must include, in addition to the financial statements of the group, financial statements for the group's New Zealand business prepared as if the members of the group were companies formed and registered in New Zealand.
- (3) In this section, the New Zealand business or the group's New Zealand business is **large** in respect of an accounting period if at least 1 of the following paragraphs applies (calculated as if that business were an entity):
  - (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the business exceed \$22 million ~~\$20 million~~;
  - (b) in each of the 2 preceding accounting periods, the total revenue of the business exceeds \$11 million ~~\$10 million~~.



- (4) A financial reporting standard (or a part of a standard) issued by the External Reporting Board that is expressed as applying for the purposes of subsection (3) must be applied in determining whether that provision applies.
- (5) If an overseas company has been granted an exemption under section 207L from a requirement to prepare financial statements under section 201 or group financial statements under section 202, subsection (1) or (2) (as the case may be) still applies (except that the financial statements for the New Zealand business are not in addition to the financial statements of the overseas company or its group).

#### **Friendly Societies and Credit Unions Act 1982**

##### **64 Registered society or branch may opt out**

- (1) This section applies to a registered society or branch that would, but for this section, be required to comply with section 63 unless the rules of the society or branch expressly provide that this section does not apply.
- (2) However, this section does not apply to a registered society or branch in respect of a financial year if, in each of the 2 preceding financial years, the total operating expenditure of the society or branch is \$33 million ~~\$30 million~~ or more.
- (3) The members of a registered society or branch may, at a meeting of the society or branch held within 6 months from the start of a financial year, opt out of compliance with section 63 in relation to that financial year by way of a resolution of a majority of the members of the registered society or branch.
- (4) If the members opt out of compliance with section 63 in relation to a financial year under this section, the section does not apply to the society or branch in relation to that financial year.
- (5) A financial reporting standard (or a part of a standard) issued by the External Reporting Board that is expressed as applying for the purposes of this section must be applied in determining whether subsection (2) applies.

**Editorial corrections to NZ IFRS**

Date posted: December 2021

Editorial corrections revise minor inaccuracies, including misspellings and numbering or grammatical mistakes. New text is underlined and deleted text is struck through.

Standard	Correction
NZ IFRS 10 <i>Consolidated Financial Statements</i>	<p>Add footnotes to paragraphs 25, 26 and B99A as shown.</p> <p style="text-align: center;"><b>Loss of control</b></p> <p>25 If a parent loses control of a subsidiary, the parent:</p> <p style="margin-left: 20px;">(a) derecognises ...</p> <p style="margin-left: 20px;">(b) recognises ...</p> <p style="margin-left: 20px;">(c) recognises ... .*</p> <p>26 Paragraphs B97–B99 set out guidance for the accounting for the loss of control.**</p> <p>...</p> <p>B99A <i>[This paragraph relates to amendments that are not yet effective, and is therefore not included in this Standard.]***</i></p> <p style="margin-left: 20px;">* See the footnote to paragraph C1C.</p> <p style="margin-left: 20px;">** See the footnote to paragraph C1C.</p> <p style="margin-left: 20px;">*** See the footnote to paragraph C1C.</p> <p>Source: domestic</p>
NZ IAS 28 <i>Investments in Associates and Joint Ventures</i>	<p>Add footnotes to paragraphs 28, 30 and 31A–31B as shown.</p> <p>28 Gains and losses...*</p> <p>...</p> <p>30 The contribution of ...**</p> <p>31A–31B <i>[These paragraphs relate to amendments that are not yet effective, and are therefore not included in this Standard.]***</i></p> <p style="margin-left: 20px;">* See the footnote to paragraph 45C.</p> <p style="margin-left: 20px;">** See the footnote to paragraph 45C.</p> <p style="margin-left: 20px;">*** See the footnote to paragraph 45C.</p> <p>Source: domestic</p>
NZ IAS 34 <i>Interim Financial Reporting</i>	<p>5 NZ IAS 1 defines a complete set of financial statements as including the following components:</p> <p style="margin-left: 20px;">(a) ...</p> <p style="margin-left: 20px;">(e) notes, <u>comprising</u> material accounting policy information and other explanatory information;</p> <p style="margin-left: 20px;">(ea) ....</p> <p>Source: IASB editorial corrections, October 2021</p>

## Editorial corrections to PBE Standards

Date posted: December 2021

Editorial corrections revise minor inaccuracies, including misspellings and numbering or grammatical mistakes. New text is underlined and deleted text is struck through.

Standard	Correction
PBE IPSAS 13 <i>Leases</i>	<p>12. The classification of leases adopted in this Standard is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of <del>(a)</del> losses from idle capacity, technological obsolescence, or <del>(b)</del> changes in value because of changing economic conditions. ...</p> <p>Source: IPSASB 2019 Handbook editorial corrections (issued Feb 2020)</p>
PBE IPSAS 22 <i>Disclosure of Financial Information about the General Government Sector</i>	<p>Cover page</p> <ul style="list-style-type: none"> <li>• PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 22 DISCLOSURE OF <u>FINANCIAL</u> INFORMATION ABOUT THE GENERAL GOVERNMENT SECTOR (PBE IPSAS 22)</li> </ul> <p>Copyright page</p> <ul style="list-style-type: none"> <li>• PBE IPSAS 22 DISCLOSURE OF <u>FINANCIAL</u> INFORMATION ABOUT THE GENERAL GOVERNMENT SECTOR</li> </ul> <p>Source: Domestic correction</p>
PBE IPSAS 23 <i>Revenue from Non-Exchange Transactions</i>	<p>72. In some jurisdictions, the government uses the tax system as a convenient method of paying to taxpayers benefits that would otherwise be paid using another payment method, such as writing a <u>cheque</u> <del>check</del>, directly depositing the amount in a taxpayer's bank account, or settling another account on behalf of the taxpayer. For example, a government may pay part of residents' health insurance premiums, to encourage the uptake of such insurance, either by reducing the individual's tax liability, making a payment by <u>cheque</u> <del>check</del>, or by paying an amount ...</p> <p>Source: Domestic correction</p>
PBE IPSAS 26 <i>Impairment of Cash-Generating Assets</i>	<p>In the text above paragraphs IG17–IG18:</p> <p><b>Reversal of an Impairment Loss</b></p> <p><i>This Example relies on the data for Government R as presented in <u>paragraphs IG9 to IG16</u> <del>Example 2</del>, with supplementary information provided in this Example. In this Example, tax effects are ignored.</i></p> <p><i>Background</i></p> <p>IG17. By 20X6 some competitors have closed down power plants and this has meant that the negative impact on the revenues of Government R has been less than projected at the end of 2004. This favourable change requires the government to re-estimate the recoverable amount of the power plant.</p> <p>IG18. Calculations similar to those in Example 2 show that the recoverable amount of the power plant is now CU157.7 million.</p> <p>Source: IPSASB 2019 Handbook editorial corrections (issued Feb 2020)</p>

Standard	Correction												
<p>PBE IPSAS 27 <i>Agriculture</i></p>	<p>In the first Illustrative Example “Disclosure Requirements” in the Statement of Financial Position change the footnote:</p> <ul style="list-style-type: none"> <li>• Dairy livestock – mature<sup>42</sup></li> </ul> <p>In the first Illustrative Example “Disclosure Requirements” in the Statement of Comprehensive Revenue and Expense, add a subtotal line above ‘558,170’ as shown:</p> <ul style="list-style-type: none"> <li>• <table style="margin-left: 40px; border-collapse: collapse;"> <tr> <td style="border-top: 1px solid black; width: 100px;"></td> <td style="text-align: right; border-top: 1px solid black;">558,170</td> </tr> </table></li> </ul> <p>In the first Illustrative Example “Disclosure Requirements”, in footnote 5 to the Cash Flow Statement change the footnote reference:</p> <ul style="list-style-type: none"> <li>• <sup>5</sup> See Footnote <del>43</del>.</li> </ul> <p>Source: IPSASB 2019 Handbook editorial corrections (issued Feb 2020)</p>		558,170										
	558,170												
<p>PBE IPSAS 31 <i>Intangible Assets</i></p>	<p><b>Revaluation Model</b></p> <p>74. <b>After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation <u>and any subsequent accumulated impairment losses</u>. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market. Revaluations shall be made with such regularity that at the reporting date the carrying amount of the asset does not differ materially from its fair value.</b></p> <p>In footnotes 5 and 6 (in the table following paragraph IE22) change the footnote references:</p> <ul style="list-style-type: none"> <li>• <sup>5</sup> See Footnote <del>43</del>.</li> <li>• <sup>6</sup> See Footnote <del>43</del>.</li> </ul> <p>Source: IPSASB 2019 Handbook editorial corrections (issued Feb 2020)</p>												
<p>PBE IPSAS 32 <i>Service Concession Arrangements: Grantor</i></p>	<p>IE15. The grantor’s accounting policy for property, plant and equipment is to recognise such assets using the cost model specified in PBE IPSAS 17.</p> <p><b>Exhibit 1: Fair Values of the Components of the Arrangement (Currency Units)</b></p> <table border="1" style="margin-left: 40px; border-collapse: collapse; width: 60%;"> <thead> <tr> <th style="text-align: center;"><u>Arrangement <del>Contact</del> Component</u></th> <th style="text-align: center;">Fair Value</th> </tr> </thead> <tbody> <tr> <td>Road – base layers</td> <td style="text-align: right;">940</td> </tr> <tr> <td>Road – original surface layers</td> <td style="text-align: right;">110</td> </tr> <tr> <td>Total FV of road</td> <td style="text-align: right;">1,050</td> </tr> <tr> <td>Annual service component</td> <td style="text-align: right;">12</td> </tr> <tr> <td>Effective interest rate</td> <td style="text-align: right;">6.18%</td> </tr> </tbody> </table> <p>IE29. The grantor’s cash flows, statement of comprehensive revenue and expense, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 2.1 to 2.3. In addition, Table <del>2.3</del> <del>2.4</del> shows the changes in the liability.</p> <p>IE30. Because there are no payments made to the operator, there are no cash flow impacts for this example.</p> <p><b>Table <del>2.1</del> <del>2.2</del> Statement of Comprehensive Revenue and Expense (Currency Units)</b></p> <p><b>Table <del>2.2</del> <del>2.3</del> Statement of Financial Position (Currency Units)</b></p> <p><b>Table <del>2.3</del> <del>2.4</del> Changes in Liability (Currency Units)</b></p> <p>Source: IPSASB 2019 Handbook editorial corrections (issued Feb 2020)</p>	<u>Arrangement <del>Contact</del> Component</u>	Fair Value	Road – base layers	940	Road – original surface layers	110	Total FV of road	1,050	Annual service component	12	Effective interest rate	6.18%
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Standard	Correction
PBE IPSAS 37 <i>Joint Arrangements</i>	<p>IE63. Municipality E recognises in its financial statements its share of the assets and liabilities resulting from the <u>binding contractual</u> arrangement (see paragraph 23).</p> <p>Source: IPSASB 2019 Handbook editorial corrections (issued Feb 2020)</p>
PBE IPSAS 38 <i>Disclosure of Interests in Other Entities</i>	<p>5A. Except as described in paragraph AG16.1, the requirements in this Standard apply to an entity’s interests listed in paragraph 53 that are classified (or included in a disposal group that is classified) as held for sale or discontinued operations in accordance with PBE IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i>.</p> <p>Source: IPSASB 2019 Handbook editorial corrections (issued Feb 2020)</p>
PBE IPSAS 39 <i>Employee Benefits</i>	<p>Change the heading styles as shown.</p> <p><del><b>Accounting for the Constructive Obligation</b></del>  <u>Accounting for the Constructive Obligation</u></p> <p>63. <b>An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity’s informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity’s informal practices would cause unacceptable damage to its relationship with employees.</b></p> <p><del><b>Statement of Financial Position</b></del>  <u>Statement of Financial Position</u></p> <p>65. <b>An entity shall recognise the net defined benefit liability (asset) in the statement of financial position.</b></p> <p>Source: IPSASB 2019 Handbook editorial corrections (issued Feb 2020)</p>
PBE IPSAS 41 <i>Financial Instruments</i>	<p>In the Table of Contents for the Illustrative Examples, change the heading above Example 23.</p> <p style="padding-left: 40px;">Financial Guarantee (Paragraphs <del>AG118–AG127</del> <u>AG131–AG136</u>)</p> <p>In the Illustrative Examples that accompany PBE IPSAS 41, change the heading above Example 20.</p> <p style="padding-left: 40px;">Concessionary Loans (paragraphs <del>AG118–AG126</del> <u>AG127</u>)</p> <p>Source: Domestic</p>
PBE IFRS 9 <i>Financial Instruments</i>	<p>B5.1.2F Any difference between the fair value of the loan and the transaction price (the loan proceeds) is treated as follows:</p> <p style="padding-left: 40px;">(a) ...</p> <p style="padding-left: 40px;">(b) ...</p> <p style="padding-left: 40px;">Illustrative Examples are provided in paragraph <del>IG54A</del> <u>54</u> of PBE IPSAS 23.</p> <p>Source: Domestic</p>

**Editorial corrections: *Financial Reporting (Inflation Adjustments) Regulations 2021***

Date posted: December 2021

These editorial corrections reflect changes to statutory size thresholds set out in the *Financial Reporting (Inflation Adjustments) Regulations 2021*. The changes to the statutory size thresholds were issued in October 2021 and take effect from 1 January 2022. New text is underlined and deleted text is struck through.

**Table 1: Editorial corrections to standards and guides issued by the XRB Board**

<b>Paragraph</b>	<b>Corrections to XRB A1 <i>Application of the Accounting Standards Framework</i></b>
XRB A1, paragraph 5, footnote 1	<sup>1</sup> Section 46 of the Financial Reporting Act 2013 provides that an entity is a “specified not-for-profit entity” if, in each of the preceding two accounting periods, its total operating payments are <del>\$125,000</del> <u>\$140,000</u> or more. Standard XRB A2 <i>Meaning of Specified Statutory Size Thresholds</i> sets out the meaning for the size threshold of a specified not-for-profit entity.
XRB A1, paragraph BC31	The Board decided to use \$30 million and \$2 million as the size thresholds for Tier 2 and Tier 3 respectively after considering costs and benefits. The Board also noted that \$30 <sup>1</sup> million revenue is used as the definition of large in legislation... <sup>1</sup> <u>The reference to \$30 million revenue is to the definition of large in section 45 of the Financial Reporting Act 2013 which was in effect when XRB A1 was issued.</u>
<b>Paragraph</b>	<b>Corrections to XRB A2 <i>Meaning of Specified Statutory Size Thresholds</i></b>
XRB A2, paragraph 5	Section 45(1) of the Financial Reporting Act 2013 provides that, for the purpose of an enactment that refers to section 45, an entity (other than an overseas company or a subsidiary of an overseas company) is “large” in respect of an accounting period if at least one of the following applies: (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed <del>\$60</del> <u>\$66</u> million; or (b) in each of the 2 preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds <del>\$30</del> <u>\$33</u> million.
XRB A2, paragraph 6	Section 45(2) of the Financial Reporting Act 2013 provides that, for the purpose of an enactment that refers to section 45, an overseas company or a subsidiary of an overseas company is “large” in respect of an accounting period if at least one of the following applies: (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed <del>\$20</del> <u>\$22</u> million; or (b) in each of the 2 preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds <del>\$10</del> <u>\$11</u> million.
XRB A2, paragraph 7	Section 204(3) of the Companies Act 1993 provides that an overseas company’s New Zealand business or the group’s New Zealand business is “large” in respect of an accounting period if at least one of the following applies (calculated as if that business were an entity): (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the business exceed <del>\$20</del> <u>\$22</u> million; or (b) in each of the 2 preceding accounting periods, the total revenue of the business exceeds <del>\$10</del> <u>\$11</u> million.
XRB A2, paragraph 14	Section 46 of the Financial Reporting Act 2013 sets out the meaning of a “specified not-for-profit entity”. For the purposes of an enactment that refers to section 46, an entity is a specified not-for-profit entity in respect of an accounting period if, in each of the 2 preceding accounting periods of the entity, the total operating payments of the entity are <del>\$125,000</del> <u>\$140,000</u> or more.

<p>XRB A2, paragraph 17</p>	<p><b>Friendly Societies and Credit Unions Act 1982: “Large” and the determination of “total operating expenditure”</b></p> <p>Section 64 of the Friendly Societies and Credit Unions Act 1982 allows a registered society or branch to opt out of preparing financial statements in respect of a financial year. However, under section 64(2), a registered society or branch cannot opt out if, in each of the 2 preceding financial years, the total operating expenditure of the society or branch is <del>\$30</del><u>\$33</u> million or more.</p>									
<p>XRB A2, paragraph 23B</p>	<p>For the purposes of section 42C, section 42D of the Charities Act 2005 provides that a charitable entity or a single entity is:</p> <p>(a) large in respect of an accounting period if, in each of the 2 preceding accounting periods of the entity, the total operating expenditure of the entity and all entities it controls (if any) is <del>\$1 million</del> <u>\$1.1 million</u> or more; and</p> <p>(b) medium size if it is not large and in each of the 2 preceding accounting periods of the entity, the total operating expenditure of the entity and all entities it controls (if any) is <del>\$500,000</del> <u>\$550,000</u> or more.</p>									
<p><b>Paragraph</b></p>	<p><b>Corrections to EG A1 Guide to Application of the Accounting Standards Framework</b></p>									
<p>EG A1, paragraph 13</p>	<p>Entities required to comply with GAAP include:</p> <p>...</p> <ul style="list-style-type: none"> <li>• Large companies<sup>8,9</sup> (with total assets of over <del>\$60</del><u>\$66</u> million or total revenue of over <del>\$30</del><u>\$33</u> million in the two preceding reporting periods) under the Companies Act 1993;</li> <li>• Large overseas companies,<sup>9</sup> large subsidiaries of overseas companies and large New Zealand businesses of large overseas companies (with total assets of over <del>\$20</del><u>\$22</u> million or total revenue of over <del>\$10</del><u>\$11</u> million in the two preceding reporting periods) under the Companies Act 1993;</li> <li>• Large registered friendly societies, large registered industrial and provident societies, large partnerships and large limited partnerships (with total assets of over <del>\$60</del><u>\$66</u> million or total revenue of over <del>\$30</del><u>\$33</u> million in the two preceding reporting periods) under their respective governing legislation.</li> </ul>									
<p>EG A1, paragraph 57, Table 2</p>	<p><b>Table 2: Public Benefit Entity Tiers and Requirements</b></p> <table border="1" data-bbox="480 1305 1410 1653"> <thead> <tr> <th data-bbox="480 1305 587 1339">Tier</th> <th data-bbox="587 1305 1046 1339">Tier Criteria</th> <th data-bbox="1046 1305 1410 1339">Standards Set</th> </tr> </thead> <tbody> <tr> <td data-bbox="480 1339 587 1361">...</td> <td data-bbox="587 1339 1046 1361">...</td> <td data-bbox="1046 1339 1410 1361">...</td> </tr> <tr> <td data-bbox="480 1361 587 1653">Tier 4</td> <td data-bbox="587 1361 1046 1653"> <ul style="list-style-type: none"> <li>• Has no public accountability (as defined); and</li> <li>• Has total operating payments of less than <del>\$125,000</del> <u>\$140,000</u> in each of the previous two reporting periods (i.e. not a specified not-for-profit entity); and</li> <li>• Is permitted by an enactment to comply with a non GAAP Standard</li> </ul> <p><i>and elects to be in Tier 4.</i></p> </td> <td data-bbox="1046 1361 1410 1653">PBE SFR-C (PS) or PBE SFR-C (NFP)</td> </tr> </tbody> </table>	Tier	Tier Criteria	Standards Set	...	...	...	Tier 4	<ul style="list-style-type: none"> <li>• Has no public accountability (as defined); and</li> <li>• Has total operating payments of less than <del>\$125,000</del> <u>\$140,000</u> in each of the previous two reporting periods (i.e. not a specified not-for-profit entity); and</li> <li>• Is permitted by an enactment to comply with a non GAAP Standard</li> </ul> <p><i>and elects to be in Tier 4.</i></p>	PBE SFR-C (PS) or PBE SFR-C (NFP)
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<p>EG A1, paragraph 66</p>	<p>Any entity... However, a PBE can only report under Tier 4 if it is not a specified not-for-profit entity (that is, its total operating payments<sup>17</sup> (excluding capital payments) for each of the two preceding accounting periods are <del>\$125,000</del> <u>\$140,000</u> or less) and is permitted by its governing legislation to report in accordance with non-GAAP standards issued by the XRB.</p>									

**Table 2: Editorial corrections to guides issued by the NZASB**

Paragraph	<b>EG A4 Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Cash (Public Sector)</b>											
EG A4, page 16	<p><b>Purpose of the templates</b></p> <p>...</p> <p>The law sets out which entities are eligible to apply the <i>Tier 4 public sector standard</i>. In simple terms, public sector entities that do not have “public accountability” (which in this context has a particular technical meaning i.e., the entity does not issue debt securities) and have total operating <del>payments</del> <del>expenses</del> of less than <del>\$125,000</del> <u>\$140,000</u> can elect to apply this Standard.</p>											
EG A4, page 27 (Table)	<table border="1"> <thead> <tr> <th data-bbox="414 568 520 658">Row</th> <th data-bbox="520 568 671 658">Category</th> <th data-bbox="671 568 783 658">PBE SFR-C PS Ref</th> <th data-bbox="783 568 1423 658">Explanation</th> </tr> </thead> <tbody> <tr> <td data-bbox="414 658 520 1016">R&amp;P11</td> <td data-bbox="520 658 671 1016">Total operating payments*</td> <td data-bbox="671 658 783 1016"><u>2&amp;2.1</u></td> <td data-bbox="783 658 1423 1016">                     Total of rows R&amp;P7 to R&amp;P10.                      ▲ This total determines whether the entity is eligible to and can elect to report in accordance with the <i>Tier 4 public sector standard</i>. If the total operating payments are greater than <del>\$125,000</del> <u>\$140,000</u> for two years in a row the entity will no longer be eligible to report under Tier 4 cash accounting and will have to report in accordance with the <i>Tier 3 public sector Standard</i>.                      ▲ If the entity controls one or more entities the total combined operating payments of the entity and its controlled entities must be less than <del>\$125,000</del> <u>\$140,000</u> for the entities to report under the <i>Tier 4 public sector standard</i>.                 </td> </tr> </tbody> </table>	Row	Category	PBE SFR-C PS Ref	Explanation	R&P11	Total operating payments*	<u>2&amp;2.1</u>	Total of rows R&P7 to R&P10. ▲ This total determines whether the entity is eligible to and can elect to report in accordance with the <i>Tier 4 public sector standard</i> . If the total operating payments are greater than <del>\$125,000</del> <u>\$140,000</u> for two years in a row the entity will no longer be eligible to report under Tier 4 cash accounting and will have to report in accordance with the <i>Tier 3 public sector Standard</i> . ▲ If the entity controls one or more entities the total combined operating payments of the entity and its controlled entities must be less than <del>\$125,000</del> <u>\$140,000</u> for the entities to report under the <i>Tier 4 public sector standard</i> .			
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Paragraph	<b>EG A6 Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Cash (Not-for-profit)</b>											
EG A6, page 21	<p><b>Purpose of the templates</b></p> <p>The templates...</p> <p>The law sets out which entities are eligible to apply the <i>Tier 4 not-for-profit standard</i>. In simple terms, registered charities that do not have “public accountability” (which in this context has a particular technical meaning i.e., the entity does not issue debt or equity securities) and have total operating payments of less than <del>\$125,000</del> <u>\$140,000</u> can elect to apply this Standard. Other not-for-profit entities that meet those criteria can do so voluntarily.</p>											
EG A6, page 35 (Table)	<table border="1"> <thead> <tr> <th data-bbox="414 1388 520 1500">Row</th> <th data-bbox="520 1388 671 1500">Category</th> <th data-bbox="671 1388 783 1500">PBE SFR-C (NFP) Ref</th> <th data-bbox="783 1388 1423 1500">Explanation</th> </tr> </thead> <tbody> <tr> <td data-bbox="414 1500 520 1863">R&amp;P12</td> <td data-bbox="520 1500 671 1863">Total operating payments* ➢ Formula</td> <td data-bbox="671 1500 783 1863"><u>2&amp;2.1</u></td> <td data-bbox="783 1500 1423 1863">                     Total of rows R&amp;P7 to R&amp;P11.                      ▲ This total determines whether the entity is eligible to and can elect to report in accordance with the <i>Tier 4 not-for-profit standard</i>. If the total operating payments are greater than <del>\$125,000</del> <u>\$140,000</u> for two years in a row the entity will no longer be eligible to report under Tier 4 cash accounting and will have to report in accordance with the <i>Tier 3 not-for-profit Standard</i>.                      ▲ If the entity controls one or more entities the total combined operating payments of the entity and its controlled entities must be less than <del>\$125,000</del> <u>\$140,000</u> for the entities to report under the <i>Tier 4 not-for-profit standard</i>.                 </td> </tr> </tbody> </table>	Row	Category	PBE SFR-C (NFP) Ref	Explanation	R&P12	Total operating payments* ➢ Formula	<u>2&amp;2.1</u>	Total of rows R&P7 to R&P11. ▲ This total determines whether the entity is eligible to and can elect to report in accordance with the <i>Tier 4 not-for-profit standard</i> . If the total operating payments are greater than <del>\$125,000</del> <u>\$140,000</u> for two years in a row the entity will no longer be eligible to report under Tier 4 cash accounting and will have to report in accordance with the <i>Tier 3 not-for-profit Standard</i> . ▲ If the entity controls one or more entities the total combined operating payments of the entity and its controlled entities must be less than <del>\$125,000</del> <u>\$140,000</u> for the entities to report under the <i>Tier 4 not-for-profit standard</i> .			
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R&P12	Total operating payments* ➢ Formula	<u>2&amp;2.1</u>	Total of rows R&P7 to R&P11. ▲ This total determines whether the entity is eligible to and can elect to report in accordance with the <i>Tier 4 not-for-profit standard</i> . If the total operating payments are greater than <del>\$125,000</del> <u>\$140,000</u> for two years in a row the entity will no longer be eligible to report under Tier 4 cash accounting and will have to report in accordance with the <i>Tier 3 not-for-profit Standard</i> . ▲ If the entity controls one or more entities the total combined operating payments of the entity and its controlled entities must be less than <del>\$125,000</del> <u>\$140,000</u> for the entities to report under the <i>Tier 4 not-for-profit standard</i> .									



Paragraph	<b>EG A8 Financial Reporting by Not-for-profit Entities: The Reporting Entity</b>
EG A8, paragraph 29, footnote 9	<p>Section 41(2)(b) of the Charities Act 2005 requires the annual return of a charitable entity to be accompanied by a copy of the financial statements<sup>8</sup> and section 42A requires those financial statements to comply with GAAP (for a specified NFP entity)<sup>9</sup> or a non-GAAP standard (for entities other than a specified NFP entity).</p> <p>...</p> <p><sup>9</sup> A specified not-for-profit entity is an entity in respect of an accounting period if, in each of the two preceding accounting periods of the entity, the total operating payments of the entity are <del>\$125,000</del> <u>\$140,000</u> or more (section 46 of the Financial Reporting Act 2013).</p>