Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Board Meeting Agenda

Virtual Meeting — Tuesday, 5 April 2022

Est Time	Item	Topic	Objective		Page
NON-PUBLIC SESSION					
PUBLIC SESSION					
9.40 am	**3**	**Disclosure of Fees Paid to Audit Firms**	(AH)		
60 min	3.1	Cover memo	Consider	Paper	2
	3.2	Draft ED – FRS 44 Amendments	Consider	Paper	25
	3.3	Draft ED – PBE IPSAS 1 Amendments	Consider	Paper	32
10.40 am	Morning tea break				
10.55 am	**4**	**Public Sector Specific Financial Instruments**	(TB)		
35 mins	4.1	Cover memo	Consider	Late Paper	–
	4.2	Draft Invitation to Comment	Approve	Late Paper	–
	4.3	Draft ED	Approve	Late Paper	–
NON-PUBLIC SESSION					
12.30 pm	Lunch break				
PUBLIC SESSION					
1.30 pm	**7**	**IPSASB Conceptual Framework Update**	(GS)		
40 min	7.1	Cover memo	Consider	Paper	39
	7.2	Draft comment letter	Consider	Paper	46
	7.3	IPSASB ED 81	Consider	Link	–
2.10 pm	**8**	**IFRS Interpretations Committee tentative agenda decision *Negative Low Emission Vehicle Credits***	(GS)		
20 min	8.1	Cover memo	Consider	Paper	56
	8.2	Draft comment letter	Approve	Paper	69
2.30 pm	**9**	**PBE Leases**	(GS)		
60 min	9.1	Issues paper: Proposed New Zealand modifications to IPSAS 43	Consider	Paper	71
	9.2	IPSAS 43 *Leases*	Consider	Link	–
3.30 pm	Afternoon tea break				
NON-PUBLIC SESSION					
4.15 pm	*Finish*				

Next NZASB meeting: 12 May 2022 (location – TBC)

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	24 March 2022
To:	NZASB Members
From:	Anthony Heffernan
Subject:	**Disclosure of Fees Paid to Audit Firms**

Introduction[1]

1. The purpose of this memo is to seek Board FEEDBACK on draft proposals to enhance the requirements in domestic accounting standards concerning the disclosure of total fees paid to audit firms in the reporting period.

2. The objective of the amendments is to introduce enhanced fee disclosure requirements to improve the consistency and transparency of information provided to general purpose users concerning the fees paid for a financial statement audit or review engagement and any other services provided by the audit or review firm in the reporting period.

3. The disclosure of total fees paid to the audit or review firm, and an understanding of the nature of the other services provided, is a disclosure of high interest to the users of the financial statements to enable them to make their own assessments about the audit or review firm's independence. Auditor independence is fundamental to maintaining public trust and confidence in New Zealand's external reporting framework.

4. The Financial Markets Authority (FMA) has previously highlighted concerns about the inadequacy of and inconsistencies in financial statement disclosures about fees charged by audit or review firms for other services performed.

5. We note that calls to improve the existing disclosure requirements concerning fees paid to audit firms comes at a time of significant public debate about audit quality in New Zealand and around the world. Questions concerning audit quality include concerns arising from perceived or actual independence threats that can arise from non-audit services being provided by the audit or review firm to their clients.

6. Key to this discussion is the understanding of who we are referring to by the "audit firm". The audit firm is defined in the Code of Ethics as a sole practitioner, partnership or corporation or other entity undertaking the audit or review of the general purpose financial statements. For fee disclosure purposes any reference to the 'audit firm' also includes fees paid to any network firm.

7. We highlight this same memorandum will be considered and discussed at NZASB/NZAuASB Joint Meeting on the day following the NZASB April Meeting. However, we welcome Board feedback on the drafting of the proposed amendments at this meeting.

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

Recommendations

8. Staff recommend that the Board CONSIDERS this memo and provides FEEDBACK on the following draft Exposure Drafts (EDs):

   - *Disclosure of Fees Paid to Audit Firms* (Proposed amendments to FRS-44) — agenda item 3.2; and
   - *Disclosure of Fees Paid to Audit Firms* (Proposed amendments to PBE IPSAS 1) — agenda item 3.3.

9. The proposed draft amendments to FRS 44 *New Zealand Additional Disclosures* (for-profit domestic standard) are provided in a clean format in the memo to support Board review and comment – refer to Appendix 1.

10. We have previously discussed with the Board the introduction of defined disclosure categories and associated fee disclosure requirements. Based on previous Board discussions and recent developments in the professional and ethical standards internationally, we feel there is now a general consensus on the defined fee categories that should be disclosed – refer to Appendix 5.

11. Rather than re-opening the discussion about what specific disclosure categories should be used for audit and non-audit services, we are primarily seeking Board FEEDBACK on two questions at this meeting.

    (a) Does the Board agree that the proposed amendments will promote increased transparency and consistency of the fees paid to audit or review firms in the reporting period?

    (b) Does the Board have any concerns that the cost of implementing the proposed disclosures will outweigh the benefits?

12. At this meeting, we welcome any suggestions on drafting improvements to clarify the differences between each proposed fee category.

Background

13. 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 the quality of disclosures due to actual or perceived concerns about auditor independence.

14. There is a diversity of views in New Zealand and internationally about the types of non-assurance work that should be restricted, and how this should be done. It is generally agreed that an audit or review firm should not undertake any work for an audit client that compromises, or could be seen to compromise, the independence, objectivity, and quality of the audit process.

15. The development of proposed amendments to improve the disclosure of fees paid to an entity's audit or review firm, as discussed in this memo, is not intended to guide the types of

non-assurance services that should be restricted or prohibited. What services an audit or review firm can and cannot provide will continue to be guided by the professional and ethical standards applied by audit practitioners

16. The Code of Ethics for Assurance Practitioners establishes a framework that requires the audit or review firm to identify, evaluate and address threats to independence created when the firm provides, or is asked to provide, other services to an audit or review client. The code provides for different independence considerations dependent on whether the reporting entity is a public interest entity (PIE).

17. The proposed amendments to the accounting standards intend to provide improved information to the users of general purpose financial statements, to allow them to assess the extent to which non-assurance services have been provided by the audit or review firm. The proposed amendments if issued will apply to all for-profit, not-for-profit, and public sector entities that apply Tier 1 and Tier 2 accounting standards as issued by the XRB.

18. Both the New Zealand Accounting Standards Board (NZASB) and the Australian Accounting Standards Board (AASB) have been contemplating changes to audit fee disclosures for some time. The AASB has agreed to propose changes to the existing disclosures requirements but is waiting on other events before finalising those proposals (discussed later in this memo).

19. The NZASB and New Zealand Auditing and Assurance Standards Board (NZAuASB) have discussed this topic at their last two NZASB/NZAuASB Joint Meetings in 2020 and 2021. There was general agreement that enhanced disclosures would be useful, but there were mixed views on the descriptions and definitions of categories for disclosing fees paid to audit or review firms.

20. In December 2021, both the Board and NZAuASB received a memo that provided comprehensive background information on the events, discussions, and key documents that have explored this disclosure topic over the past few years.

21. In December 2021, the Board agreed to commence a project to develop enhanced audit fee disclosure requirements by proposing amendments to its domestic standards for for-profit and public benefit entities.

22. The NZASB had previously agreed to complete this project in conjunction with the AASB, but in December 2021 agreed to move forward and issue proposals ahead of the AASB. This decision was based on the need to respond to calls for improved disclosure from New Zealand constituents and to ensure disclosures supported recent changes to ethical and professional standards in New Zealand.

Structure of this memo

23. The remainder of this memo is set out as follows.

    (a) Existing disclosure requirements in New Zealand

    (b) Harmonisation with Australia

    (c) Rationale for proposing amendments

(d) Recent developments concerning the Code of Ethics for Assurance Practitioners

(e) Proposed amendments to domestic accounting standards

(f) Tier 2 — Reduced disclosure regime

(g) Other potential disclosures

(h) Questions for the Board

Existing disclosure requirements in New Zealand

24. There are no specific audit fee disclosure requirements in IFRS Standards (or IPSAS). The International Accounting Standards Board (IASB) recognises that in many jurisdictions audit fee disclosure requirements are established through local laws and regulations. In New Zealand, we have a long history of reporting entities disclosing audit fees and other fees charged by the audit or review firms. These disclosures are currently established through domestic reporting requirements through domestic standards issued by the XRB.

25. The audit fee disclosures in New Zealand accounting standards and the Companies Act 1993 are shown below. The accounting standards refer to 'all other services' without specifying any further level of detail. However, there is a general requirement to disclose the nature of these other services.

Table 1 Current audit fee disclosure requirements

FRS-44 *New Zealand Additional Disclosures* (Tier 1 and Tier 2 for-profit entities)
*8.1 An entity shall disclose fees to each auditor or reviewer, including any network firm, separately for: (a) the audit or review of the financial statements; and (b) all other services performed during the reporting period. *8.2 For 8.1 (b) above, an entity shall describe the nature of other services.
PBE IPSAS 1 *Presentation of Financial Statements* (Tier 1 and Tier 2 public benefit entities)
*116.1 **An entity shall disclose fees to each auditor or reviewer, including any network firm,[1] separately for:** (a) **the audit or review of the financial statements; and** (b) **all other services performed during the reporting period.** *116.2 **To comply with paragraph 116.1 above, an entity shall describe the nature of other services.** [1] Network firm is discussed in Professional and Ethical Standard (PES) 1 (Revised) *Ethical Standards for Assurance Practitioners.*
Companies Act 1993
211 Contents of annual report (1) Every annual report for a company must be in writing and be dated and, subject to subsection (3), must— …

> (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.

26. There have been calls for reporting entities to provide improved disclosure about the total fees paid to the audit or review firm, by using defined categories of non-audit services. In response to this demand, FMA guidance[2] has shaped recent accounting practice. The categories suggested by the FMA are as follows.

    (a) Audit and review of financial statements.

    (b) Other services

    - Regulatory audit work
    - Other assurance services
    - Tax services
    - Other services.

Harmonisation with Australia

27. The New Zealand Accounting Standards Framework, which forms the basis for developing New Zealand accounting Standards, recognises that the differences between accounting standards issued in Australia and New Zealand for for-profit entities should be minimised wherever possible to reduce the costs for entities operating trans-Tasman.

28. The Australian and New Zealand audit fee disclosures for **Tier 1** entities are currently harmonised.

29. 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. We note that Tier 2 entities in Australia are currently required to apply all disclosure requirements in relation to fees paid to audit firms, but Tier 2 entities in New Zealand are provided with an RDR concession.

30. We note the AASB is working on proposals to require *auditor remuneration* disclosures that intend to achieve the same outcomes as the amendments discussed in this memo. The AASB project is currently in a holding position while the AASB waits for a Federal Government response to the recommendations made by the Australia Joint Committee (PJC) report, *Regulation of Auditing in Australia* (November 2020). The next step in the AASB project is the issuance of an ED, but no expected issuance date has yet been set.

[2] *Disclosure of fees paid to auditors by listed issuers* (FMA, April 2014)

31. The intention remains to continue working closely with the AASB on this project and to seek harmonisation. However, as previously mentioned the Board in December 2021 agreed to move ahead and develop proposed amendments to disclosures on fees paid to audit firms ahead of AASB pronouncements on this topic.

32. Further background information on the AASB Project on *Auditor Remuneration* is provided in Appendix 3.

Rationale for proposing amendments

33. 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 assessments about auditor independence. They also give stakeholders information about the cost of the audit, assurance, and other services provided by the audit firm.

34. Regulators consider that mandatory disclosure of audit fees and the types of services provided by the audit firm allows investors and other financial statement users to evaluate potential conflicts of interest that could compromise auditor objectivity.[3] The disclosure in the financial statements, together with disclosures in the auditor's report about any relationship between the reporting entity and the audit firm other than as auditor, informs the user's evaluation of auditor independence.

35. We note that fee disclosure is only one of the mechanisms used to ensure auditor independence and transparency around that independence. Other mechanisms available 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.

36. We appreciate auditors are sometimes asked or are required to provide other services to audit clients. There are three main types of non-audit services where it is generally considered beneficial for these services to be performed by the auditor or reviewer of the general purpose financial statements:

    (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.

[3] Similar views have been expressed by New Zealand investors in interviews with XRB staff.

37. We also note comments previously received from XRAP members that it is important that any required disclosures on fees paid to audit firms do not provide the impression that all no-audit related-fees should be avoided because they lead to independence risk. It is important not to exclude the possibility of the entity deriving benefit from additional services that are best provided by the auditor or reviewer of the entity's general purpose financial statements, without compromising the audit firm's independence.

38. Based on the understanding that audit firms will continue to provide other non-audit services to their audit clients (even with increased restrictions in ethical standards), there is a case for introducing enhanced disclosure about non-audit services being performed by an entity's audit firm.

39. Separating fees paid to audit firms into additional categories of non-audit services will provide enhanced information to users (to assist them to evaluate whether the auditors and those charged with governance have appropriately exercised their judgement as to whether those other services impair auditor independence). XRAP members previously highlighted the importance of such disclosures.

Recent developments concerning the Code of Ethics for Assurance Practitioners

40. In April 2021 the International Ethics Standards Board (IESBA) issued a final pronouncement relating to fees — *Revisions to the Fee-related Provisions of the Code*. These revisions to the fee-related provisions of the Code provide factors that the audit firm should consider when assessing threats to independence arising from fees for other non-audit services charged to audit clients.

41. Key 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 and to the public to assist their judgements about auditor independence.

42. The international revisions to the fee-related provisions of the Code were issued by the NZAuASB in March 2022.

43. The revisions to the fee-related provisions of the Code include a discussion on public disclosure of fee related information. The code recognises that "*in view of the public interest in the audits of public interest entities, it is beneficial for stakeholders to have visibility about the professional relationships between the firm and the audit client which might reasonably be thought to be relevant to the evaluation of the firm's independence*."

44. The New Zealand provisions note that the accounting standards issued by the XRB and the Companies Act 1993 set out the requirements for the reporting entity to disclose information about audit services and non-audit services provided during the reporting period.

45. The New Zealand provisions in the Code concerning *public disclosure of fee related information* are provided in Appendix 4.

Proposed amendments to domestic accounting standards

46. Accompanying this memo, we have included draft EDs of the proposed amendments to introduce defined enhanced categories and associated fee disclosure requirements in relation to audit and non-audit services performed in the reporting period.

- *Disclosure of Fees Paid to Audit Firms* (Proposed amendments to FRS-44) — agenda item 3.2; and
- *Disclosure of Fees Paid to Audit Firms* (Proposed amendments to PBE IPSAS 1) — agenda item 3.3.

47. The proposed amendments in FRS 44 and PBE IPSAS 1 are consistent except for some terminology differences to reflect the for-profit/PBE context.

48. The proposed draft amendments to FRS 44 *New Zealand Additional Disclosures* are provided in a clean format in the memo to support Board review and comment – refer to Appendix 1.

49. The remainder of this section includes some commentary on the key matters considered by staff during the development of these draft proposed amendments.

Defined categories

50. The amendments propose to introduce the following defined categories for disclosing the total fees paid to each audit or review firm (including any network firm) in the reporting period for different types of services.

(a)	**Fee for audit and assurance services:**
	(i) Financial statement audit or review engagement;
	(ii) Audit-related or review-related services; and
	(iii) Other assurance services.
(b)	**Fees for non-assurance services**
	(i) Taxation services; and
	(ii) Other non-assurance services.

51. A comparison of disclosure categories required by other jurisdictions for the disclosure of fees paid to audit firms is provided in Appendix 5.

52. Under each category, the reporting entity will be required to disclose the nature of each type of service provided by the audit or review firm, together with the fees for each type of service as expensed through the profit or loss in the reporting period.

53. The proposed amendments include guidance paragraphs in the form of examples of the types of services provided by the audit or review firm that may fall under each category.

54. Please refer to draft EDs (agenda items 3.2 and 3.3 and Appendix 1) for further detail on the proposed disclosures. The proposals include descriptions and additional guidance to assist preparers when classifying different types of non-audit services under the defined categories.

55. The disclosure of total fees paid to the audit or review firm is only required when the firm has completed an audit or review of the entity's general purpose financial statements in the reporting period. Any fees paid to other firms (which are not the entity's auditor or reviewer) are not within the scope of these disclosure requirements.

Audit-related or review-related services vs other assurance services

56. From our analysis of categories used by other jurisdictions, professional and ethical standards, and regulators, we note there is a strong desire for the disclosure of fees from assurance services (excluding the financial statement audit or review engagement) to be classified under two categories:

    (a) Audit-related or review-related services; and

    (b) Other assurance services.

57. The desire for the separate disclosure of *audit-related or review-related services* arises from the understanding that these are non-audit services that are largely carried out by members of the audit engagement team, and where the work is closely related to the work performed in the audit or review of the general purpose financial statements. The provision of these types of services by the audit firm, are generally considered to provide a low risk to auditor independence.

58. During the development of the proposed amendments, we noted the distinction between these two categories of assurance services is very fine as discussed further below.

Audit-related services or review-related services

59. The draft ED defines audit-related or review-related services as services that are closely related to the work performed as part of the financial statement audit or review engagement but does not include services that are completed as part of the audit or review engagement.

60. The draft ED further elaborates that audit-related or review-related services specifically include:

    (a) services that would normally be completed by the auditor or reviewer due to their independence and understanding of the entity obtained by completing the financial statement audit or review engagement*;* and/or

    (b) regulatory requirements for which the entity has an obligation to undertake, which are specifically required by laws or regulations to be performed by a qualified auditor or reviewer.

61. Services that would normally be expected to be completed by the auditor or reviewer include services that involve providing assurance over (or performing agreed-upon procedures on)

separately reported information that has been derived from the audited or reviewed general purpose financial statements.

62. The ED provides examples of types of audit-related or review-related services:

    (a) review of interim financial statements;

    (b) review of summary financial statements;

    (c) regulatory work required to be completed by a qualified auditor; and

    (c) agreed-upon procedures report on compliance with banking covenants.

Other assurance services

63. The draft ED defines *other assurance services* as other types of assurance and agreed-upon procedures engagements not classified as a 'financial statement audit or review engagement' or an 'audit-related service or review-related service'.

64. As a result of this definition, <u>any</u> assurance service related to regulatory requirements which are specifically required by laws or regulations to be performed by a qualified auditor or reviewer would be classified under 'audit-related services or review-related services'.

65. This category includes assurance and agreed-upon procedures services that do not rely significantly on any synergies in knowledge gained from undertaking the financial statement audit or review engagement. Consequently, other assurance services may be performed by the audit or review firm or by another firm.

66. The draft ED provides examples of types of other assurance services:

    (a) review of pro forma financial information included in a prospectus;

    (b) review of regulatory returns;

    (c) review of forecast financial information;

    (d) review of greenhouse gas statements or other sustainability reports;

    (e) monitoring a raffle draw; and

    (f) scrutineering votes at an annual general meeting.

Practical expedient

67. We appreciate that it will not always be clear whether certain types of services provided by the audit firm should be classified as '*audit-related services or review-related services'* or *'other assurance services'*. The same type of service, in different circumstances, could be classified in either one of these categories.

68. To improve the information disclosed about the fees paid to an audit firm, the requirement to clearly disclose the nature of each type of service provided is the most important aspect of the proposed disclosures. Rather than the requirement to determine the most appropriate category under which to disclose different types of services provided by an audit firm.

69. For this reason, we have included paragraph 8.19 in the draft EDs as a practical expedient.

> 8.19 If it is not straightforward whether an assurance (or agreed-upon procedures) engagement is an 'audit-related or review-related service' or an 'other assurance service', an entity shall disclose the description of the service under the category 'other assurance services'.

Applying the proposed disclosure requirements

70. Appendix 2 provides a flowchart of how we envisage the proposed disclosure requirements would be applied in practice.

71. A reporting entity will consider what fees have been expensed in the period for services provided by its audit or review firm. The preparer will work down the defined categories as ordered in the ED to allocate the fees charged for non-audit services.

72. If a reporting entity only receives audit or review services from the firm, then only these fees will require disclosure. Therefore, for many entities, the proposed new disclosures will not have a significant impact – but where a firm provides non-audit services to an audit or review client then additional disclosure will be required.

Tier 2 — Reduced disclosure regime

73. Disclosure of information concerning fees paid to an entity's audit or review firm will provide useful and important information for users of both Tier 1 and Tier 2 financial statements. Staff, therefore, suggest no disclosure concessions be proposed.

74. Although the requirements and accompanying guidance paragraphs are detailed, we anticipate that the cost of applying disclosures by Tier 2 entities will not outweigh the benefits. In the invitation to comment we could ask a question on this point.

Other potential disclosures

75. Based on the review of the Australia Joint Committee (PJC) report, *Regulation of Auditing in Australia* (November 2020), and recent revisions to professional and ethical standards, we note the recommendation to provide the following additional disclosure to address perceived or actual concerns over auditor independence.

Audit tenure

76. The PJC recommended that audit tenure be disclosed in an entity's general purpose financial statements. Such disclosures should include both the length of tenure of the entity's external auditor (i.e. the audit firm), and of the lead partner.

77. The PJC also recommended that audited entities should disclose when they have not undertaken a public tender process in the last 10 years and explain why this has not occurred.

78. We note that the Australian Institute of Directors (AICD) plans to develop voluntary guidance for directors on disclosing information about audit tenure. The AICD intends to seek the incorporation of this guidance into the ASX Corporate Governance Principles at a later date.

79. The AASB in June 2021 agreed not to propose amendments to the Australian Accounting Standards to require auditor tenure disclosure in general purpose financial statements at this stage, but instead agreed to continue monitoring the work being carried out by the AICD in respect of listed entities.

Disclosure of safeguards

80. We also note recommendations in professional and ethical standards, that when an auditor provides non-audit services it should explain to the client the safeguards it has in place to avoid any self-review threat to independence. Some have suggested disclosures of this nature would also be useful in general purpose financial statements. This would provide investors and other users which useful information about the nature of safeguards in place when non-audit services are provided by the entity's audit firm.

FMA guidance – Corporate Governance in New Zealand

81. The FMA's 2018 *Corporate Governance in New Zealand Handbook* provides useful principles and guidelines on the additional disclosures discussed above.

> 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:
>
> - how they satisfied themselves about auditor quality and effectiveness of the audit;
> - their approach to tenure and reappointment of auditors; and
> - any threats to auditor independence and how those threats were mitigated.

82. We note that in New Zealand there is mandatory rotation of audit partners for FMC audits (engagement lead audit partners have to rotate every seven years, or five years for most of the NZX-listed markets). However, New Zealand has no mandatory audit firm rotation to avoid a long or overly close relationship with a client

Staff view

83. At present, our view is consistent with the AASB, in that we believe that the New Zealand accounting standards should not require the disclosure of audit tenure at this stage. This is information that should be considered by the entity's audit committee or directors, but the case is not yet strong enough to include this information in the general purpose financial statements.

84. We however agree that it would be useful to encourage disclosure about how the entity has satisfied itself that any fees for non-assurance services have not compromised the financial statement auditor or reviewer objectivity and independence. This encouragement is reflected in the draft proposed amendment to FRS 44 and PBE IPSAS 1:

> When non-assurance services have been received in the reporting period, the entity is encouraged to provide disclosure about how the entity has satisfied itself that the non-assurance services provided by the audit or review firm have not compromised the financial statement auditor or reviewer objectivity and independence.

Questions for the Board

Q1.	Does the Board agree that the proposed amendments in agenda items 3.2 and 3.3 (also included in Appendix 1) will promote increased transparency and consistency of disclosures about fees paid to the audit or review firm in the reporting period?
Q2.	Does the Board have any concerns that the cost of implementing the proposed disclosures will outweigh the benefits?
Q3.	Does the Board agree with the staff view that a requirement to disclose audit tenure not be included in the proposed amendments?
Q4.	Does the Board have any other suggestions for improving the draft proposals?

Next steps

85. The next steps will involve completing targeted outreach to receive feedback on the draft proposals before issuing for public comment.

    (a) XRAP meeting, 30 March 2022

    (b) NZAuASB/NZASB feedback at the joint meeting, 6 April 2022

    (c) FMA, Charities Services, and OAG

86. Following consideration of the feedback received from targeted outreach, we will bring to the Board the draft ITCs and EDs (for proposed amendments to FRS -4 and PBE IPSAS 1) for approval to issue for public consultation.

Attachments:

3.2 Draft ED: *Disclosure of Fees Paid to Audit Firm* (Proposed amendments to FRS-44)

3.3 Draft ED: *Disclosure of Fees Paid to Audit Firm* (Proposed amendments to PBE IPSAS 1)

Appendix 1: Enhanced Disclosure of Fees Paid to Audit Firms – proposed amendments to FRS 44

Fees paid to audit firms

8.1 An entity shall disclose the fees paid to each audit or review firm,[4] including any network firm,[5] separately for each type of service performed during the reporting period, using the following categories.

(a) Fees for audit and assurance services:

(i) financial statement audit or review engagement (see paragraph 8.4–8.6);

(ii) audit-related or review-related services (see paragraph 8.7–8.12); and

(iii) other assurance services (see paragraph 8.13–8.19).

(b) Fees for non-assurance services:

(i) taxation services (see paragraph 8.20–8.22); and

(ii) other non-assurance services (see paragraph 8.23–8.25).

8.2 The fees disclosed are the fees expensed in the statement of profit or loss and other comprehensive income for the reporting period.

8.3. The disclosure of the fees paid to each audit firm in accordance with paragraph 8.1, is only required when the firm has performed (or is performing) a financial statement audit or review engagement in the reporting period. This will include any firm involved in the audit or review of the consolidated financial statements (when applicable).

Fees for audit and assurance services

***Financial statement audit or review engagement*[6]**

8.4 A financial statement *audit engagement* is a reasonable assurance engagement where an assurance practitioner (henceforth referred to as an 'auditor') expresses an opinion on whether the general purpose financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. A financial statement audit engagement is conducted in accordance with applicable auditing and assurance standards.

8.5 A *review engagement* is a limited assurance engagement where an assurance practitioner (henceforth referred to as a 'reviewer') provides a conclusion as to whether anything has come to their attention to indicate that the general purpose financial statements have not been prepared, in all material respects, in accordance with an applicable financial reporting

[4] An 'Audit or review firm' is defined as a sole practitioner, partnership or corporation or other entity undertaking the audit or review of the general purpose financial statements. "Firm" should be read as referring to its public sector equivalents where relevant.

[5] A 'Network firm' is defined as a audit or review firm or entity that belongs to a network. A 'network' is a larger structure:

(a) That is aimed at cooperation, and

(b) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

[6] The description of an 'audit engagement' and 'review engagement' in this Standard is based on the definition of these terms in PES 1 *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* (PES 1).

framework. A review engagement is conducted in accordance with the applicable review engagement standards.

8.6 The services referred to in paragraph 8.1(a)(i) relate to the audit or review of the entity's general purpose financial statements, as presented in accordance with NZ IAS 1 *Presentation of Financial Statements.*

Audit-related or review-related services

8.7 Audit-related or review-related services are services that are closely related to the work performed as part of the financial statement audit or review engagement but do not include services that are completed as part of the audit or review engagement described in paragraphs 8.4 and 8.5.

8.8 Audit-related or review-related services specifically include:

(a) services that would normally be expected to be completed by the auditor or reviewer due to their independence and understanding of the entity obtained by completing the financial statement audit or review engagement*;* and/or

(b) regulatory requirements for which the entity has an obligation to have undertaken, which are specifically required to be performed by a qualified auditor or reviewer.

8.9 Services that would normally be expected to be performed by the auditor or reviewer include services that involve providing assurance over (or performing agreed-upon procedures on) separately reported information that has been derived from the audited or reviewed general purpose financial statements.

8.10 To satisfy the disclosure requirements in paragraph 8.1(a)(ii), the entity shall:

(a) describe the nature of each type of audit-related or review-related service received; and

(b) disclose the total fees for each type of audit-related or review-related service.

8.11 Examples of types of audit-related or review-related services include:

(a) review of interim financial statements;

(b) review of summary financial statements;

(c) regulatory work required to be completed by a qualified auditor; [7] and

(c) agreed-upon procedures report on compliance with banking covenants.

[7] For example,the the audit or review of registers of an issuer of regulated products as required by section 218 of the Financial Markets Conduct Act 2013.

Other assurance services

8.12 Other assurance services include other types of assurance[8] and agreed-upon procedures[9] engagements not classified under category 8.1(a)(i) and 8.1(a)(ii).

8.13 This category includes assurance and agreed-upon procedures services that do not rely significantly on any synergies in knowledge gained from undertaking the financial statement audit or review engagement. Consequently, other assurance services may be performed by the audit or review firm or by another firm.

8.14 To satisfy the disclosure requirements in paragraph 8.1(a)(iii), the entity shall:

(a) describe the nature of each type of other assurance service received; and

(b) disclose the total fees for each type of other assurance service.

8.15 Examples of types of other assurance services include:

(a) review of pro forma financial information included in a prospectus;

(b) review of regulatory returns;

(c) review of forecast financial information;

(d) review of greenhouse gas statements or other sustainability reports;

(e) monitoring a raffle draw; and

(f) scrutineering votes at an annual general meeting.

8.16 If it is not straightforward whether an assurance (or agreed-upon procedures) engagement is an 'audit-related or review-related service' or an 'other assurance service', an entity shall disclose the description of the service under the category 'other assurance services'.

Fees for non-assurance services

Taxation services

8.17 Taxation services comprise non-assurance services relating to ascertaining the entity's tax liabilities (or entitlements) or satisfying other obligations under taxation law. This category excludes the review of tax balances or disclosures as part of performing the audit or review of the general purpose financial statements and excludes any services that are categorised as 'audit-related or review-related services' or 'other assurance services'.

[8] An *assurance engagement* involves an assurance practitioner evaluating information against certain criteria and expressing a conclusion about the information as a result of this evaluation, with a view to enhance the confidence of the intended users of this conclusion.

[9] An *agreed-upon procedures engagement* is normally carried out by an assurance practitioner and involves the performance of activities as agreed upon between the entity and the assurance practitioner. The assurance practitioner does not express an opinion but instead reports on the procedures used and any resulting findings.

8.18 To satisfy the disclosure requirements in paragraph 8.1(b)(i), the entity shall:

(a) describe the nature of each type of taxation service received; and

(b) disclose the total fees for each type of service.

8.19 Examples of types of taxation services include:

(a) tax return preparation;

(b) tax calculations to prepare accounting entries;

(c) tax planning and other tax advisory services;

(d) tax services involving valuations; and

(e) assistance in the resolution of tax disputes.

Other non-assurance services

8.20 Other non-assurance services include any other services provided by the audit firm, including any network firm, other than the services classified under category 8.1(a)(i) –(iii) and 8.1b(i).

8.21 To satisfy the disclosure requirements in paragraph 8.1(b)(ii), the entity shall:

(a) describe the nature of each type of other non-assurance service received; and

(b) disclose the total fees for each type of service.

8.22 Examples of types of other non-assurance services include:

(a) accounting and bookkeeping;

(b) administration;

(c) valuations (including actuarial valuations);

(d) internal audit;

(e) information technology;

(f) litigation support;

(g) legal;

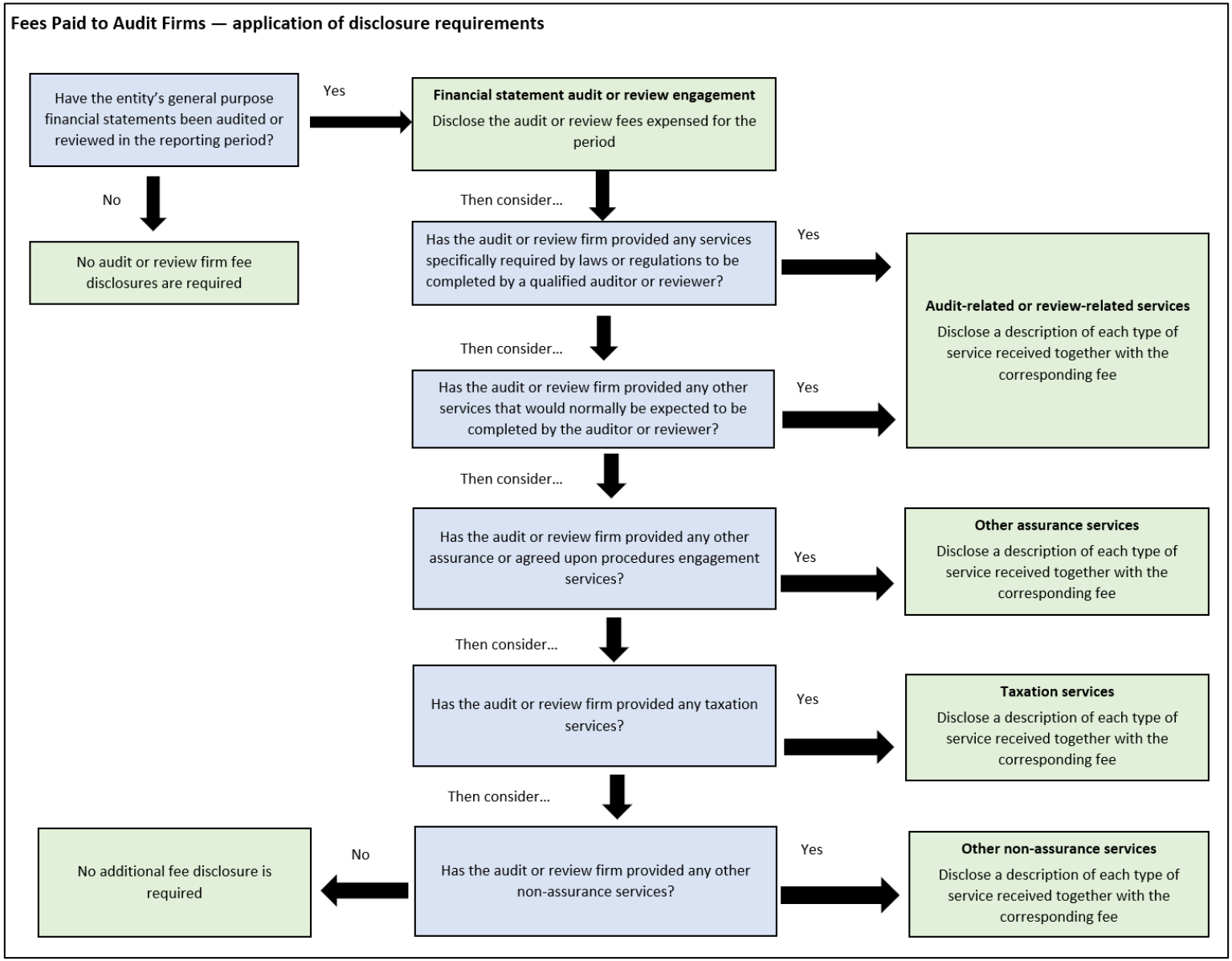
(h) recruitment and remuneration;

(i) corporate finance and restructuring; and

(j) business acquisition due diligence.

8.23 When non-assurance services have been received in the reporting period, the entity is encouraged to provide disclosure about how the entity has satisfied itself that the non-assurance services provided by the audit or review firm have not compromised the financial statement auditor or reviewer objectivity and independence.

Appendix 2: Applying the proposed disclosure requirements



Appendix 3: Background information AASB *Auditor Remuneration* Project

1. 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.

2. 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

Recommendation 3 Disclose auditor remuneration
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: • defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and • a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.
Recommendation 6 Disclose auditor tenure
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.
Recommendation 7 Disclose why no public tender
Audited entities that have not undertaken a public tender process in the last 10 years should explain why this has not occurred.

3. 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.

4. 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.

5. In June 2021 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[10] 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
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 *Taxation Services*)
All other non-audit services, together with a description of the nature of services in each category	Fees for other services

[10] Accounting Professional and Ethical Standards Board (APESB)

Appendix 4: Professional and Ethical Standard 1 (PES 1)

Public Disclosure of Fee-related Information

410.29 A1 In view of the public interest in the audits of public interest entities, it is beneficial for stakeholders to have visibility about the professional relationships between the firm and the audit client which might reasonably be thought to be relevant to the evaluation of the firm's independence. In a wide number of jurisdictions, there already exist requirements regarding the disclosure of fees by an audit client for both audit and services other than audit paid and payable to the firm and network firms. Such disclosures often require the disaggregation of fees for services other than audit into different categories.

R410.30 If laws and regulations do not require[11] an audit client to disclose audit fees, fees for services other than audit paid or payable to the firm and network firms and information about fee dependency, the firm shall discuss with those charged with governance of an audit client that is a public interest entity:

(a) The benefit to the client's stakeholders of the client making such disclosures that are not required by laws and regulations in a manner deemed appropriate, taking into account the timing and accessibility of the information; and

(b) The information that might enhance the users' understanding of the fees paid or payable and their impact on the firm's independence.

410.30 A1 Examples of information relating to fees that might enhance the users' understanding of the fees paid or payable and their impact on the firm's independence include:

- Comparative information of the prior year's fees for audit and services other than audit.
- The nature of services and their associated fees as disclosed under paragraph R410.31(b).
- Safeguards applied when the total fees from the client represent or are likely to represent more than 15% of the total fees received by the firm.

R410.31 After the discussion with those charged with governance as set out in paragraph R410.30, to the extent that the audit client that is a public interest entity does not make the relevant disclosure, subject to paragraph R410.32, the firm shall publicly disclose:

(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;

(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

[11] FRS 44 *New Zealand Additional Disclosures* and PBE IPSAS 1 *Presentation of Financial Statements* issued by the New Zealand Accounting Standards Board require disclosure of fees paid to the audit firm. Additionally, section 211 of the Companies Act 1993 requires the annual report to include the amounts payable to the audit firm.

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;

(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

(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.

410.31 A1 The firm might also disclose other information relating to fees that will enhance the users' understanding of the fees paid or payable and the firm's independence, such as the examples described in paragraph 410.30 A1.

410.31 A2 Factors the firm might consider when making the determination required by paragraph R410.31(c) are set out in paragraph 410.26 A1.

410.31 A3 When disclosing fee-related information in compliance with paragraph R410.31, the firm might disclose the information in a manner deemed appropriate taking into account the timing and accessibility of the information to stakeholders, for example:

- On the firm's website.
- In the firm's transparency report.
- In an audit quality report.
- Through targeted communication to specific stakeholders, for example a letter to the shareholders.
- In the auditor's report.

R410.32 As an exception to paragraph R410.31, the firm may determine not to publicly disclose the information set out in paragraph R410.31 relating to:

(a) A parent entity that also prepares group financial statements provided that the firm or a network firm expresses an opinion on the group financial statements; or

(b) An entity (directly or indirectly) wholly-owned by another public interest entity provided that:

(i) The entity is consolidated into group financial statements prepared by that other public interest entity; and

(ii) The firm or a network firm expresses an opinion on those group financial statements.

Appendix 5: Comparison table of required categories for fees paid to entity's audit or review firm

Current NZ categories	Proposed NZ categories	FMA Guidance	AASB Research Report 15 Recommendations	Australian Professional Ethical Standards Board	US and Canada	Germany
Audit or review of the financial statements	Financial statement audit or review engagement	Audit or review of financial statements	Audit services	Audit services	Audit fees	Audit services
All other services performed during the reporting period	Audit-related or review-related services	Regulatory audit work	Audit related services	Audit related services	Audit related services	
	Other assurance services	Other assurance services	Other assurance services	Other assurance services		Other assurance services
	Taxation services	Tax services	Taxation services	Tax services	Tax fees	Tax services
	Other non-assurance services	Other services	All other non-audit services	Other services	All other fees	Other services

Please note this is a high-level comparison of the requirements in different jurisdictions, in most cases the disclosure of fees paid to audit firms is only required for listed entities.

The UK requires companies that are not SMEs to disclose the fees charged by the entity's audit firm for each of the following applicable services:

Any remuneration received for the financial statement audit engagement	Taxation compliance services
Audit-related assurance services	Other taxation advisory services
All other assurance services	Internal audit services
	Corporate finance transactions
	All other non-audit services

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

NZASB EXPOSURE DRAFT 2022-X

Disclosure of Fees Paid to Audit Firms

Issued [Date]

This [draft][1] 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 for-profit standard requires an entity to describe the services provided by the audit firm and to disclose the fees paid by the entity for those services.

[1] References to "this Standard" throughout this Exposure Draft should be read as referring to "this draft Standard".

ISBN

CONTENTS

Part A – Introduction

This Standard sets out amendments to FRS-44 *New Zealand Addition Disclosures*. The amendments require an entity to describe the services provided by the audit firm and to disclose the fees paid by the entity for those services.

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 FRS-44 *New Zealand Additional Disclosures*

Paragraphs 8.1 and 8.2 and the preceding heading are amended. New text is underlined and deleted text is struck through.

Paragraphs 8.3 to 8.22 (and the related headings) and paragraph 21 are added. For ease of reading, new text is not underlined.

Disclosures

...

~~Audit fees~~ Fees paid to audit firms

~~*~~8.1 An entity shall disclose the fees paid to each ~~auditor or reviewer~~ audit or review firm[2], including any network firm[3], separately for each type of service performed during the reporting period, using the following categories:

(a) Fees for audit and assurance services:

(i) financial statement audit or review engagement (see paragraph 8.4–8.6);

(ii) audit-related or review-related services (see paragraph 8.7–8.11); and

(iii) other assurance services (see paragraph 8.12–8.16).

(b) Fees for non-assurance services:

(i) taxation services (see paragraph 8.17–8.19); and

(ii) other non-assurance services (see paragraph 8.20–8.22).

~~(a) the audit or review of the financial statements; and~~

~~(b) all other services performed during the reporting period.~~

~~*~~8.2 The fees disclosed are the fees expensed in the statement of profit or loss and other comprehensive income for the reporting period. ~~For 8.1 (b) above, an entity shall describe the nature of other services.~~

8.3. The disclosure of the fees paid to each audit firm in accordance with paragraph 8.1, is only required when the firm has performed (or is performing) a financial statement audit or review engagement in the reporting period. This will include any firm involved in the audit or review of the consolidated financial statements (when applicable).

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[2] 'Audit or review firm' is defined as a sole practitioner, partnership or corporation or other entity undertaking the audit or review of the general purpose financial statements. "Firm" should be read as referring to its public sector equivalents where relevant.

[3] 'Network firm" is defined as an audit or review firm or entity that belongs to a network. A 'network' is a larger structure:

(a) that is aimed at cooperation; and

(b) that is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

Fees for audit and assurance services

Financial statement audit or review engagement[4]

8.4 A financial statement *audit engagement* is a reasonable assurance engagement where an assurance practitioner (henceforth referred to as an 'auditor') expresses an opinion on whether the general purpose financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. A financial statement audit engagement is conducted in accordance with applicable auditing and assurance standards.

8.5 A *review engagement* is a limited assurance engagement where an assurance practitioner (henceforth referred to as a 'reviewer') provides a conclusion as to whether anything has come to their attention to indicate that the general purpose financial statements have not been prepared, in all material respects, in accordance with an applicable financial reporting framework. A review engagement is conducted in accordance with the applicable review engagement standards.

8.6 The services referred to in paragraph 8.1(a)(i) relate to the audit or review of the entity's general purpose financial statements, as presented in accordance with NZ IAS 1 *Presentation of Financial Statements.*

Audit-related or review-related services

8.7 Audit-related or review-related services are services that are closely related to the work performed as part of the financial statement audit or review engagement but do not include services that are completed as part of the audit or review engagement described in paragraphs 8.4 and 8.5.

8.8 Audit-related or review-related services include:

(a) services that would normally be expected to be completed by the auditor or reviewer due to their independence and understanding of the entity obtained by completing the financial statement audit or review engagement*;* and/or

(b) regulatory requirements for which the entity has an obligation to have undertaken, which are specifically required to be performed by a qualified auditor or reviewer.

8.9 Services that would normally be expected to be completed by the auditor or reviewer include services that involve providing assurance over (or performing agreed-upon procedures on) separately reported information that has been derived from the audited or reviewed general purpose financial statements.

8.10 To satisfy the disclosure requirements in paragraph 8.1(a)(ii), the entity shall:

(a) describe the nature of each type of audit-related or review-related service received; and

(b) disclose the total fees for each type of audit-related or review-related service.

8.11 Examples of types of audit-related or review-related services include:

(a) review of interim financial statements;

(b) review of summary financial statements;

(c) regulatory work required to be completed by a qualified auditor[5]; and

(c) agreed-upon procedures report on compliance with banking covenants.

Other assurance services

8.12 Other assurance services include other types of assurance[6] and agreed-upon procedures[7] engagements not classified under category 8.1(a)(i) and 8.1(a)(ii).

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[4] The description of an 'audit engagement' and 'review engagement' in this Standard is based on the definition of these terms in PES 1 *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* (PES 1).

[5] For example, the audit or review of registers of an issuer of regulated products as required by section 218 of the Financial Markets Conduct Act 2013.

[6] An assurance engagement involves an assurance practitioner evaluating information against certain criteria and expressing a conclusion about the information as a result of this evaluation, with a view to enhance the confidence of the intended users of this conclusion.

[7] An agreed-upon procedures engagement is normally carried out by an assurance practitioner and involves the performance of activities as agreed upon between the entity and the assurance practitioner. The assurance practitioner does not express an opinion but instead reports on the procedures used and any resulting findings.

8.13 This category includes assurance and agreed-upon procedures services that do not rely significantly on any synergies in knowledge gained from undertaking the financial statement audit or review engagement. Consequently, other assurance services may be performed by the audit or review firm or by another firm.

8.14 To satisfy the disclosure requirements in paragraph 8.1(a)(iii), the entity shall:

(a) describe the nature of each type of other assurance service received; and

(b) disclose the total fees for each type of other assurance service.

8.15 Examples of types of other assurance services include:

(a) review of pro forma financial information included in a prospectus;

(b) review of regulatory returns;

(c) review of forecast financial information;

(d) review of greenhouse gas statements or other sustainability reports;

(e) monitoring a raffle draw; and

(f) scrutineering votes at an annual general meeting.

8.16 If it is not straightforward whether an assurance (or agreed-upon procedures) engagement is an 'audit-related or review-related service' or an 'other assurance service', an entity shall disclose the description of the service under the category 'other assurance services'.

Fees for Non-assurance services

Taxation services

8.17 Taxation services comprise non-assurance services relating to ascertaining the entity's tax liabilities (or entitlements) or satisfying other obligations under taxation law. This category excludes the review of tax balances or disclosures as part of performing the audit or review of the general purpose financial statements and excludes any services that are categorised as 'audit-related or review-related services' or 'other assurance services'.

8.18 To satisfy the disclosure requirements in paragraph 8.1(b)(i), the entity shall:

(a) describe the nature of each type of taxation service received; and

(b) disclose the total fees for each type of service.

8.19 Examples of types of taxation services include:

(a) tax return preparation;

(b) tax calculations to prepare accounting entries;

(c) tax planning and other tax advisory services;

(d) tax services involving valuations; and

(e) assistance in the resolution of tax disputes.

Other non-assurance services

8.20 Other non-assurance services include any other services provided by the audit firm, including any network firm, other than the services classified under category 8.1(a)(i)–(iii) and 8.1b(i).

8.21 To satisfy the disclosure requirements in paragraph 8.1(b)(ii), the entity shall:

(a) describe the nature of each type of other non-assurance service received; and

(b) disclose the total fees for each type of service.

8.22 Examples of types of other non-assurance services include:

(a) accounting and bookkeeping;

(b) administration;

(c) valuations (including actuarial valuations);

(d) internal audit;

(e) information technology;

(f) litigation support;

(g) legal;

(h) recruitment and remuneration;

(i) corporate finance and restructuring; and

(j) business acquisition due diligence.

8.23 When non-assurance services have been received in the reporting period, the entity is encouraged to provide disclosure about how the entity has satisfied itself that the non-assurance services provided by the audit or review firm have not compromised the financial statement auditor or reviewer objectivity and independence.

...

Effective date

...

21 *Disclosure of Fees Paid to Audit Firms*, issued in [date], amended paragraphs 8.1 and 8.2 and the preceding heading and added paragraphs 8.3–8.x and the related headings. An entity shall apply those amendments for annual periods ending on or after [date]. Earlier application is permitted.

Part D – Effective Date

This [draft] Standard shall be applied for annual financial statements covering periods beginning on or after [date]. Earlier application is permitted.

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

NZASB EXPOSURE DRAFT 2022-X

Disclosure of Fees Paid to Audit Firms

Issued [Date]

This [draft][1] 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 requires an entity to describe the services provided by the audit firm and to disclose the fees paid by the entity for those services.

[1] References to "this Standard" throughout this Exposure Draft should be read as referring to "this draft Standard".

ISBN

CONTENTS

Part A – Introduction

This Standard sets out amendments to PBE IPSAS 1 *Presentation Financial Statements*. The amendments require an entity to describe the services provided by the audit firm and to disclose the fees paid by the entity for those services.

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 public benefit entities.

Part C – Amendments to PBE IPSAS 1 *Presentation of Financial Statements*

Paragraphs 116.1 and 116.2 are amended. New text is underlined and deleted text is struck through.

Paragraphs 116.3 to 116.22 (and the related headings) and paragraph 154.14 are added. For ease of reading, new text is not underlined.

Statement of Comprehensive Revenue and Expense

...

Information to be Presented either on the Face of the Statement of Comprehensive Revenue and Expense or in the Notes

...

Fees Paid to Each Audit Firm

*116.1 **An entity shall disclose the fees paid to each ~~auditor or reviewer~~ audit or review firm[2], including any network firm[3], separately for each type of service performed during the reporting period, using the following categories:**

(a) **Fees for audit and assurance services:**

(i) **Financial statement audit or review engagement (see paragraph 116.4–116.6);**

(ii) **Audit-related or review-related services (see paragraph 116.7–116.11); and**

(iii) **Other assurance services (see paragraph 116.12–116.16).**

(b) **Fees for non-assurance services:**

(i) **Taxation services (see paragraph 116.17–116.19); and**

(ii) **Other non-assurance services (see paragraph 116.20–116.22).**

~~(a) The audit or review of the financial report; and~~

~~(b) All other services performed during the reporting period.~~

*116.2 **The fees disclosed are the fees expensed in the statement of comprehensive revenue and expense for the reporting period. ~~To comply with paragraph 116.1 above, an entity shall describe the nature of other services.~~**

[2] 'Audit or review firm' is defined as a sole practitioner, partnership or corporation or other entity undertaking the audit or review of the general purpose financial statements. "Firm" should be read as referring to its public sector equivalents where relevant.

[3] Network firm is discussed in Professional and Ethical Standard (PES) 1 (Revised) *Ethical Standards for Assurance Practitioners*.

116.3. The disclosure of the fees paid to each audit firm in accordance with paragraph 116.1, is only required when the firm has performed (or is performing) a financial statement audit or review engagement in the reporting period. This will include any firm involved in the audit or review of the consolidated financial statements (when applicable).

Fees for audit and assurance services

Financial statement audit or review engagement[4]

116.4 A *financial statement audit engagement* is a reasonable assurance engagement where an assurance practitioner (henceforth referred to as an 'auditor') expresses an opinion on whether the general purpose financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. A financial statement audit engagement is conducted in accordance with applicable auditing and assurance standards.

116.5 A *review engagement* is a limited assurance engagement where an assurance practitioner (henceforth referred to as a 'reviewer') provides a conclusion as to whether anything has come to their attention to indicate that the general purpose financial statements have not been prepared, in all material respects, in accordance with an applicable financial reporting framework. A review engagement is conducted in accordance with the applicable review engagement standards.

116.6 The services referred to in paragraph 116.1(a)(i) relate to the audit or review of the entity's general purpose financial statements, as presented in accordance with this Standard.

Audit-related or review-related services

116.7 Audit-related or review-related services are services that are closely related to the work performed as part of the financial statement audit or review engagement but do not include services that are completed as part of the audit or review engagement described in paragraphs 116.4 and 116.5.

116.8 Audit-related or review-related services include:

(a) Services that would normally be expected to be completed by the auditor or reviewer due to their independence and understanding of the entity obtained by completing the financial statement audit or review engagement*;* and/or

(b) Regulatory requirements for which the entity has an obligation to have undertaken, which are specifically required to be performed by a qualified auditor or reviewer.

116.9 Services that would normally be expected to be completed by the auditor or reviewer include services that involve providing assurance over (or performing agreed-upon procedures on) separately reported information that has been derived from the audited or reviewed general purpose financial statements.

116.10 **To satisfy the disclosure requirements in paragraph 116.1(a)(ii), the entity shall:**

(a) **describe the nature of each type of audit-related or review-related service received; and**

(b) **disclose the total fees for each type of audit-related or review-related service.**

116.11 Examples of types of audit-related or review-related services include:

(a) Review of interim financial statements;

(b) Review of summary financial statements;

(c) Regulatory work required to be completed by a qualified auditor[5]; and

(c) Agreed-upon procedures report on compliance with banking covenants.

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[4] The description of an 'audit engagement' and 'review engagement' in this Standard is based on the definition of these terms in PES 1 *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* (PES 1).

[5] For example, the audit or review of registers of an issuer of regulated products as required by section 218 of the Financial Markets Conduct Act 2013.

Other assurance services

116.12 Other assurance services include other types of assurance[6] and agreed-upon procedures[7] engagements not classified under category 116.1(a)(i) and 116.1(a)(ii).

116.13 This category includes assurance and agreed-upon procedures services that do not rely significantly on any synergies in knowledge gained from undertaking the financial statement audit or review engagement. Consequently, other assurance services may be performed by the audit or review firm or by another firm.

116.14 **To satisfy the disclosure requirements in paragraph 116.1(a)(iii), the entity shall:**

(a) **Describe the nature of each type of other assurance service received; and**

(b) **Disclose the total fees for each type of other assurance service.**

116.15 Examples of types of other assurance services include:

(a) Review of pro forma financial information included in a prospectus;

(b) Review of regulatory returns;

(c) Review of forecast financial information;

(d) Review of greenhouse gas statements or other sustainability reports;

(e) Monitoring a raffle draw; and

(f) Scrutineering votes at an annual general meeting.

116.16 If it is not straightforward whether an assurance (or agreed-upon procedures) engagement is an 'audit-related or review-related service' or an 'other assurance service', an entity shall disclose the description of the service under the category 'other assurance services'.

Fees for non-assurance services

Taxation services

116.17 Taxation services comprise non-assurance services relating to ascertaining the entity's tax liabilities (or entitlements) or satisfying other obligations under taxation law. This category excludes the review of tax balances or disclosures as part of performing the audit or review of the general purpose financial statements and excludes any services that are categorised as 'audit-related or review-related services' or 'other assurance services'.

116.18 **To satisfy the disclosure requirements in paragraph 116.1(b)(i), the entity shall:**

(a) **Describe the nature of each type of taxation service received; and**

(b) **Disclose the total fees for each type of service.**

116.19 Examples of types of taxation services include:

(a) Tax return preparation;

(b) Tax calculations to prepare accounting entries;

(c) Tax planning and other tax advisory services;

(d) Tax services involving valuations; and

(e) Assistance in the resolution of tax disputes.

Other non-assurance services

116.20 Other non-assurance services include any other services provided by the audit firm, including any network firm, other than the services classified under category 116.1(a)(i)–(iii) and 116.1b(i).

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[6] An assurance engagement involves an assurance practitioner evaluating information against certain criteria and expressing a conclusion about the information as a result of this evaluation, with a view to enhance the confidence of the intended users of this conclusion.

[7] An agreed-upon procedures engagement is normally carried out by an assurance practitioner and involves the performance of activities as agreed upon between the entity and the assurance practitioner. The assurance practitioner does not express an opinion but instead reports on the procedures used and any resulting findings.

116.21 **To satisfy the disclosure requirements in paragraph 116.1(b)(ii), the entity shall:**

(a) **Describe the nature of each type of other non-assurance service received; and**

(b) **Disclose the total fees for each type of service.**

116.22 Examples of types of other non-assurance services include:

(a) Accounting and bookkeeping;

(b) Administration;

(c) Valuations (including actuarial valuations);

(d) Internal audit;

(e) Information technology;

(f) Litigation support;

(g) Legal;

(h) Recruitment and remuneration;

(i) Corporate finance and restructuring; and

(j) Business acquisition due diligence.

116.23 When non-assurance services have been received in the reporting period, the entity is encouraged to provide disclosure about how the entity has satisfied itself that the non-assurance services provided by the audit or review firm have not compromised the financial statement auditor or reviewer objectivity and independence.

...

Effective date

...

154.14 ***Disclosure of Fees Paid to Audit Firms*, issued in [date], amended paragraphs 116.1 and 116.2, added a heading above paragraph 116.1 and added paragraphs 116.3–116.22 and the related headings. An entity shall apply those amendments for annual financial statements covering periods beginning on or [date]. Earlier application is permitted.**

Part D – Effective Date

This [draft] Standard shall be applied for annual financial statements covering periods beginning on or after [date]. Earlier application is permitted.

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	24 March 2022
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	**IPSASB ED 81 *Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements in Financial Statements***

Purpose and introduction[1]

1. The purpose of this paper is to seek the Board's feedback on our draft comment letter on IPSASB Exposure Draft 81 *Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements in Financial Statements* (the ED). The draft comment letter is based on preliminary staff views on the ED, as well as feedback from the TRG.

2. The full ED is provided as agenda item 7.3 (in the supporting papers). We note that the ED includes Chapters 3 and 5 of the IPSASB Conceptual Framework in their entirety. For the Board's convenience, this paper includes references to the specific paragraphs in the ED where amendments are proposed.

Recommendation

3. The Board is asked to provide FEEDBACK on the draft comment letter (agenda item 7.2).

Background

4. The IPSASB issued the ED in February 2022. The ED proposes limited-scope updates to the IPSASB Conceptual Framework. The proposals arise from the following developments since the Framework was approved in 2014:

   (a) the IPSASB's experience in applying the Framework to the development and maintenance of IPSAS; and

   (b) developments in international thinking about conceptual issues (specifically, the IASB's updates to its Conceptual Framework in 2018).

5. The ED follows another recent proposal to update the IPSASB Conceptual Framework. In 2021, as part of its project on Measurement, the IPSASB proposed to amend Chapter 7 of the Framework, which deals with the measurement of assets and liabilities.

6. In summary, the ED proposes the following amendments to the IPSASB Conceptual Framework.

   (a) Chapter 3, Qualitative Characteristics: The amendments clarify the role of prudence and update the guidance on materiality.

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

(b) Chapter 5, Elements in Financial Statements: Amendments include a revised definition of a liability that refers to 'transfer of resources', amendments to the description of a 'resource' in the context of the definition of an asset, and amendments to the related guidance on assets and liabilities. New guidance is also proposed on the 'unit of account'.

7. At its February 2022 meeting, the Board agreed to comment on the ED, and that staff should carry out targeted outreach to inform the comment letter. Comments are due to the NZASB by 15 April 2022.

8. We have discussed the ED with the TRG in March 2022. We also plan to discuss the ED with Treasury and OAG/Audit New Zealand.

9. Comments on the ED are due to IPSASB by 31 May 2022. Therefore, we are seeking the Board's feedback on the draft comment letter at this meeting, and we plan to seek approval of the comment letter at the Board's May 2022 meeting.

Summary of proposals in ED 81

Proposed amendments to Chapter 3 Qualitative Characteristics

10. The proposed amendments to Chapter 3 are summarised in the table below. Please note that *no* new qualitative characteristics are being added (and none are deleted).

Table 1: Summary of proposed amendments to Chapter 3

Proposed amendments	ED Ref
Prudence The ED proposes to clarify the role of prudence in supporting neutrality, which is an aspect of faithful representation. The amendments note the following. • Prudence is the exercise of caution when making judgements under conditions of uncertainty. Exercising prudence means that assets, liabilities, revenue, and expenses are not overstated or understated. • The exercise of prudence does not imply a need for asymmetry (e.g. systematically requiring more evidence for recognising assets or revenue as compared to liabilities and expenses). However, some standards may include asymmetric requirements. These amendments are aligned with the IASB's Conceptual Framework.	Para 3.14A – 3.14B

Proposed amendments	ED Ref
Materiality The ED proposes to update the guidance on materiality by adding a reference to the *obscuring* of information. That is, information is material if omitting, misstating *or obscuring* it could be reasonably expected to influence the discharge of accountability by the entity or the decisions made by users of the financial statements. This amendment is aligned with the IASB's Conceptual Framework. In addition, the ED proposes to add a sentence about considering disclosure when an item is not separately or prominently displayed on the face of the financial statements, and to explain that it is not possible to specify a uniform set of characteristics that makes information material.	Para 3.32–3.32A

XRB staff's preliminary views

11. We generally support the proposed amendments to the guidance on prudence and materiality. We agree with the IASB and the IPSASB that obscuring information is an important factor when considering materiality.

12. Regarding the additional materiality guidance that is not based on the IASB Framework – we generally support this guidance, but we think that the sentence on the disclosure of information that is not displayed on the face of the financial statements could be reworded for better clarity.

TRG feedback (March 2022)

13. TRG members' comments on the proposed amendments to Chapter 3 included the following.

    (a) The ED proposal would improve alignment of the IPSASB Conceptual Framework with the IASB Conceptual Framework, which is beneficial.

    (b) The proposed reference to not obscuring information in the guidance on materiality is welcome – particularly given that in New Zealand, some not-for-profit PBEs tend to provide excessively detailed disclosures in the financial statements.

    (c) The need for the proposed new sentence on providing disclosures about items that are not prominently displayed is not clear.

Proposed amendments to Chapter 5 Elements in Financial Statements

14. The proposed amendments to Chapter 5 are summarised in the table below.

Table 2: Summary of proposed amendments to Chapter 5

Proposed amendments	ED Ref
Definition of an asset: *Rights-based approach to description of 'resource'* The ED proposes amendments to the description of a 'resource' – which is an element of the definition of an asset – and to the related guidance. Specifically, the IPSASB proposes to adopt a rights-based approach to the description of a resource – similarly to the IASB Framework. The IPSASB Conceptual Framework currently describes a resource as an 'item' with service potential or the ability to generate economic benefits. The related guidance refers to benefits arising either from the resource itself or from rights to use it. As explained in the ED's Basis for Conclusions, in 2018 the IASB decided that the guidance on assets in its Conceptual Framework should not distinguish between benefits that arise from owning an object and those that arise from the right to use an object. The IASB noted that rights conferred by legal ownership of an object and rights to use the object for some of its useful life are both types of rights – not separate phenomena. The IPSASB found this argument persuasive. The proposed new description of a resource in the ED is: "a right to either service potential or the capacity to generate economic benefits, or a right to both". Most of the added guidance on rights is based on the guidance in the IASB's Conceptual Framework. However, unlike the IASB, the IPSASB has had to refer both to economic benefits and service potential in its proposed description of a resource and the accompanying guidance. *Minor amendment to the definition of an asset* The IPSASB proposes to refer to 'past events' (plural), rather than a 'past event', in the definition of an asset. The IPSASB notes that an asset may arise from a single past event or from multiple past events.	Para 5.6– 5.13
Definition of a liability *Reference to 'transfer of resources'* The ED proposes to define a liability as the present obligation to *transfer resources* – rather than a present obligation for an outflow of resources. In 2018, the IASB made a similar amendment to the definition of a liability in its Conceptual Framework. The previously used term 'outflow of [economic] resources' was linked to guidance on *expected* outflow of resources. The IASB considered that this focus on expectation of outflow conflates the requirements for meeting the *definition* of a liability with the requirements for the *recognition* of a liability. Therefore, in the IASB's Conceptual Framework,	Para 5.14 – 5.26

Proposed amendments	ED Ref
the IASB replaced the notion of expected outflow of resources with the notion of potential to require transfer of resources. The IPSASB found this argument persuasive and proposed a similar amendment. The IPSASB also proposes to amend the guidance on the definition of a liability, based on the IASB's guidance in its Conceptual Framework – with modifications to reflect the public sector context. As noted above, similarly to the IASB's amendments to its Conceptual Framework, previous references to the *probability/expectation* of outflows of resources are removed, as such notions are deemed to relate to the recognition of a liability. For example, paragraph 5.16A states that to meet the definition of a liability, an obligation must have the *potential to require the entity to transfer a resource* to another party – but the *transfer does not have to be certain or even likely* and might be dependent on a specified uncertain future event occurring. The amendments to the guidance on the definition of a liability include new guidance on the concept of 'transfer of resources'. This guidance is particularly important in the context of the IPSASB's project on *Revenue and Transfer Expenses*, where proposals focus on liabilities arising from binding arrangements. *Minor amendment to the definition of a liability* As with the definition of an asset, the IPSASB proposes to refer to 'past events' (plural), rather than a 'past event', in the definition of a liability. *Reorganisation of the section on liabilities* The ED proposes to rearrange the section on liabilities in Chapter 5, so that the order of topics discussed in the guidance are aligned with the proposed new definition of a liability.	
<u>Unit of account</u> The 'unit of account' is the unit to which recognition criteria and measurement concepts are applied. Currently, there is no specific guidance on the 'unit of account' in the IPSASB Conceptual Framework. The ED proposes to add into Chapter 5 a new section on the 'unit of account'. The proposed guidance is largely based on the equivalent guidance in the IASB's Conceptual Framework.	Para 5.26A–5.26J
<u>Binding arrangements that are equally unperformed (executory contracts)</u> The proposed new guidance on the unit of account includes guidance on 'binding arrangements that are equally unperformed'. This guidance is based on the IASB's guidance on executory contracts in its Conceptual Framework. However, the IPSASB decided not to use the term 'executory contracts', because in some jurisdictions the term 'contract' is problematic in the public sector. Unlike the IASB, the IPSASB decided to integrate the guidance on 'binding arrangements that are equally underperformed' into the section on 'unit of account'.	Para 5.26G–5.26H

XRB staff's preliminary views

15. In general, we support the IPSASB's proposed amendments to Chapter 5. We think it is beneficial to incorporate into the IPSASB Conceptual Framework the IASB's latest conceptual thinking about assets and liabilities – with appropriate modifications to reflect the public sector context. However, we think the proposals could be improved as follows.

    (a) The description of a resource (in the context of the definition of an asset) could be further streamlined and simplified, in line with the IASB's description of a resource.

    (b) The IPSASB should consider enhancing the guidance on the *recognition* of liabilities in its Conceptual Framework – given that the proposed updated guidance on the definition of a liability emphasises that an outflow of resources need not be likely for the definition of a liability to be met.

Comments from a Board member (February 2022)

16. After the February 2022 meeting, we received a comment from a Board member about certain paragraphs in the ED that relate to liabilities. The comment related to enhancing the consistency, or strengthening the link, between paragraphs 5.15A and 5.17C of the ED.

17. The Board member noted the following.

    (a) Paragraph 5.15A states that an obligation must be to an external party to give rise to a liability, and that an entity "cannot be obligated to itself, *even where it has publicly communicated an intention to behave in a particular way*" [italics added for emphasis].

    (b) Paragraph 5.17C then discusses the communication of intention to other parties, in the context of identifying the point when a liability arises. This paragraph states that a promise made in an election is unlikely to give rise to a present obligation that meets the definition of a liability, but an announcement might have "such political support that the government has little option to withdraw".

    (c) The Board member noted that the distinction between the election promise and the announcement referred to in paragraph 5.17C is not very clear and that this paragraph seems to lack specificity. On the other hand, paragraph 5.15A clearly states that a public communication to behave in a certain way does not give rise to a liability if there is no obligation to an external party. The Board member noted that it may be useful if paragraph 5.17C included a reference to paragraph 5.15A.

TRG feedback (March 2022)

18. The following table summarises TRG members' comments on the proposed amendments to Chapter 5.

    (a) Description of a resource: A TRG member supported staff's recommendation to streamline the definition of a resource. However, another TRG member noted that in staff's original suggested wording, staff referred to the *ability* to generate economic benefit or service potential – whereas the IASB's description of a resources refers to the

potential to generate economic benefits. The TRG member was concerned that the difference between 'ability' and 'potential' might have unintended consequences. We note that the problem with using 'potential' in the same way as the IASB is that in the context of the IPSASB Conceptual Framework, this would lead to the phrase "potential to generate […] service potential". We have considered what alternative term could be used to respond to the TRG members' concerns. We note that the IPSASB has used the term 'capacity' in its proposed description of a resource, albeit only with respect to economic benefit (not service potential). Therefore, in the current draft of our comment letter, we have used the term 'capability' (rather than 'ability') in the recommendation to streamline the description of a resource.

(b) Past events: The IPSASB proposes to refer to 'past events' (plural) in the definition of an asset and the definition of a liability, instead of the current reference to 'past event' (singular). TRG members questioned the reason for this proposal and noted that the reference to 'events' implies that there must be more than one event for an asset or liability to arise.

(c) Location of guidance on binding arrangements that are equally unperformed: Unlike the IASB, the IPSASB proposes to include guidance on 'binding arrangements that are equally underperformed' (i.e. executry contracts) within the section on 'unit of account', rather than in a separate section. A TRG member questioned the reason for not including this guidance in a separate section.

Draft comment letter

19. We have reflected our preliminary views, the abovementioned comment received from a Board member and the TRG's feedback in the draft comment letter in agenda item 7.2.

Questions for the Board

Q1. Does the Board have any feedback on the draft comment letter in agenda item 7.2?

Next steps

20. We will update the comment letter based on the Board's feedback at this meeting. We also plan to discuss the ED proposals with Treasury and OAG/Audit New Zealand, and to update the comment letter for their feedback.

21. We plan to seek the Board's approval of the comment letter at the Board's May meeting.

Attachments

Agenda item 7.2: Draft comment letter

Agenda item 7.3: IPSASB ED 81 (in the Supporting Papers)

XX May 2022

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

Submitted to: www.ifac.org

Dear Ross

ED 81 *Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements in Financial Statements*

Thank you for the opportunity to comment on ED 81 *Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements in Financial Statements* (the ED). The ED has been exposed for comment in New Zealand and some New Zealand constituents may comment directly to you.

[*The main points from the Appendix will be summarised here – this part will be updated in time for the NZASB May 2022 meeting. We plan to say that we generally support the proposals to update the Conceptual Framework to reflect the IASB's latest international conceptual thinking (with appropriate modifications for the public sector) and to reflect the IPSASB's experience in applying the Conceptual Framework. However, we recommend that the IPSASB consider the following suggested changes and additional amendments. We would then list our recommended changes.*]

Our recommendations and responses to the Preliminary Views and Specific Matters for Comment are set out in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Gali Slyuzberg (gali.slyuzberg@xrb.govt.nz) or me.

Yours sincerely

Carolyn Cordery
Chair – New Zealand Accounting Standards Board

APPENDIX

Response to Specific Matters for Comment

Specific Matter for Comment 1: Prudence

In paragraphs 3.14A and 3.14B, the IPSASB has provided guidance on the role of prudence in supporting neutrality, in the context of the qualitative characteristic of faithful representation. Paragraphs BC3.17–BC3.17E explain the reasons for this guidance. Do you agree with this approach?

If not, why not? How would you modify these paragraphs?

Draft response

We support the proposed amendments on the guidance on prudence. We note that the proposed changes are aligned with the IASB's Conceptual Framework, and we have received feedback from constituents that such alignment is beneficial.

Specific Matter for Comment 2: Obscuring information as a factor relevant to materiality judgement

In discussing materiality in paragraph 3.32 the IPSASB has added obscuring information to misstating or omitting information as factors relevant to materiality judgments. The reasons for this addition are in paragraphs BC3.32A and 3.32B.

Do you agree with the addition of obscuring information to factors relevant to materiality judgments? If not, why not?

Draft response

Obscuring information

1. We support the proposed addition of 'obscuring information' to the factors that should be considered when determining whether an item is material, for the following reasons.

    (a) We consider materiality to be an important concept in general in the preparation of financial statements, including in the public sector. For example, we note that in our submission on ED 77 *Measurement*, we emphasised the importance of considering materiality when requiring and providing disclosures about inputs into current value measurements of assets and liabilities. Therefore, we welcome the proposed additional guidance on materiality that is aligned with the recent international thinking on this topic (i.e. the IASB's 2018 updates to its Conceptual Framework).

    (b) We have received feedback from constituents that the proposed alignment of the guidance on materiality with the guidance in the IASB's Conceptual Framework is beneficial.

    (c) We also note that in New Zealand, the *Public Benefit Entities Conceptual Framework* – which is based on the IPSASB's Conceptual Framework – is applicable to public benefit entities (PBEs) in both the public and not-for-profit sectors. We have received feedback

that in New Zealand, there is a tendency among some not-for-profit entities to provide overly detailed disclosures (such as detailed breakdowns of expenses) – and that the proposal in the ED to refer 'obscuring information' in the guidance on materiality could help reduce this tendency.

Display and disclosure of information

2. In addition to the proposal to refer to 'obscuring information', the ED proposes to add the following sentence to paragraph 3.32 of the IPSASB Conceptual Framework:

   "Where an entity judges that a material item is not separately displayed on the face of a financial statement (or displayed sufficiently prominently) an entity considers disclosure".

3. The rationale for this proposal is not explained in the Basis for Conclusions, and the proposal does not seem to be based on the IASB's Conceptual Framework.

4. We consider that the wording of the abovementioned proposed new sentence could be clarified, and we are not convinced that this sentence is needed in the Conceptual Framework – as explained in the following paragraphs.

5. Firstly, we are not convinced that it is necessary to include the abovementioned sentence in the guidance on materiality in the IPSASB Conceptual Framework. We agree that disclosure should be considered (and arguably should be provided) for material items that are not presented separately or prominently in the primary financial statements. However, we are not convinced that it is necessary to discuss the question of whether an item is displayed or disclosed in the general materiality guidance in the Conceptual Framework. We note that IPSAS 1 *Presentation of Financial Statements* discusses separate presentation of items in the primary financial statements and disclosures in the notes – including the presentation of additional items that are not specified in IPSAS 1, and disclosure of items that are not presented in the financial statements.

6. Secondly, we think the wording of the proposed sentence on 'display and disclosure' is unclear. The words '[not] displayed sufficiently prominently' imply an omission – i.e. that the item should have been displayed more prominently, but was not. We would have thought that in such a situation, the solution would be to ensure that the item is displayed, or displayed more prominently, in the primary financial statements – rather than only providing disclosure in the notes to the financial statements. IPSAS 1 requires certain items to be presented in the primary financial statements (i.e. 'displayed on the face of the financial statements') – but also requires additional items to be presented if such presentation is relevant to the understanding of the entity's financial performance or position.

7. If the IPSASB decides to retain the proposed sentence on 'display and disclosure', we would recommend the following.

   (a) Amending the sentence as follows, for greater clarity: "Where an entity judges that a material item need not be separately (or prominently) displayed ~~is not separately displayed~~ on the face of a financial statement ~~(or displayed sufficiently prominently)~~, an entity considers disclosure".

(b) Including the sentence in a separate paragraph – rather than as part of paragraph 3.32, which includes general discussion on materiality.

(c) Including an explanation for the reason for adding this sentence in the Basis for Conclusions.

Specific Matter for Comment 3: Rights-based approach to resources

Paragraphs 5.7A-5.7G reflects a rights-based approach to the description of resources in the context of an asset. The reasons for this approach are in paragraphs BC5.3A-5.3F.

Do you agree with this proposed change? If not, why not?

Draft response

General comment: rights-based approach to describing a resource

8. We support the proposal to describe a resource as a right in the context of the definition of an asset – instead of the current description, which distinguishes between 'items' and 'rights'. We agree with the IPSASB that service potential or economic benefit associated with the ownership of an item arises from the rights conferred by such ownership. Therefore, for the purpose of describing a resource in the context of the definition of an asset, we agree that it is not useful to distinguish between owned items and rights to use an item.

9. We also generally support the proposed guidance accompanying the rights-based description of a resource.

10. However, we have a suggestion for further improving the wording of the proposed new description of a resource. We also have a comment about the updated definition of an asset.

Recommendation to simplify the description of a resource

11. We think the proposed description of a resource could be further streamlined and simplified, to enhance the clarity of the description, as explained below.

(a) The proposed description of a resource in paragraph 5.6A of the ED is: "a right to either service potential or the capacity to generate economic benefits, or a right to both".

(b) The part of the description relating to economic benefits refers to a "right to […] the capacity to generate economic benefits". We think this part of the description could be streamlined.

(c) We note that the IASB's description of a resource is: "a right that has the potential to produce economic benefits".

(d) Considering the IASB's description, as well as the need to also refer to service potential to reflect the public sector context, we would recommend that the IPSASB considers the following alternative description of a resource:

"A resource is a right that has the capacity to generate economic benefits or service potential or both."

Definition of an asset: reference to 'past events'

12. The respective definitions of 'asset' and 'liability' in the IPSASB Conceptual Framework currently refer to resources controlled, and obligations arising, as a result of a past event (singular). The ED proposes to replace the reference to 'a past event' with 'past events' (plural).

13. We have received feedback that this change seems to imply that a single event is no longer sufficient for an asset or a liability to arise. We have considered whether to recommend any changes with respect to this feedback.

14. On one hand, we note the following points in support of the proposal to refer to 'past events'.

    (a) The proposal is consistent with the IASB's Conceptual Framework and reflects the fact that resources and obligations can accumulate over time as a result of multiple events.

    (b) The Basis for Conclusions in the ED explains that the term 'past events' include scenarios where an asset or a liability arises as a result of a single past event.

15. However, we also note that the following points may justify the feedback we received and may warrant further clarification for users of the IPSASB Conceptual Framework.

    (a) The IASB's Conceptual Framework has been referring to 'past events' for many years, since before the IPSASB issued its Conceptual Framework in 2014. We understand that when first publishing its Conceptual Framework, the IPSASB will have deliberately decided to use the term 'past event', rather than 'past events' as per the IASB's Conceptual Framework. The IPSASB is now proposing to change this decision.

    (b) Users of the IPSASB Conceptual Framework would have become accustomed to the reference to 'past event' in the definition of assets and liabilities. Like our constituents, such users might question whether the proposed change from 'past event' to 'past events' implies that a single event is no longer sufficient for a liability to arise – despite the explanation in the Basis for Conclusions.

16. On balance, we recommend clarifying in the core text of the IPSASB Conceptual Framework that the term 'past events' includes a single past event or multiple past events. This could be done as a new paragraph, or as a footnote next to the term 'past event'. We acknowledge that the IASB Conceptual Framework does not include such additional explanation. However, in light of the feedback we have received and our considerations above, we think this explanation would be useful for users of the IPSASB Conceptual Framework.

17. If the IPSASB decides not to specifically state in the core text of the Framework that 'past events' also includes a single past event, we recommend that the IPSASB emphasise this in the communications that accompany the finalised amendments to the Conceptual Framework.

Specific Matter for Comment 4: Definition of a liability

The revised definition of a liability is in paragraph 5.14:

A present obligation of the entity to transfer resources as a result of past events.

The reasons for the revised definition are in paragraphs 5.18A-5.18H

Do you agree with the revised definition? If you do not agree with the revised definition, what definition do you support and why?

Draft response

18. We generally support the proposal to refer to the transfer or resources in the definition of a liability. However, we have some comments on the guidance accompanying this proposed new definition. Please refer to the next SMC.

Specific Matter for Comment 5: Guidance on the transfer of resources

The IPSASB has included guidance on the transfer of a resource in paragraphs 5.16A-5.16F of the section on Liabilities. The reasons for including this guidance are in paragraphs BC5.19A-BC5.19D.

Do you agree with this guidance? If not, how would you modify it?

Draft response

General comment

19. We generally support including guidance on the transfer of a resource, to support the proposed new definition of a liability. However, we recommend that the IPSASB considers enhancing the guidance on the *recognition* of liabilities (and assets) in light of these proposals. This is explained in the paragraphs that follow.

Recommendation to enhance the guidance on the recognition of liabilities (and assets)

20. The proposed amendments to the guidance on liabilities in the ED emphasises that an obligation may meet the definition of a liability even if the probability of having to transfer resources is low. For example:

    (a) the proposed new paragraph 5.16A says: "To satisfy the definition of a liability the obligation must have the potential to require the entity to transfer a resource to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer a resource […]"; and

    (b) the proposed new paragraph 5.16B says: "An obligation can meet the definition of a liability even if the probability of a transfer of a resource is low. […]".

21. We understand the rationale for these proposals, i.e. to avoid conflating the principles of the definition of a liability with the recognition principles. We also note that the IASB made similar amendments to the guidance of the definition of a liability in its Conceptual Framework in 2018.

22. However, in light of the abovementioned proposals, we think it would be useful to consider enhancing the guidance on the *recognition* of liabilities in the IPSASB Conceptual Framework.

23. We note that the guidance on the recognition of liabilities in the IASB's Conceptual Framework appears to be more detailed and robust than the IPSASB's existing guidance on the recognition of liabilities. The chapter on recognition in the IPSASB Conceptual Framework includes some references to considering the qualitative characteristics. However, the chapter on recognition in the IASB's Conceptual Framework includes specific sections on considering relevance and faithful representation when determining whether a liability (or an asset) is recognised. These sections include a specific discussion on low probability of outflow (and inflow) of economic resources, as well as a discussion on existence uncertainty and measurement uncertainty.

24. We recommend enhancing the guidance on the recognition of liabilities in the IPSASB Conceptual Framework in a similar vein to the abovementioned IASB guidance. Such enhancements would help clarify that when the likelihood of a transfer of resources is low, an item may meet the definition of a liability but might not meet the criteria for recognition.

Specific Matter for Comment 6: Revised structure of guidance on liabilities

In addition to including guidance on the transfer of resources, the IPSASB has restructured the guidance on liabilities so that it aligns better with the revised definition of a liability. This guidance is in paragraphs 5.14A-5.17D. Paragraph BC 5.18H explains the reasons for this restructuring.

Do you agree with this restructuring? If not, how would you modify it?

Draft response

General comment

25. We agree with the restructure of the guidance on liabilities, to match the order in which terms are described in the revised definition of a liability.

26. However, we recommend considering enhancing the link between paragraphs 5.15A and 5.17C (two existing paragraphs that are being restructured), as explained below.

Enhancing the link between paragraphs 5.15A and 5.17C

27. We note that paragraphs 5.15A and 5.17C both make reference to public communication of intentions in the context of a liability.

    (a) Paragraph 5.15A states that an obligation must be to an external party to give rise to a liability, and that an entity "cannot be obligated to itself, *even where it has publicly communicated an intention to behave in a particular way*" [italics added for emphasis].

    (b) Paragraph 5.17C then discusses the communication of intention to other parties, in the context of identifying the point when a liability arises. This paragraph states that a promise made in an election is unlikely to give rise to a present obligation that meets the definition of a liability, but an announcement might have "such political support that the government has little option to withdraw".

28. We think the distinction between the election promise and the announcement referred to in paragraph 5.17C is not very clear, and that this paragraph seems to lack specificity. On the other hand, paragraph 5.15A clearly states that a public communication to behave in a certain way does not give rise to a liability if there is no obligation to an external party.

29. Therefore, we think it would be useful if paragraph 5.17C included a reference to paragraph 5.15A. This will also help ensure that the two paragraph are applied consistently.

Specific Matter for Comment 7: Unit of account

The IPSASB has added a section of Unit of Account in paragraphs 5.26A-5.26J. The reasons for proposing this section are in paragraphs BC5.36A-BC5.36C.

Do you agree with the addition of a section on Unit of Account and its content? If not, how would you modify it and why?

Draft response

30. We generally support the proposal to add a section with guidance on the unit of account. However, we have a comment on the inclusion of guidance on accounting principles for binding arrangement that are equally unperformed within the section on unit of account. Please refer to the next SMC.

Specific Matter for Comment 8: Accounting principles for binding arrangements that are equally unperformed

The IPSASB took the view that guidance on accounting principles for binding arrangements that are equally unperformed should be included in the Conceptual Framework, but that a separate section on accounting principles for such binding arrangements is unnecessary. These principles are included in paragraphs 5.26G-5.26H of the section on Unit of Account. The explanation is at paragraphs BC5.36D-BC5.36F.

Do you agree that:

(a) Guidance on principles for binding arrangements that are equally unperformed is necessary; and if so

(b) Such guidance should be included in the Unit of Account section, rather than in a separate section?

If you do not agree, please give your reasons.

Draft response

General comment

31. We support the proposal to include guidance on principles for binding arrangements that are equally unperformed in the IPSASB Conceptual Framework. However, we recommend relocating this guidance into a separate section – or otherwise acknowledging in the Basis for Conclusions that the principles in this guidance have broader application that just the 'unit of account' topic. Further information is included below.

Location of guidance on binding arrangements that are equally unperformed

32. Some of our constituents questioned the rationale for including the guidance on binding arrangements that are equally unperformed within the section on 'unit of account' – noting that in the IASB Conceptual Framework, the equivalent guidance on executory contracts is included in a separate section. The Basis for Conclusions explains that the IPSASB decided that a separate section on this topic is 'unnecessary', but the reason for this decision is not provided.

33. We are concerned that including the guidance on 'binding arrangements that are equally unperformed' within the section on 'unit of account' would imply to readers of the Conceptual Framework that the concepts in this guidance are confined solely to the determination of the unit of account. We do not think that this implication is correct. For example, we note the following.:

    (a) Paragraph 5.26G states that "The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the term of the exchange are currently unfavourable". Arguably, this guidance relates to meeting the definition of an asset or a liability.

    (b) Paragraph 5.26H states "To the extent that either party fulfils its obligations under the binding arrangement, the binding arrangement changes character. If the reporting entity performs first under the binding arrangement, that performance is the event that changes the reporting entity's right and obligation to exchange resources into a right to receive a resource. That right is an asset. If the other party performs first, that performance is the event that changes the reporting entity's right and obligation to exchange resources into an obligation to transfer a resource. That obligation is a liability". Arguably, this guidance relates to meeting the definition of an asset or a liability, as well as the timing of recognising an asset or a liability.

34. Therefore, we would recommend including the guidance on 'binding arrangements that are equally unperformed' in a separate section in Chapter 5, rather than within the 'unit of account' section (similarly to the IASB).

35. If the IPSASB decides to proceed with including this guidance within the section on 'unit of account', then we recommend the following amendments to the Basis for Conclusions:

    (a) adding an acknowledging that the principles in this guidance have broader application that just the 'unit of account' topic; and

    (b) clarifying why the IPSASB decided that it is not necessary to have a separate section on 'binding arrangements that are equally unperformed'.

XRB | Te Kāwai Ārahi Pūrongo Mōwaho EXTERNAL REPORTING BOARD

Memorandum

Date:	24 March 2022
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	**IFRIC tentative agenda decision *Negative Emission Vehicle Credits* (IAS 37)**

Purpose and introduction[1]

1. The purpose of this paper is to recommend that the Board submits a comment letter to the IFRS Interpretations Committee (IFRIC) on its tentative agenda decision *Negative Low Emission Vehicle Credits* (IAS 37).

2. As explained in this paper, while the agenda decision may be relevant to some entities in New Zealand, we think the decision would result in appropriate outcomes for such entities. We therefore have no specific concern with the tentative agenda decision itself to raise with the IFRIC or the IASB. However, based on feedback received from the XRB's Accounting Technical Reference Group (TRG), we recommend submitting a brief comment letter to reiterate the importance of commencing a broader standard-setting project on emission trading rights and 'pollutant price mechanisms'.

Recommendations

3. The Board is asked to:

   (a) AGREE to comment on the IFRIC tentative agenda decision *Negative Low Emission Vehicle Credits* (IAS 37); and

   (b) APPROVE the draft comment letter on this tentative agenda decision (agenda item 8.2).

Background

4. At the Board's February 2022 meeting, as part of the standing item on recent IFRIC agenda decisions, the Board noted the IFRIC tentative agenda decision *Negative Low Emission Vehicle Credits* (IAS 37). At that meeting, the Board asked staff to consider this tentative agenda decision further, with a view to:

   (a) gain a better understanding of the relevance of this decision in New Zealand, and;

   (b) recommend whether the Board should comment on the tentative decision.

5. Following the February 2022 meeting, we have considered whether there are any emission reduction programmes in New Zealand that may be similar to the programme described in the IFRIC tentative agenda decision, and if so, whether the agenda decision results in appropriate outcomes for New Zealand entities that participate (or will participate) in such programmes.

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

6. We also discussed the tentative agenda decision with the TRG on 8 March 2022.

7. The results of the above considerations and discussions – and our subsequent recommendation to submit a brief comment letter to IFRIC – are summarised in this paper.

Structure of this memo

8. The remaining sections in this memo are:

   (a) Summary of the tentative agenda decision;

   (b) Carbon emission reduction programmes in New Zealand;

   (c) Analysis of the tentative agenda decision in the New Zealand context;

   (d) TRG discussion; and

   (e) Recommendation to comment.

Summary of the tentative agenda decision

9. The IFRIC received a query about a government programme to reduce carbon emissions from vehicles. The government programme can be summarised as follows.

   (a) Under this programme, vehicle manufacturers and importers receive 'positive credits' or 'negative credits', depending on whether the average emissions of the vehicles produced/imported during the year is below or above a specific target.

   (b) Negative credits must be eliminated, either by purchasing positive credits, or by generating positive credits in the following year by producing/importing low-emission vehicles.

   (c) If the entity fails to eliminate its negative credits in one of the ways mentioned above, the government can impose sanctions on the entity – for example, restricting the entity's access to the market.

10. The IFRIC was asked whether, under this government programme, an entity that produced/imported vehicles whose emissions exceed the government's target has a present obligation that meets the definition of a liability under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

11. The IFRIC noted that the following requirements in IAS 37 are relevant:

   (a) Paragraph 10 defines a liability as 'a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'.

   (b) Paragraph 10 distinguishes legal obligations (which derive from an operation of law) from constructive obligations (which derive from an entity's actions) and defines an obligating event as 'an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation'.

(c) Paragraph 17 clarifies that an entity has no realistic alternative to settling an obligation only if settlement can be enforced by law or, in the case of a constructive obligation, where an event has created valid expectations in other parties that the entity will discharge the obligation.

(d) Paragraph 19 further clarifies that it is only those obligations arising from past events existing independently of an entity's future actions that meet the definition of a liability.

12. The Committee tentatively decided that in this scenario, assuming that accepting the government's sanctions is not a realistic alternative for the entity, the entity has a legal obligation that meets the definition of a liability in IAS 37, for the following reasons.

(a) A *past event* (the production/import of vehicles whose emissions exceed the government target) has given rise to a *present obligation* (to eliminate negative credits), which will result in an *outflow of resources* from the entity (purchasing positive credits for cash or giving up next year's positive credits that could otherwise be sold).

(b) The obligation is a legal obligation – the government can enforce the obligation by law by imposing sanction (unless accepting the sanctions is a realistic alternative for the entity).

(c) The obligation exists *independently of the entity's future actions*. The only action required to trigger the obligation is the production/import of vehicles whose emissions exceed the government's target. The entity's future actions affect only the way in which the obligation will be settled.

13. If accepting the government's sanction is a realistic alternative for the entity, then the entity does not have a *legal* obligation to eliminate the negative credits, but it might still have a *constructive* obligation that meets the definition of a liability under IAS 37, for same the reasons listed above. A constructive obligation would exist, for example, if the entity has taken action that creates a valid expectation that it will eliminate negative credits.

14. The Committee tentatively decided that no standard-setting activity is required. The full text of the tentative agenda decision is included in Appendix A.

15. The tentative decision is open for comment until 12 April 2022.

Carbon emission reduction programmes in New Zealand

16. We have considered whether there are any emission reduction programmes in New Zealand that may be similar to the programme described in the IFRIC tentative agenda decision. We did this because if there are similar programmes in New Zealand, then the tentative agenda decision is likely to be relevant to New Zealand entities that are subject to those programmes. The next step would then be to consider whether the tentative agenda decision is likely to result in appropriate outcomes for such New Zealand entities.

17. The emission reduction programmes listed below appear to have some similarities to the programme described in the tentative agenda decision. Please note that our search for such programmes in New Zealand was not exhaustive and other similar schemes may exist. Please

also note that the descriptions below are summarised and do not include the full detail of each programme and are based our understanding of the programmes.

Clean Vehicle Standard

18. The *Land Transport (Clean Vehicles) Amendment Bill* received Royal Assent on 22 February 2022. Among other changes, this Bill introduces the Clean Vehicle Standard. The purpose of the Clean Vehicle Standard is to rapidly reduce carbon dioxide emissions from light vehicles imported into New Zealand.

19. We understand that the Clean Vehicle Standard would operate as follows.

    (a) Suppliers of vehicles will need to ensure that on average, the carbon dioxide emissions from the vehicles they import into New Zealand do not exceed a specified emissions target.

    (b) If the average emissions of the vehicles imported by the supplier during the year is below the specific target, the supplier receives 'carbon dioxide credits', which can be used in future years to offset fees (see below).

    (c) If the average emissions of the vehicles imported by the supplier during the year exceed the specified target, the supplier will be charged a fee. The supplier can offset this fee with credits carried forward from previous years.

    (d) If the supplier does not have enough credits to offset the fee, the supplier must:

    - pay the fee, or;
    - offset the fee in the following year using carbon dioxide credits to be generated in the following year (known as 'borrowing'), or;
    - arranging to receive a 'transfer' of carbon dioxide credits from another supplier.

    (e) The Bill does not seem to specify whether receiving a transfer or credits would require a payment of cash, but we presume that this would be the case. We note that transfers can be made only between suppliers of the same type of vehicle (i.e. a supplier of new vehicles meeting the definition of 'category 1' under the Bill may transfer credits only to another supplier of 'category 1' new vehicles – and not to suppliers of used vehicles or suppliers of 'category 2' new vehicles.

    (f) Fees will start to be charged from 2023 onwards.

    (g) The Bill does not specifically state how the fees payable under the Clean Vehicle Standard will be enforced. However, the Bill states that the Governor-General may issue regulations "providing for unpaid charges […] to be recoverable debt due to the Crown". Presumably the Governor-General would issue such regulations.

20. More information on the Clean Vehicle Standard is available here.

The New Zealand Emission Trading Scheme (ETS)

21. The ETS was established by the Climate Change Response Act 2002. ETS participants are required to surrender New Zealand Units (NZUs) to the Government for every tonne of

carbon-equivalent greenhouse gas emissions arising from certain activities. For example, NZUs must be surrendered for de-foresting, mining coal/gas, producing iron/steel, removing liquid fuel from the refinery, operating a waste disposal facility and certain other activities.

22. ETS participants can obtain NZUs (also known as 'carbon credits') in the following ways.

    (a) Some ETS participants receive NZUs from the Government. For example, participants receive NZU for activities that remove greenhouse gases from the atmosphere – such as growing forests. Participants can use NZUs received to satisfy their surrender obligation, and can sell surplus NZUs.

    (b) Participants that do not receive NZUs from the Government (or do not receive enough NZUs to satisfy their surrender obligation) need to purchase NZUs to satisfy their surrender obligation. NZUs can be purchased from the Government (directly or at an auction), or from other entities on the secondary market.

23. Under the ETS, entities in the following sectors must surrender carbon credits with respect to their emissions (forestry participants must also surrender NZUs for deforestation).

    (a) Forestry;

    (b) Waste;

    (c) Synthetic gases;

    (d) Industrial processes (such as manufacturers of iron and steel);

    (e) Liquid fossil fuels (such as petrol and diesel suppliers), and;

    (f) Stationary energy (such as electricity generation and industrial heating).

24. The obligation to surrender carbon credits is set 'as far up the supply chain as possible'. For example, in the liquid fossil fuel sector, the obligation is placed importing the fuel, rather than on the drivers of fossil-fuelled vehicles.

25. Under the Climate Change Response Act 2002, failure to surrender NZU on time results in monetary penalties.

26. More information on the ETS is available here.

Proposals for the agriculture sector

27. Under the ETS, entities in the agriculture sector must report on their emissions, but currently they do not have an obligation to surrender carbon credits for their emissions.

28. In April 2022, the Government is expected to receive recommendations from *He Waka Eke Noa – Primary Sector Climate Action Partnership* about a pricing system for agricultural emissions. Pricing options being considered include the following.

    (a) Farm-level levy: A levy would be charged based on a farm's net emissions (calculated based on farm-specific data).

(b) Processor-level hybrid levy: Emissions are calculated at the meat, milk, and fertiliser processor level, based on the quantity of product received from farms, or in the case of fertiliser, sold to farms. Processors would likely pass on the cost to farms based on the quantity of product processed, or fertiliser bought.

29. Rewards for on-farm 'sequestration' of carbon (e.g. planting vegetation that would not be harvested or would be harvested and renewed) could be used to offset levies under both options mentioned above.

30. If neither of the above options is accepted, the 'backstop' option is for the Government to require the agriculture sector to surrender NZUs as part of the ETS (see above).

31. The abovementioned pricing system is expected to be in place by 2025.

32. More information on the proposed pricing system is available here.

Analysis of the tentative agenda decision in the of New Zealand context

33. The table below compares the abovementioned emission reduction programmes that are currently in place or in development in New Zealand with the IFRIC tentative agenda decision – including an analysis of whether the requirements in IAS 37 for meeting the definition of a liability are met in each case.

Table 1 Comparison of New Zealand emission reduction schemes with the programme described in the IFRIC tentative agenda decision

	IFRIC tentative decision	Clean Vehicle Standard	New Zealand ETS	Agriculture proposals
Past event giving rise to obligation	Producing or importing vehicles whose emissions (on average) exceed the government's target, leading to a balance of negative credits	Importing vehicles whose emissions (on average) exceed the government's target, where the emissions exceed the balance of accumulated credits from previous years (if any)	Carrying out activities that lead to emission of greenhouse gases (or equivalent activities, such as deforesting)	Emitting greenhouse gases/carrying out activities that cause emission of greenhouse gases
Present obligation	Obligation to eliminate the negative credits balance, by: • purchasing positive credits, or • giving up positive credits to be generated next year.	Obligation to: • pay the fee, or • give up credits to be generated next year to offset the fee, or • have credits transferred from another entity to offset the fee (presumably for a payment).	Obligation to surrender NZU on hand (if any) or to purchase NZUs and surrender them.	Obligation to pay levy.

	IFRIC tentative decision	Clean Vehicle Standard	New Zealand ETS	Agriculture proposals
Future outflow of resource embodying economic benefit	Each of the settlement options above would result in the outflow of resources, i.e. paying cash or giving up future positive credits that could otherwise be sold for cash.	Assuming that receiving a transfer of credits from another entity would require the payment of cash, each of the settlement options above would result in the outflow of resources – i.e. paying cash, or of giving up future credits that could otherwise be used to offset future fees or transferred for cash.	Settling the obligation will require the outflow of resources, in the form of paying cash to purchase NZUs, or surrendering NZUs on hand that could otherwise be sold or used to reduce future surrender obligations.	Settling the obligation will require outflow of resources, in the form of cash payment for the levy.
Legal enforceability of obligation	Failure to eliminate negative credits leads to government sanctions, including loss of access to the market.	The Bill states that the Governor-General may issue regulations "providing for unpaid charges […] to be recoverable debt due to the Crown".	Failure to surrender NZUs results in monetary penalties under the related legislation.	These proposals are still at a relatively early stage, so we are not certain how the proposed levies will be enforced.
Existence of obligation independent of future actions?	Yes. The entity has options in terms of the manner of settling the obligation, but the obligation exists irrespective of this choice.	Yes. The entity has options in terms of the manner of settling the obligation, but the obligation exists irrespective of this choice.	Yes. The entity has options in terms of the manner of settling the obligation, but the obligation exists irrespective of this choice.	Yes, based on currently available information. It appears that the entity will not be able to avoid paying the levy (assuming that the Government can enforce payment).
In light of the agenda decision, would the definition of a liability be met under NZ IAS 37?	Yes, assuming that accepting government sanctions for failure to comply is not a realistic alternative for the entity.	Yes – and this seems to be an appropriate outcome, based on the analysis in the rows above.	Yes – and this seems to be an appropriate outcome, based on the analysis in the rows above.	Yes – and this seems to be an appropriate outcome, based on the analysis in the rows above.

34. Based on the analysis above, the tentative agenda decision is likely to be relevant to some New Zealand entities, both in the automotive industry and potentially in other industries that are subject to the ETS (and in future years, to the agriculture sector).

35. However, we think that the decision would lead to a sensible outcome for the abovementioned New Zealand entities. That is, it seems sensible that a liability would be

recognised when a vehicle importer exceeds the government's emissions target under the Clean Vehicle Standard, or when an ETS participant undertakes activities that incur a 'surrender obligation', or when an entity in the agriculture sector engages in activities that generate emissions. This is because of the following.

(a) As noted in the table on the previous page, in these circumstances the entity seems to have a present obligation as a result of a past transaction that would result in either the outflow of resources (cash or credits/units).

(b) While some of the New Zealand programmes give entities a choice as to how to settle their obligation, the obligation resulting in outflow of resources embodying economic benefit exists irrespective of the entity's choice of settlement method.

(c) The obligations in the programmes are legally enforceable (assuming that regulations will be issued with respect to the Clean Vehicle Standard to provide for unpaid fees to be 'recoverable debt due to the Crown, and that the proposed agriculture levy is enforceable by the Government).

(d) In the programme described in the tentative agenda decision, failure to eliminate negative credits involves government sanctions that do not result in the direct payment to the government. However, the method of enforcement in the New Zealand programmes involve either monetary penalties (ETS) or enforced debt collection (Clean Vehicle Standard – assuming that the relevant regulation is issued). Arguably, this makes it clearer that the obligations under the New Zealand programmes represent obligation to transfer resources that cannot be avoided and meet the definition of a liability.

36. In summary, based on the analysis above, we think that the tentative agenda decision could be relevant to some New Zealand entities that are subject to programmes that are somewhat similar to the programme described in the tentative decision. However, we think that the outcome of the decision (i.e. that the obligations under the programmes would meet the definition of a liability) is sensible.

TRG discussion

37. At the March 2022 TRG meeting, we sought TRG members' feedback on the tentative agenda decision, our analysis described above, and our preliminary recommendation (at the time) that the Board should not comment on the tentative agenda consultation.

38. TRG members agreed with staff's preliminary view that the tentative agenda decision may be relevant in New Zealand but result in an appropriate outcome for New Zealand entities that are subject to the emission reduction schemes described above.

39. However, TRG members noted that the measurement of liabilities relating to emission reduction programmes can be challenging. They noted the need for a broader standard-setting project on accounting for participation in emission trading schemes.

40. Therefore, TRG member recommended that the Board comment on the tentative agenda decision – to support the agenda decision itself, but also to encourage the IASB to undertake a broader standard-setting project on emission trading schemes/pollutant pricing mechanisms.

41. We acknowledge that the tentative agenda decision focuses on a specific emission reduction programme, and that it focuses only on meeting the definition of a liability – rather than on the measurement of such liabilities or on assets arising from emission reduction schemes/emission reduction programmes. However, we note that the TRG's comments are consistent with the comments made by the Board in its submission on the IASB's Request for Information (RFI) *Third Agenda Consultation* (please see the next section of this memo). We think there is merit in reiterating these comments in a brief comment letter on the tentative agenda decision.

The Board's submission on the IASB's Third Agenda Consultation

42. The IASB's RFI *Third Agenda Consultation* included a list of possible projects that the IASB could undertake in the next five years. This list included a project on pollutant price mechanisms. Our survey on the RFI indicated that 'pollutant price mechanism' was the third most popular high-priority project among respondents. In its submission on the RFI, the Board ranked pollutant price mechanism as a medium-priority project.

43. The Board's submission on the RFI also included comments relating to emission trading rights, in the context of the Board's recommendation that the IASB should commence a project on intangible assets as a matter of high priority. These comments relate to assets arising from emission trading schemes, whereas the tentative agenda decision relates to liabilities. Nevertheless, we think these comments are relevant in the context of the TRG's recommendations about a broader project on emission trading schemes.

44. The following extract from the Board's submission on the RFI discusses emission trading rights.

> 30. IAS 38 was first issued in the late 1990s and has not had any substantive changes made to it over time. As a result, it has become outdated as a plethora of intangibles have developed and evolved since that time. These new kinds of intangibles could not have been anticipated when IAS 38 was first issued. For example, developments in digital technologies, emissions trading rights, cryptocurrencies and cloud storage, were not (and could not) have been contemplated in the late 1990s.
>
> […]
>
> 37. In undertaking a comprehensive review of IAS 38 we consider the IASB needs to:
>
> […]
>
> (b) determine the extent to which emerging financial reporting issues (e.g. emission trading rights, cloud-based computing arrangements and crypto-currencies) should be addressed by an IFRS Standard on intangible assets;"

45. In drafting the comment letter on the tentative agenda decision, we have re-iterated the abovementioned points from the Board's comment letter on the IASB's Third Agenda Consultation, consistently with the TRG's recommendations.

Recommendation to comment on the tentative agenda decision

46. Based on the TRG's recommendations, we recommend that the Board submits a brief comment letter on the tentative agenda decision. We recommend that the comment letter notes the following.

    (a) We do not have any concerns with tentative agenda decision itself (based on our understanding that the decision may be relevant to some New Zealand entities, but results in an appropriate outcome for such entities).

    (b) However, we think it is important that the IASB commence standard-setting work on accounting for emission trading rights and related liabilities and 'pollutant price mechanisms', as noted in our submission on the IASB's Third Agenda Consultation.

Questions for the Board

Q1. Does the Board agree to comment on the tentative agenda decision *Negative Low Emission Vehicle Credits* (IAS 37)?

Q2. Does the Board have any comments on the draft comment letter in agenda item 8.2?

Q3. Does the Board approve the draft comment letter in agenda item 8.2?

Next steps

47. If the Board approves the draft comment letter, we will submit it to the IFRIC by the due date of 12 April 2022. We propose that any changes to the comment letter based on the Board's feedback at this meeting will be finalised through review and final approval by the Chair.

Attachments

Agenda item 8.2: Draft comment letter

Appendix A

IFRIC tentative agenda decision Negative Low Emission Vehicle Credits (full text)

The IFRS Interpretations Committee (Committee) discussed the following matter and tentatively decided not to add a standard-setting project to the work plan. The Committee will reconsider this tentative decision, including the reasons for not adding a standard-setting project, at a future meeting. The Committee invites comments on the tentative agenda decision. All comments will be on the public record and posted on our website unless a respondent requests confidentiality and we grant that request. We do not normally grant such requests unless they are supported by good reason, for example, commercial confidence.

Tentative Agenda Decision

The Committee received a request asking whether particular measures to encourage reductions in vehicle carbon emissions give rise to obligations that meet the definition of a liability in IAS 37.

The request

The request described government measures that apply to entities that produce or import passenger vehicles for sale in a specified market. Under the measures, entities receive positive credits if in a calendar year they have produced or imported vehicles whose average fuel emissions are lower than a government target, and negative credits if in that year they have produced or imported vehicles whose average fuel emissions are higher than the target.

The measures require an entity that receives negative credits for one year to eliminate those negative credits, either by purchasing positive credits from another entity or by generating positive credits itself in the next year (by producing or importing more low emission vehicles) and using those positive credits to eliminate the negative balance. If the entity fails to eliminate its negative credits in one or other of those two ways, the government can impose sanctions on the entity, for example restrict the entity's access to the market.

The request considered the position of an entity that has produced or imported vehicles with average fuel emissions higher than the government target, and asked whether such an entity has a present obligation that meets the definition of a liability in IAS 37.

Applicable requirements

Paragraph 10 of IAS 37 defines a liability as 'a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'. Paragraph 10 of IAS 37 distinguishes legal obligations (which derive from an operation of law) from constructive obligations (which derive from an entity's actions) and defines an obligating event as 'an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation'. Paragraph 17 of IAS 37 clarifies that an entity has no realistic alternative to settling an obligation only if settlement can be enforced by law or, in the case of a constructive obligation, where an event (which may be an action of the entity) has created valid expectations in other parties that the entity will discharge the obligation. Paragraph 19 of IAS 37 further clarifies that it is only those obligations arising from past events existing independently of an entity's future actions that meet the definition of a liability.

The Committee's conclusions

The Committee concluded that an entity that has produced or imported vehicles with average fuel emissions higher than the government target has a legal obligation that meets the definition of a liability in IAS 37, unless accepting the sanctions that the government can impose is a realistic alternative to eliminating negative credits for that entity. The Committee's reasoning was that:

- the activity that may give rise to an obligation to eliminate negative credits is the production or import of vehicles. To the extent that an entity has produced or imported vehicles with average fuel emissions higher than the government target by the end of the reporting period, that obligation has arisen from past events.
- the measures that create the obligation and give the government the authority to impose sanctions derive from an operation of law. Hence, the obligation is a legal obligation and the sanctions the government can impose are the means by which settlement can be enforced by law. The requirement that 'settlement of the obligation can be enforced by law' is met, unless accepting sanctions for non-settlement is a realistic alternative for an entity.
- an entity can settle its obligation either by purchasing positive credits from another entity or by generating positive credits itself in the next year and using those positive credits to eliminate the negative balance. In either case, settlement involves an outflow from the entity of resources embodying economic benefits. In the first case, the resource is cash; in the second case, the resources are the positive credits the entity will receive for the next year and surrender to eliminate its current negative balance. The entity could otherwise have used those self-generated positive credits for other purposes—for example, to sell to other entities with negative credits.
- the obligation arises from past events and exists independently of the entity's future actions (the future conduct of its business). Under the measures, the only action required to trigger an obligation is the production or import of vehicles with average fuel emissions higher than the government target, and this action has already occurred. The entity's future actions will determine only the means by which the entity settles its present obligation—whether it purchases credits from another entity or generates positive credits itself by producing or importing more low emission vehicles. The fact pattern described in the request differs from the fact pattern in other examples that illustrate or interpret the application of paragraph 19 of IAS 37 and for which the conclusion is that no present obligation exists—for example, part (a) of Illustrative Example 6 (Legal requirement to fit smoke filters), IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and Example 2 in IFRIC 21 *Levies*. In all these other examples, the entity has not yet taken the actions necessary to trigger an obligation under the applicable legislation.

The Committee considered the position of an entity that:

(a) has produced or imported vehicles with average fuel emissions higher than the government target; but

(b) does not have a *legal* obligation that meets the definition of a liability in IAS 37, because accepting sanctions is a realistic alternative for that entity, meaning the obligation cannot be enforced by law.

The Committee concluded that such an entity nevertheless could have a *constructive* obligation that meets the definition of a liability in IAS 37. The entity would have such an obligation if it has taken an action (for example, made a sufficiently specific current statement) that has created valid

expectations in other parties that it will eliminate negative credits generated from its past production or import activities.

The request asked only whether the government measures give rise to obligations that meet the definition of a liability in IAS 37. The Committee noted that, having identified such an obligation, an entity would apply other requirements in IAS 37 to determine how to measure the liability. The Committee did not discuss those other requirements.

The Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine whether, in the fact pattern described in the request, an entity has an obligation that meets the definition of a liability in IAS 37. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

The deadline for commenting on the tentative agenda decision is **12 April 2022**. The Committee will consider all comments received in writing by that date; agenda papers analysing comments received will include analysis only of comments received by that date.

XX April 2022

Mr Bruce Mackenzie
Chair of the IFRS Interpretations Committee
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7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Submitted to: www.ifrs.org

Dear Bruce

IFRS Interpretations Committee tentative agenda decision *Negative Low Emission Vehicle Credits*

Thank you for the opportunity to comment on the tentative agenda decision *Negative Low Emission Vehicle Credits*.

We support the tentative agenda decision that 'negative credits' arising from the emission reduction programme described in the decision result in an obligation that meets the definition of a liability under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Having considered the tentative agenda decision in the New Zealand context, we consider that the tentative agenda decision will support appropriate outcomes when applying the definition of a liability in IAS 37 to the specific circumstances described in the request.

We acknowledge that the tentative agenda decision focuses on a specific emission reduction programme, and that it focuses only on meeting the definition of a liability – rather than on the measurement of such liabilities or on assets arising from emission reduction schemes. However, discussion with our Technical Reference Group highlighted that the measurement of liabilities relating to emission reduction programmes can be challenging, and that there is need for a broader standard-setting project on accounting for matters relating to emission trading schemes, as there is currently limited guidance in IFRS Standards on such matters.

We note that in 2021, the IASB's Request for Information (RFI) *Third Agenda Consultation* included a possible project on pollutant price mechanisms, which includes accounting for participation in emission trading schemes. Consistent with our submission on that RFI, we re-emphasise the importance of commencing a standard-setting project on this topic – including addressing matters related to emission trading rights, as well as the related obligations.

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

Yours sincerely

Carolyn Cordery
Chair – New Zealand Accounting Standards Board

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	24 March 2022
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	**PBE Leases: Proposed New Zealand modifications to IPSAS 43**

Purpose and introduction[1]

1. At its February 2022 meeting, the Board agreed to commence the development of an Exposure Draft (ED) based on IPSAS 43 *Leases* – rather than delaying this work until after the IPSASB finishes its project on concessionary leases.

2. While the ED would be based on IPSAS 43 *Leases*, we propose to make certain modifications to the text of IPSAS 43, to enhance the appropriateness and usefulness of this standard for New Zealand PBEs and the users of their financial statements.

3. The purpose of this paper is to seek the Board's feedback on some of the main areas where we think modifications may be required, to advance the development of the ED. Please note that this memo does not cover all areas where New Zealand modifications may be needed.

Recommendation

4. We recommend that the Board AGREES on the approach to developing New Zealand modifications to IPSAS 43 *Leases* (IPSAS 43 is attached as agenda item 9.2).

Background

5. In January 2022, the IPSASB issued IPSAS 43 *Leases*. The requirements in IPSAS 43 are based on ED 75 *Leases* and are substantially aligned with the requirements in IFRS 16 for both lessees and lessors. That is:

   (a) IPSAS 43 requires lessees to account for all leases (with limited exception) using the 'right-of-use' (ROU) model.

   (b) The ROU model requires the recognition of a ROU asset with respect to the right to use the leased asset for a specified period of time, and a lease liability with respect to the future lease payments.

   (c) This means that for lessees, there is no longer a distinction between 'finance leases' (which were previously recognised on the balance sheet) and 'operating leases' (which were previously not on the balance sheet) – meaning that lessees need to bring onto the balance sheet those leases that were previously classified as 'operating leases'.

   (d) For lessors, IPSAS 43 continues to distinguish between operating and finance leases.

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

6. The IPSASB has a separate (but related) project on *Concessionary Leases and Other Arrangements Similar to Leases*. The IPSASB published a Request for Information (RFI) on this topic in September 2022. The IPSASB expects to publish an ED on this topic in December 2022, with a final pronouncement expected in March 2024.

7. At its February 2022 meeting, the Board applied the PBE Policy Approach to IPSAS 43.

   (a) The Board agreed that it should propose incorporating the requirements into IPSAS 43 into PBE Standards.

   (b) In terms of timing, the Board agreed to commence the development of a domestic ED based on IPSAS 43 now – rather than delaying this work until after the IPSASB finishes the abovementioned project on concessionary leases.

8. We are currently considering the content of the draft ED. Specifically, we are considering whether to propose New Zealand modification text of IPSAS 43, to enhance the appropriateness and usefulness of this standard for New Zealand PBEs and the users of their financial statements. We are seeking the Board's agreement on some of the key proposed modifications, to help advance the development of the ED. We plan to bring a draft ED to a future Board meeting.

9. We plan to publish the ED for consultation in September or October 2022.

Structure of this memo

10. The remaining sections of this memo are:

    (a) Consideration of New Zealand modifications to IPSAS 43 *Leases*:

        (i) Scope;

        (ii) Meaning of 'low value' leases;

        (iii) Discount rate

        (iv) Interaction with IFRS 15;

        (v) Effective date;

        (vi) Other matters; and

    (b) Next steps.

Consideration of New Zealand modifications to IPSAS 43

11. The paragraphs that follow consider areas for possible New Zealand modifications to the requirements on IPSAS 43. These considerations are mainly based on the points raised by the Board in its submission to the IPSASB on ED 75 *Leases*.

Scope

Issue: Scope clarification with respect to concessionary leases

12. In its submission to the IPSASB on ED 75 *Leases*, the Board recommended clarifying the scope of the ED with respect to concessionary leases and leases for nominal consideration (hereafter referred to as 'concessionary leases'). The Board noted the following.

    (a) The Board *agreed that concessionary leases should be in the scope* of the standard based on ED 75, as concessionary leases meet the definition of a lease in the ED. That is, a concessionary lease still represents a right to use an asset for a period of time in exchange for consideration, even if the consideration is less than normal market terms.

    (b) However, the Board recommended that the *accounting for the concessionary component of the lease should be explicitly excluded from the scope* of the standard based on ED 75 – until the IPSASB completes its work on concessionary leases ('Phase 2' of the IPSASB's work on leases).

    (c) Furthermore, the Board recommended the scope of IPSAS 23 *Revenue from Non-exchange Transactions* should specifically exclude leases within the scope of the standard based on ED 75, until Phase 2 of the IPSASB's work on leases is complete. The scope exclusion would ensure that entities are not required to account for concessionary leases at fair value under IPSAS 23. The IPSASB's previous proposal in ED 64 *Leases* was not supported by most respondents, and it is not yet known whether the IPSASB will propose this treatment when it issue an ED on concessionary leases.

    (d) The Board recommended that the standard based on ED 75 and IPSAS 23 need to be clear that the accounting for the concessionary component of a lease will be addressed under 'Phase 2' of the project. As a consequence, *all concessionary leases including leases for nominal consideration, would be accounted for at cost – rather than fair value* – until Phase 2 of the IPSASB's work on leases is completed.

    (e) Furthermore, until Phase 2 of the project is completed, it should be made clear that the *accounting requirements for "leases for nil consideration" have not yet been developed*.

13. In finalising IPSAS 43, the IPSASB did not amend its proposals for the abovementioned recommendations made by the Board.

Consideration of New Zealand modifications

14. We note that the Board's comments in its submission reflect feedback received from New Zealand constituents. Therefore, we recommend that our domestic ED includes an explicit clarification of the scope of the proposals with respect to concessionary leases, as per the Board's comments above.

15. Specifically, we recommend that the ED based on IPSAS 43 includes the following New Zealand modifications, as shown in Table 1 below.

Table 1 Proposed New Zealand modifications to IPSAS 43 in relation to scope

Location of modification	Content of modification
Scope section of the draft Standard on PBE Leases	We propose to add paragraphs to specify the following: • For the purpose of this Standard, *concessionary leases* are leases that meet the definition of a lease in this Standard, but which have below-market terms. Such leases include leases for nominal consideration (but not nil consideration). Arrangements where no consideration is paid for the right to use an asset over a specified term do not meet the definition of a lease in this Standard. • Concessionary leases, including leases for nominal consideration, are within the scope of the [draft] Standard. • In applying the measurement requirements in this Standard, an entity takes into account the amounts of lease payments as per the lease agreement, and not the amounts of lease payments that would have been charged had the lease been on market terms.
Basis for Conclusions (BC) of the draft Standard on PBE Leases	We propose to add BC paragraphs to explain the following: • There are currently no accounting requirements in PBE Standards for the 'concessionary component' of a concessionary lease, or for arrangements to use an asset for a specified period for no consideration. • Such requirements will be developed after the IPSASB finalises its project on concessionary leases and other public sector-specific lease-like arrangements. • Until such requirements are developed, the Standard requires concessionary leases to be measured based on the lease payments as per the lease agreement, and not the amounts of lease payments that would have been charged had the lease been on market terms. • Furthermore, arrangements where no consideration is paid for the right to use an asset over a specified term do not meet the definition of a lease in this Standard and are therefore outside the scope of the Standard. • This will be reconsidered after the IPSASB completes its project on concessionary leases and other public sector-specific lease-type arrangements.

Location of modification	Content of modification
Consequential amendments to the core text of PBE IPSAS 23 *Revenue from Non-exchange Transactions*	We propose to add a paragraph to the scope section of PBE IPSAS 23, to specify the following: • Leases within the scope of the [draft] Standard on leases and arrangements to use an asset for a specified period for no consideration are excluded from the scope of PBE IPSAS 23.
Consequential amendments to the BC of PBE IPSAS 23	We propose to add paragraphs to the BC of PBE IPSAS 23, to explain the following: • The IPSASB is considering the development of accounting requirements for concessionary leases and arrangements to use an asset for a specified period for no consideration. • Once the IPSASB finishes this work, the NZASB will consider the development of requirements on this topic. • Until such requirements are developed, it is not appropriate to require fair value measurement for the concessionary component of a concessionary lease or for 'leases' for nil consideration. • Therefore, leases within the scope of the [draft] Standard on leases and arrangements to use an asset for a specified period for no consideration are specifically excluded from the scope of PBE IPSAS 23. • This will be reconsidered after the IPSASB completes its project on concessionary leases and other public sector-specific lease-type arrangements.

16. Please note that in the proposed amendments to the scope section of the draft standard on PBE Leases, we have referred generally to 'the measurement requirements of the Standard' – rather than referring to measuring the ROU asset and lease liability. This is because we understand that the scope clarification would need to apply to all concessionary leases – regardless of whether the entity is a lessee or a lessor, and if the entity is a lessee, regardless of whether the recognition exemption for short-term and 'low value' leases applies or not.

Question for the Board

Q1. In relation to the scope of the PBE Standard on leases, does the Board have any feedback on the proposed modifications in Table 1 above?

Meaning of 'low value' leases

Issue: Assessment of whether a lease is of 'low value'

17. Paragraphs 6 of IPSAS 43 provides a recognition exemption for short-term leases and 'lease for which the underlying asset is of low value' (hereafter referred to as 'low value leases'). An entity need not recognise a ROU asset and a lease liability for short-term leases and low value leases. Instead, the lease payments relating to such leases may be accounted for as expenses on a straight-line basis.

18. Similar to the IASB's IFRS 16 *Leases*, IPSAS 43 requires entities to determine whether a lease is of 'low value' on an *absolute basis* – and *not* based on whether the lease is *material to the entity*. Paragraph AG5 of IPSAS 43 notes that the determination of whether a lease is of 'low value' is unaffected by the size, nature or circumstances of the lessee. Therefore, different lessees are expected to arrive at the same conclusion as to whether a lease is of 'low value'. Examples of 'low value' leases are included in paragraph AG9 of IPSAS 43, and these are aligned with the IASB's application guidance in IFRS 16.

19. However, unlike the IASB, the IPSASB did not provide an indicative figure that would constitute a 'low value' lease. The Basis for Conclusion of IFRS 16 states that when developing the recognition exemption for 'low value' leases, the IASB had in mind leases of assets whose value (when new) is "in the order of magnitude of US $5,000 or less". In the Basis for Conclusions of IPSAS 43, the IPSASB explains that it decided not to refer to a specific monetary threshold for 'low value' leases, noting that the application guidance in AG4–AG9 provides sufficient guidance on how to determine 'low value'.

20. In its submission of ED 75 *Leases*, the Board:

    (a) agreed with the IPSASB's proposal not to include a monetary amount in the Basis for Conclusions with respect to 'low value' leases;

    (b) noted that in principle, the assessment of whether an underlying asset is of low value should be based on the materiality of the leasing transaction in relation to the reporting entity's financial statements;

    (c) recommend additional guidance on determining whether a lease is low value;

    (d) noted that there is an inconsistency between the Basis for Conclusion, which refers to considering materiality in determining whether a lease is of low value (see paragraph BC78 of IPSAS 43) and the application guidance in the authoritative part of the standard (paragraph AG4–AG9), which says that the assessment of 'low value' should be done on an absolute basis;

    (e) noted that the Basis for Conclusions is missing an adequate discussion of the advantages and disadvantages of the decision not to refer to a monetary amount for low value leases; and

    (f) noted that the disadvantages of not referring to a monetary amount includes more discussions between preparers and auditors as to whether a lease is of low value, less

comparability, and consequences for mixed groups (given that a monetary threshold is specified for for-profit entities).

21. In finalising IPSAS 43, the IPSASB did not amend its proposals with respect to the abovementioned points raised by the Board.

Consideration of New Zealand modifications

22. We are concerned that under the 'low value' requirements in paragraphs AG4–AG9 of IPSAS 43, it would be difficult for PBEs to determine whether a lease is of 'low value'.

23. Specifically, we think it would be difficult for a PBE to determine what constitutes 'low value' in absolute terms without reference to a monetary threshold. We are not sure how a PBE would go about determining this – other than by reaching an agreement with other PBEs as to what they consider 'low value', or working out the range of values for the assets listed as examples in paragraph AG9 and checking if the asset that they are leasing is in that range. Both of these methods are likely to be time-consuming and/or challenging to implement.

24. At the same time, we note that in its submission on ED 75, the Board agreed in principle that materiality should be used in determining whether a lease is of 'low value' – and agreed with the IPSASB's decision not to refer to a monetary threshold.

25. Therefore, we recommend taking one of the following two approaches to modify the IPSASB's requirements on the assessment of whether a lease is of 'low value'.

    (a) **Option 1:** Require lessees to *apply materiality* in deciding whether a lease is of low value – unlike the IPSASB's requirement to determine whether a lease is of 'low value' on an absolute basis. Under this option, we would not specify an indicative amount for low value leases. However, we would consider the development of guidance on the application of materiality to the assessment of whether a lease is of 'low value'.

    (b) **Option 2**: Retain the IPSASB's requirement to assess *on an absolute basis* whether a lease is low value – but also provide *an indicative monetary threshold* for what constituents 'low value, unlike the IPSASB. This threshold may not necessarily be the same as the IASB threshold, i.e. US $5,000.

26. The table below summarises the advantages and disadvantages of each option.

Table 2: Options for modifying the requirements for assessing whether a lease is 'low value'

Option 1: 'Low value lease' assessment is based on materiality – without reference to a monetary amount	**Option 2:** 'Low value lease' assessment is determined on an absolute basis – with reference to a monetary amount
Advantages: • Determining whether a lease is 'low value' based on materiality is consistent with the principles-based nature of PBE Standards.	*Advantages:* • This approach is consistent with the IASB's approach – which is beneficial for mixed groups.

Option 1: 'Low value lease' assessment is based on materiality – without reference to a monetary amount	**Option 2:** 'Low value lease' assessment is determined on an absolute basis – with reference to a monetary amount
Advantages (continued): • There is existing guidance on materiality in PBE Standards (e.g. PBE IPSAS 1), and additional guidance is likely to be added as the IPSASB considers alignment with the IASB's recent projects to enhance guidance on materiality. • Even though different entities might treat the lease of the same asset in different ways, such difference in treatment is arguably justified, because it reflects the specific circumstances of the specific entity. • The Board would not need to determine what amount constitutes 'low value' and will not need to subsequently consider adjustment for inflation, etc. • Potential challenges in applying materiality judgement could be addressed by the development of additional guidance.	*Advantages (continued):* • Alignment with the IASB is consistent with the notion that similar transactions should be treated similarly across the for-profit and PBE sectors (this is a benefit if it is believed that matters relating to low value leases are the same across both sectors). • Different entities would treated leases of the same item similarly, regardless of the entity's size and circumstances – which arguably enhances comparability. • The reference to a monetary amount would make it easier for prepares to decide whether a lease is 'low value' or not, and there would be fewer disagreements with auditors in this regard.
Disadvantages: • Developing guidance to help New Zealand PBEs apply materiality judgement when assessing whether a lease is of 'low value' will take up Board and staff resources. • Not referring to a monetary threshold would require preparers to spend more time on deciding whether the value of a leased asset is material, and on discussing this judgement with the auditors. • Different entities would treat leases of similar items differently, which could negatively impact comparability.	*Disadvantages:* • Referring to a monetary threshold is arguable a 'bright line' or 'rules-based' approach – whereas PBE Standards are generally principles-based. • The Board would need to determine what the monetary threshold should be, i.e. whether the IASB's threshold of US $5,000 is also appropriate for New Zealand PBEs, and if not, then what the threshold should be. • The Board may need to adjust the monetary threshold for inflation in the future.

27. We would appreciate the Board's feedback as to which option they would prefer.

Question for the Board

Q2. In relation to low value leases, does the Board prefer modifications in line with Option 1 or Option 2 (see paragraphs 25 and 26 above)? Or, does the Board prefer another option?

Issue: Whether the assessment of 'low value' leases applies on an individual asset basis

28. In addition to the points noted in the Board's submission on ED 75 with respect to low value leases, we also note that IPSAS 43 could be clearer as to whether an entity applies the 'low value lease' assessment to a group of similar leased assets, or whether the assessment is done for each individual leased asset.

29. IPSAS 43 is clear that if a lessee cannot benefit from an asset on its own or together with other readily available resources, or if the asset is highly interrelated with or dependent on other assets, then the 'low value' assessment cannot be applied to that individual asset. Therefore, if an entity leases several modules of a server, and the modules are highly interrelated, then each module individually cannot be treated as a 'low value' lease.

30. We acknowledge that paragraphs AG4–AG9 on the assessment of 'low value' leases refer to 'the value of an underlying asset [singular]'. However, the standard does not specifically state whether a group of similar assets that are leased together (but are not interrelated and are used independently), should be considered together or individually for the purpose of the 'low value' assessment. For example, if an entity leases 100 laptop computers for its employees, the does the entity group all 100 laptops together for the purpose of assessing whether the lease is of low value? Or does, does the entity assess whether each individual laptop represents a low value lease?

31. We note that in the non-authoritative illustrative examples accompanying IPSAS 43, Example 11 at paragraph IE3 considers the application of the 'low value lease' assessment to a number of leases – including a lease of IT equipment for use by individual employees, such as laptop computers and mobile devices. The example says that this lease of IT equipment would "qualify as a lease of low-value assets, on the basis that the underlying assets, when new, are *individually* of low value" [italics added for emphasis].

32. The wording of Example 11 implies that for assets that are not interrelated the assessment of whether a lease is of 'low value' is done on the basis of *individual assets*, and that there is no need to group similar leased assets (presumably even if they are leased together as part of the same contract).

33. It could be argued that the reference to 'an underlying asset' in paragraphs AG4–AG9, together with the use of the term 'individually' in Example 11 in the non-authoritative guidance, are sufficient for concluding that the 'low value lease' assessment is undertaken for each individual leased assets, even when a number of similar assets are leased together (as long as these assets are not interdependent and can be used separately).

34. However, we think it would be useful for New Zealand PBEs if this was specifically stated in the authoritative part of standard.

Consideration of New Zealand modifications

35. Based on the discussion above, we recommend adding a paragraph into the Application Guidance section of the standard (which is authoritative), after paragraphs AG4–AG9 on low value leases.

36. The additional paragraph would specifically state that the 'low value lease' assessment is undertaken for each individual leased assets, and an entity need not group together similar assets for the purpose of this assessment, even if those assets are leased together (as long as these assets are not interdependent and can be used separately, as explained in paragraph AG6).

Question for the Board

Q3. Does the Board agree to add an Application Guidance paragraph, to clarify that the 'low value lease' assessment is undertaken for each individual leased asset, as explained in the paragraphs above?

Q4. Does the Board consider than any other modifications are required to the requirements relating to low value leases?

Interaction with IFRS 15

Issue: References to IFRS 15 in IPSAS 43

37. IPSAS 43 includes references to the requirements of IFRS 15 *Revenue from Contracts with Customers*. This is because IFRS 16 *Leases* includes such references – and the IPSASB has not yet completed its project to develop an IPSAS on revenue based on the principals of IFRS 15.

38. IPSAS 43 refers to IFRS 15 in the following sections (please refer to Appendix 1 of this memo for paragraph references and more detail). Please note that these sections do not replicate the relevant requirements in IFRS 15. Rather, users of IPSAS 43 are directed to refer to IFRS 15 itself for the relevant requirements.

    (a) *Separating components of a contract – lessor:* When a contract contains more than one lease component, or a lease component and a non-lease component, a lessor applies IFRS 15 to allocate the consideration in the contract to the lease and/or non-lease components.

    (b) *Sale and leaseback transactions:* When a seller-lessee transfers an asset to a buyer-lessor, both entities need to determine whether the transfer is accounted for as a sale – which must be done by applying the requirements in IFRS 15 for determining when a performance obligation is satisfied.

(c) *Effective date and transition*: For sale and leaseback transactions occurring before the date of initial application of IPSAS 43, an entity does not re-assess whether such transactions would constitute a sale under the abovementioned requirements of IFRS 15.

(d) *Illustrative examples*: There is an example on sale and leaseback transactions, in which it is assumed that the transaction constituents a sale because the requirements in IFRS 15 for determining when a performance obligation is satisfied.

39. The IPSASB acknowledged that referring to IFRS 15 in IPSAS 43 is not ideal. However, it was in the public interest to issue IPSAS 43 without waiting for the completion of the IPSASB's revenue project. The IPSASB noted that this timing issue will be temporary and will be resolved by the time IPSAS 43 becomes effective, i.e. in 2025 – by which time a new IPSAS based on IFRS 15 will have been issued.

40. In February 2022, we discussed with the Board the timing of developing a standard based on IPSAS 43. As part of that discussion, we mentioned the reference to IFRS 15 in IPSAS 43. We noted that there would be challenges in developing a PBE Standard based on IPSAS 43 ahead of introducing a PBE Standard that brings in new revenue recognition principles based on IFRS 15. The New Zealand Accounting Standards Framework specifically provides for a multi-sector approach, whereby the suite of PBE of Standards is intended to be applied without reference to the for-profit (IFRS-based) suite of standards.

41. Nevertheless, the Board agreed to proceed with the development of a standard based on IPSAS 43 – and not to wait for the IPSASB to finalise its project on revenue.

42. Therefore, we need to consider whether the New Zealand standard based on IPSAS 43 should include references to NZ IFRS 15, as per the IPSASB's approach – or whether a different approach should be taken.

<u>Consideration of New Zealand modifications</u>

43. We consider that there are two key options that the Board could take in relation to the references to IFRS 15 in IPSAS 43:

(a) Option 1: To retain the IPSASB's approach, i.e. include references to NZ IFRS 15 in the standard based on IPSAS 43; or

(b) Option 2: To include the relevant text from NZ IFRS 15 in the standard based on IPSAS 43 (with modifications for PBE terminology where appropriate).

44. It could be argued that there is a third option: to develop requirements for allocating consideration to the components of a contract and for determining whether a transfer between a seller-lessee and buyer-lessor is a sale based on existing requirements in PBE Standards. However, the existing PBE Standards on revenue do not contain the guidance that IFRS 15 contains on identifying the components of a contract and on satisfying performance obligations. Therefore, while this option is theoretically possible, in practice it does not seem to be a viable option.

45. We have also not considered the option of developing requirements based on the IPSASB's proposals to develop an IPSAS based on IFRS 15 – as this standard is not yet finalised and the proposed requirements are still subject to change.

46. The table below summarises the advantages and disadvantages of Option 1 (to retain the IPSASB's approach) and Option 2 (to include the relevant text from IFRS 15 in the standard based on IPSAS 43).

Table 3: Options for dealing with references to IFRS 15 in IPSAS 43

Option 1: Include references to IFRS 15 in the standard based on IPSAS 43 (i.e. retain the IPSASB's approach)	**Option 2:** Include the relevant text from NZ IFRS 15 in the PBE Standard based on IPSAS 43

Advantages:
• No additional standard-setting work is required, so the development of the PBE Standard could proceed more quickly.
• Less risk of inadvertently excluding relevant requirements from the standard.
• Less risk of unintended consequences due to PBEs applying the NZ IFRS 15 requirements by analogy to other transactions – as the requirements would not be directly included in the PBE Standard itself.
• The references to NZ IFRS 15 would be relatively limited: they would only apply when a lessor has to allocate the consideration in a contract to different lease and/or non-lease components, and for sale and leaseback transactions. Therefore, it could be argued that most entities would not need to refer to NZ IFRS 15 when applying the standard.
Disadvantages
• PBE Standards generally do not refer to for-profit standards.
• Certain PBE preparers (i.e. lessors that have contracts with multiple components, buyer-lessors and seller-lessees) will need to consider the requirements of a standard that they are unfamiliar with – which includes unfamiliar terminology, etc. The same also applies to the auditors of these PBEs.
	Advantages:
	• Under this approach, PBE Standards remain a 'self-contained' suite that does not refer to for-profit standards
	• PBE preparers and their auditors do not need to refer to an unfamiliar standard in a different standards suite.
	Disadvantages
	• Additional standard-setting work is required to:
	  ○ determine which specific paragraphs of NZ IFRS 15 should be included in the PBE Standard (IPSAS 43 does not specify which IFRS 15 paragraphs users should refer to); and
	  ○ adapt the NZ IFRS 15 text for PBE terminology, etc.
	• There is a risk that when selecting which NZ FRS 15 paragraphs should be included in the PBE Standard, we may inadvertently omit some relevant paragraphs or modify them in a way that leads to unintended consequences.
	• There is also a risk that PBEs may try to apply the NZ IFRS 15 paragraphs included in the PBE Standard to other transactions by analogy, and this might have unintended consequences.

47. On balance, we recommend including references to NZ IFRS 15 in the standard based on IPSAS 43, consistently with the IPSASB's approach.

Question for the Board

Q5. Does the Board agree that the PBE Standard based on IPSAS 43 should include references to NZ IFRS 15, as per the IPSASB's approach to refer to IFRS 15 in IPSAS 43?

Discount rates

Issue: Guidance on the determination of the discount rate

48. IPSAS 43 require lessees to measure the lease liability at the present value, by discounting the expected lease payments using the interest rate implicit in the lease, or if that rate cannot be readily determined, using the lessee's incremental borrowing rate. This requirement is consistent with IFRS 16 *Leases*.

49. In the Basis for Conclusions, paragraph BC84 says that the lessee's incremental borrowing rate can be determined by:

    (a) taking into account the terms and conditions of the lease;

    (b) referring to a rate that is readily observable as a starting point (for example, the rate that a lessee has paid, or would pay, to borrow money to purchase the type of asset being leased, or the property yield when determining the discount rate to apply to property leases); and

    (c) adjusting such observable rates as is needed to determine the lessee's incremental borrowing rate as defined in the standard

50. In its submission on ED 75, the Board agreed with the proposed requirements on discounting. However, the Board noted that based on feedback from New Zealand constituents, determining an appropriate discount rate could be a significant implementation issue for many public sector entities. While for-profit entities encounter similar challenges, the Board recommended that the IPSASB develop additional guidance in this area for public sector entities – "to ensure the cost of implementing the new standard does not exceed the benefits".

51. In finalising IPSAS 43, the IPSASB decided not to add guidance on determining the discount rate. The IPSASB noted that challenges in determining the discount rate are not a public sector-specific issue, and that paragraph BC84 in the Basis for Conclusions already clarifies how the incremental borrowing rate can be determined.

52. Nevertheless, as noted in the Board's submission on ED 75, we have received feedback that determining the discount rate for a lease could be challenging for New Zealand public sector entities – despite the abovementioned BC paragraph, which was included in the ED.

Consideration of New Zealand modifications

53. To address the abovementioned concern and ensure that the cost of applying the new lease requirements do not exceed the benefit, we recommend considering the development of non-authoritative guidance for New Zealand PBEs on determining the discount rate for lease liabilities.

54. This non-authoritative guidance would focus on determining the lessee's incremental borrowing rate (as the rate implicit in the lease will often not be determinable).

55. The non-authoritative guidance could be in the form implementation guidance and/or illustrative examples, or it could be in the form of educational material issued by XRB staff.

56. This guidance could be developed and issued after the standard based on IPSAS 43 is finalised.

Question for the Board

Q6. Does the Board agree with the recommendation to consider development of non-authoritative guidance on determining the discount rate for lease liabilities?

Q7. Does the Board agree that such guidance could be developed after the issuance of a PBE Standard based on IPSAS 43, or does the Board consider that this guidance should be developed concurrently with the standard?

Effective date

57. IPSAS 43 is effective from 1 January 2025.

58. In our discussion with the Board at its February 2022 meeting, Board members recommended allowing a long 'lead time' between the issuing of the standard and its effective date – to allow PBEs sufficient time to implement the standard.

59. We also note that the IPSASB expects to issue a standard on concessionary leases in March 2024, and the effective date is expected to be 1 January 2027.

60. We recommend that the proposed effective date of the PBE Standard based on IPSAS 43 should be 1 January 2027 (or later). This would ensure that:

    (a) PBEs have enough time to implement the standard, and;

    (b) the 'core' lease accounting requirements based on IPSAS 43 do not become mandatory before the requirements on concessionary leases become mandatory.

61. However, we recommend allowing early adoption of the PBE Standard based on IPSAS 43 – noting that Treasury and possibly local councils may wish or need to apply the standard early in forecasts/budgets.

Question for the Board

Q8. Does the Board agree that the proposed effective date of the PBE Standard based on IPSAS 43 should be 1 January 2027, with early application permitted?

Other matters

62. As we continue our work on developing an ED based on IPSAS 43, we will continue to consider areas where New Zealand modifications may be required. Any significant proposed modifications that we identify after this meeting will be discussed with the Board at a future meeting.

63. We note that in February, a Board member recommended exploring the possibility of simplifying the lease accounting requirements for Tier 2 not-for-profit PBEs. As we have not yet considered this matter in detail, we will discuss this matter with the Board at a future meeting. In considering this matter, we will bear in mind that while we could develop disclosure concessions for PBEs in Tier 2, any simplifications that we propose in relation to measurement and/or recognition requirements would need to apply to both Tier 1 and Tier 2 PBEs.

Question for the Board

Q9. Does the Board have any feedback at this stage on any other areas of IPSAS 43 where New Zealand modifications should be proposed?

Next steps

64. We will develop an ED based on IPSAS 43 *Leases* with New Zealand modifications – taking into account comments made by Board members at this meeting.

65. At this stage, we plan to take a first draft of the ED to the Board's June 2022 meeting, and to see approval of the ED in the August 2022 or October 2022 meeting.

66. An indicative timeline for this project is included in Appendix B of this memo.

Attachments

Agenda item 9.2: IPSAS 43 *Leases* (in the supporting papers)

Appendix 1: References to IFRS 15 in IPSAS 43 (excluding references in the Basis for Conclusions

Section of IPSAS 43	Reference to IFRS 15
Separating components of a contract – lessor (within the section 'Identifying a lease')	18. For a contract that contains a lease component and one or more additional lease or non-lease components, a lessor shall allocate the consideration in the contract applying IFRS 15 *Revenue from Contracts with Customers*.
Sale and leaseback transactions	98. An entity shall apply the requirements for determining when a performance obligation is satisfied in IFRS 15 to determine whether the transfer of an asset is accounted for as a sale of that asset. 99. If the transfer of an asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset: (a) The seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. […]. (b) The buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this Standard. 102. If the transfer of an asset by the seller-lessee does not satisfy the requirements of IFRS 15 to be accounted for as a sale of the asset: (a) The seller-lessee shall continue to recognize the transferred asset and shall recognize a financial liability equal to the transfer proceeds. It shall account for the financial liability applying IPSAS 41. (b) The buyer-lessor shall not recognize the transferred asset and shall recognize a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IPSAS 41.
Effective date	120. An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements in IFRS 15 to be accounted for as a sale.
Illustrative Examples – sale and leaseback transaction	Example 24–Sale and Leaseback Transaction An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. […] At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in IFRS 15 *Revenue from Contracts with Customers*. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback.

Appendix B: Indicative project timeline – PBE Standard on leases