

Board Meeting Agenda

Virtual Meeting — Thursday , 11 August 2022

Est Time	Item	Topic	Objective		Page
NON-PUBLIC SESSION					
10.30 am	Morning tea				
PUBLIC SESSION					
11.15 am	5	PBE Leases Standard	(GS)		
30 min	5.1	Board memo	Consider	Paper	3
	5.2	Draft Exposure Draft	Approve	Paper	19
	5.3	Draft Consultation Document	Approve	Paper	127
NON-PUBLIC SESSION					
12.35 pm 30 mins	Lunch				
PUBLIC SESSION					
1.35 pm 90 min	8	PBE IFRS 17 Insurance Contracts	(AT/TB)		
	8.1	Board memo – Consider stakeholder feedback	Note	Paper	143
	8.2	Indicators for determining which arrangements are in the scope of the Standard	Consider	Paper	149
	8.3	Risk adjustments in measuring insurance liabilities	Consider	Paper	178
	8.4	Emerging issues: adverse development covers and investment components	Consider	Paper	194
	8.5	Comment letters received	Note	Supporting Paper	-
	8.6	Bank depositor compensation schemes	Consider	Paper	200
3.05 pm 15 min	Afternoon tea break				
3.20 pm 15 min	9	Public Sector Specific Financial Instruments	(TB)		
	9.1	Board memo	Consider	Paper	205
	9.2	Treasury comment letter on NZASB ED 2022-4	Note	Paper	209
	9.3	Draft <i>Public Sector Specific Financial Instruments</i>	Approve	Paper	211
	9.4	Draft signing memorandum	Approve	Paper	217

Est Time	Item	Topic	Objective		Page
3.35pm	9A	Standards approved	(GS)		
1 min	9A.1	Approval 136 <i>Initial Application of PBE IFRS 17 and PBE IPSAS 41 – Comparative Information</i>	Note	Paper	220
	9A.2	Approval 137 <i>2022 Omnibus Amendments to PBE Standards</i>	Note	Paper	221
NON-PUBLIC SESSION					
4.06 pm	<i>Finish</i>				

Next NZASB meeting: 18 October 2022 in-person Auckland

Date: 28 July 2022
To: NZASB Members
From: Gali Slyuzberg
Subject: PBE IPSAS 43 *Leases*: Draft ED and Consultation Document

COVER SHEET

Project priority and complexity

Project priority	<p>Medium</p> <ul style="list-style-type: none"> The proposed new lessee accounting model for PBEs was supported when we conducted broad outreach in New Zealand on the IPSASB’s exposure drafts (except for matters taken to Phase 2 of the IPSASB’s project). Proposals are based on IPSAS 43 <i>Leases</i>, which is based on IFRS 16 <i>Leases</i>, and the extent of proposed New Zealand modifications are relatively minor.
Complexity of Board decision-making at this meeting	<p>Low</p> <ul style="list-style-type: none"> The Board is being asked to approve for issue the Exposure Draft (ED) for PBE IPSAS 43 <i>Leases</i> and accompanying Consultation Document, which is based on an international standard. The Board has discussed and agreed at previous meetings the proposed New Zealand modifications to IPSAS 43.

Overview of agenda item

Project status	ED approval stage: seeking approval to issue ED PBE IPSAS 43 <i>Leases</i> and accompanying Consultation Document.
Project purpose	<ul style="list-style-type: none"> ED proposes to introduce a right-of-use model for lessees Proposals will align the lease accounting requirements in PBE Standards with those in IPSAS, and with for-profit entities (NZ IFRS 16) Proposals will allow New Zealand PBEs to benefit from the latest international thinking on lessee accounting and will help reduce mixed group issues.
Board action required at this meeting	<p>APPROVAL to issue the ED and accompanying Consultation Document.</p> <p>We will ask for Board feedback on the questions as raised in this memo.</p> <p>We encourage any editorial comments to be sent directly to staff - gali.slyuzberg@xrb.govt.nz</p>

Purpose and introduction¹

1. The purpose of this paper is to seek the Board’s approval to issue the Exposure Draft (ED) PBE IPSAS 43 *Leases*, and the accompanying Consultation Document.

Recommendation

2. We recommend that the Board APPROVES the following documents to be issued for public consultation.
 - (a) ED PBE IPSAS 43 *Leases* (agenda item 5.2); and
 - (b) the accompanying Consultation Document (agenda item 5.3).

Structure of this memo

3. This memo includes the following sections.
 - (a) Background
 - (b) New Zealand modifications: scope clarification
 - (c) Other New Zealand modifications included in the ED
 - (d) New Zealand modifications that were considered but *not* included in the ED
 - (e) Approval of the ED and Consultation Document
 - (f) Outreach plan
 - (g) Next steps

Background

4. The table below summarises the key steps of this project to date (and future steps to be taken after this meeting).

Table 1 PBE Leases project timeline

Date	Project activity
Jan 2018	IPSASB issues IPSASB ED 64 <i>Leases</i> – which includes lessee accounting proposals aligned with IFRS 16 <i>Leases</i> , but also proposals to introduce the ROU model for lessors, and proposals for the fair value measurement of concessionary leases.
Feb-May 2018	NZASB carried out broad outreach in New Zealand on IPSASB ED 64 (including roundtables, etc.)
Jun 2018	NZASB submitted comments on IPSASB ED 64 <i>Leases</i>
Jan 2021	IPSASB issued IPSASB ED 75 <i>Leases</i> – proposals aligned with IFRS 16 <i>Leases</i> (for lessees and lessors) <ul style="list-style-type: none"> • Separate Request for Information (RFI) issued on <i>Concessionary Leases and Other Arrangements Similar to Leases</i>
Feb 2021	NZASB started public consultation on IPSASB ED 75 <i>Leases</i>

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).

Date	Project activity
May 2021	NZASB submitted comments on IPSASB ED 75 <i>Leases</i>
Jan 2022	IPSASB issued IPSAS 43 <i>Leases</i> – aligned with ED 75 proposals and IFRS 16 <ul style="list-style-type: none"> No specific requirements for concessionary leases and public sector arrangements that are similar to leases are scoped out – the IPSASB has a separate project on <i>Other Lease-type Arrangements</i> expects to publish an ED on this topic in Dec 2022.
Feb 2022	NZASB agreed that it should propose incorporating the requirements in IPSASB 43 into PBE Standards and not wait for the project on concessionary leases and public sector arrangements that are similar to leases
Apr 2022	NZASB discussed certain modification text to IPSAS 43 – to enhance the appropriateness and usefulness of this standard for New Zealand PBEs and the users of their financial statements
Jun 2022	NZASB discussed working draft of the ED and Consultation Document
NOW	Seeking NZASB approval to issue the ED and Consultation Document for public consultation
FUTURE	<i>Potential next steps if ED approval obtained and dependant on submissions received</i>
Aug–Nov 2022	Outreach
Dec–Jan 2023	Analysis of submissions
Feb 2023	NZASB discussion on submissions received and whether to make changes to the ED proposals
Feb–Mar 2023	Update draft standard based on Board feedback
Apr 2023	PBE IPSAS 43 <i>Leases</i> approved as final standard
Dec 2023–June 2024	Consider changes to PBE IPSAS 43 based on the IPSASB’s pronouncement on concessionary leases and other lease-type arrangements in the public sector
1 Jan 2027	PBE IPSAS 43 becomes effective for periods beginning on or after this date.

New Zealand modifications: scope clarification

- Based on the Board’s discussion in April and June 2022, the ED includes New Zealand modifications to clarify the scope of PBE IPSAS 43 in relation to concessionary leases and lease-like arrangements for nil consideration. These clarifications – and the related explanations in the Basis for Conclusions and Consultation Document – are summarised in Table 2 on the next page. Updates made since the June 2022 meeting are highlighted in blue.

Table 2 New Zealand scope clarification included in the draft ED

Location	ED proposals/Consultation Document text	Explanation of change since the June 2022 meeting
ED core text	<p>Paragraphs 4.1 and 4.2 of the ED note the following.</p> <ul style="list-style-type: none"> • Concessionary leases that meet the definition of a lease and are within the scope of the standard (unless specifically excluded by paragraph 3). • Arrangements that confer the right to use an asset for a specified period of time for nil consideration do not meet the definition of a lease (and are therefore outside the scope of PBE IPSAS 43). • In applying the requirements of PBE IPSAS 43, an entity takes into account the lease payments per the lease agreement, and not what the payments would have been had the lease been at market terms (but an entity measures its ROU assets at fair value in specific circumstances – please see the explanation on the right). 	<p>The ED includes the following paragraphs that require/allow an <i>ROU asset</i> to be measured at <i>fair value</i>:</p> <ul style="list-style-type: none"> • <u>Paragraph 35</u> [based on IPSAS 43, consistent with NZ IFRS 16]: Subsequent measurement at fair value is <i>required</i> for a ROU asset that meets the definition of investment property, if the entity applies the fair value model to its investment properties under PBE IPSAS 16. • <u>Paragraph 36</u> [based on IPSAS 43, consistent with NZ IFRS 16]: Subsequent measurement at fair value is <i>allowed</i> for a ROU asset if it relates to a class of property, plant and equipment that is revalued under PBE IPSAS 17. • <u>Consequential amendments to PBE FRS 47</u> [based on NZ IFRS 1]: A first-time adopter of PBE Standards is <i>allowed</i> to recognise a ROU asset at ‘deemed cost’ on the date of transition to PBE Standards – which can be fair value. <p>We have considered whether the above paragraphs may conflict with the proposed New Zealand scope clarification paragraphs, i.e. paragraphs 4.1–4.2 and the consequential amendment to PBE IPSAS 23. We think that the two sets of paragraphs have a <i>different focus</i>:</p> <ul style="list-style-type: none"> • The proposed New Zealand scope clarifications focus on ensuring that <i>lessees and lessors do not measure at fair value the concessionary portion of their concessionary leases and their lease-like arrangements for nil consideration</i> (i.e. the ‘non-exchange’ element of the transaction)– on initial recognition or subsequently – until specific requirements for concessionary leases and lease-like arrangements for nil consideration are developed. • By contrast, paragraphs 35 and 36 and the ‘deemed cost’ provision in PBE FRS 47 apply regardless of whether a lease is at market terms or not, and they do not deal with accounting for the concessionary element of a lease. Paragraphs 35 and 36 require/allow <i>subsequent fair value measurement of a ROU asset when assets similar to the leased asset are revalued</i> after initial recognition. The deemed cost provisions in PBE FRS 47 provide an <i>optional practical expedient for lessees that are first-time adopters of PBE Standards</i>.
ED Appendix B – Amendments to Other PBE Standards	<p>Consequential amendment to PBE IPSAS 23, paragraph 2.1:</p> <p>Concessionary leases and lease-like arrangements for nil consideration are outside the scope of PBE IPSAS 23 <i>Revenue from Non-exchange Transactions</i> (therefore, the concessionary portion of a concessionary lease and lease-like arrangements for nil consideration are not to be measured at fair value).</p>	<p>Nevertheless, to avoid potential inconsistency, we have added a clarification to paragraph 4.2. The clarification specifies that despite paragraphs 4.1–4.2, an entity measures ROU assets at fair value:</p> <ul style="list-style-type: none"> • after initial recognition if it is required to do so under paragraph 35 or elects to do so under paragraph 36; or • at the date of transition to PBE Standards if it elects to use fair value as the ‘deemed cost’ of the ROU asset on transition to PBE Standards.

Table 2 New Zealand scope clarification included in the draft ED (continued)

Location	ED proposals/Consultation Document text	Explanation of change since the June 2022 meeting
ED Basis for Conclusions	<ul style="list-style-type: none"> • Paragraphs BC11 – BC14 (and Appendix B – consequential amendments to the Basis for Conclusions for PBE IPSAS 23): <ul style="list-style-type: none"> ○ there are currently no requirements in PBE Standards for the accounting for the ‘concessionary component’ of concessionary leases, or for lease-like arrangements for no consideration; ○ the New Zealand-specific scope paragraphs above will be reconsidered when the IPSASB finalises its project on <i>Other Lease-type Arrangements</i>; and • Paragraphs BC18 – BC 19: General materiality considerations apply when determining the accounting policy for a lease in the scope of PBE IPSAS 43 (please see the right-hand column). 	<p>At the June 2022 meeting, a Board Member noted that for a concessionary lease:</p> <ul style="list-style-type: none"> • the underlying asset may not be of low value, in which case, the exemption from the ROU model for ‘low value leased assets’ would not apply; • however, the lease payments (and therefore the lease liability and ROU asset) may be immaterial – which could be a reason not to apply the ROU model to such a concessionary lease. <p>To acknowledge the above and as a reminder for constituents, we have added BC paragraphs BC18 and BC19. These paragraphs explain that – as with all PBE Standards – general materiality considerations apply when determining how to account for a lease in the scope of PBE IPSAS 43. The ROU asset and lease liability that would arise from applying the ROU model to a concessionary lease may not be material.</p>
Consultation Document	<p>The Consultation Document includes the following:</p> <ul style="list-style-type: none"> • Rationale for the proposed New Zealand scope clarification – including the rationale for <i>requiring</i> entities not to measure the concessionary portion of their concessionary leases and their lease-like arrangements for nil consideration at fair value, instead of making fair value <i>optional</i> for such arrangements (please see the paragraphs that follow). • A reiteration that the requirements for concessionary leases and lease-like arrangements for nil consideration will be reconsidered when the IPSASB finalises its project on <i>Other Lease-type Arrangements</i> – therefore, by the time PBE IPSAS 43 becomes effective, we expect to have developed requirements for concessionary leases and lease-like arrangements for nil consideration. 	<p>At the June meeting, some Board Members questioned the draft proposals to <i>require</i> entities to measure leases based on actual lease payments, and to <i>exclude</i> concessionary leases and lease-like arrangements for nil consideration from the scope and fair value measurement requirements of PBE IPSAS 23. These Board Members noted the following.</p> <ul style="list-style-type: none"> • It may be preferable to make fair value measurement for the abovementioned optional, rather than prohibited. • Some PBEs might currently measure lease-like arrangements for nil consideration at fair value – it is difficult to justify requiring such PBEs to account for such arrangements ‘at cost’ (which is less relevant than fair value), particularly given that the IPSASB’s <i>Other Lease-type Arrangements</i> project may yet lead to fair value measurement requirements for such arrangements. <p>However, other Board Members and staff noted the following points in favour of <i>not providing a ‘fair value option’</i> for concessionary leases and lease-like arrangements for nil consideration (please see the next page).</p>

Table 2 New Zealand scope clarification included in the draft ED (continued)

Location	ED proposals/Consultation Document text	Explanation of change since the June 2022 meeting
		<ul style="list-style-type: none"> • Allowing fair value measurement for concessionary leases and lease-like arrangements for nil consideration could lead to lengthy discussions with auditors as to whether the fair value option should be applied, and to lack of comparability between PBEs. • The cost of measuring fair value of concessionary leases and lease-like arrangements for nil consideration would often outweigh the benefits. • We do not plan to issue any guidance on fair value for the concessionary portion of concessionary leases and for lease-like arrangements for nil consideration until the IPSASB has finalised its project on <i>Other Lease-like Arrangements</i>. Therefore, if we provide a ‘fair value option’ for such arrangements, an early adopter of PBE IPSAS 43 that elects this fair value option would have to determine fair value without guidance. This could lead to inconsistent and potentially inappropriate fair value measurement. <p>On balance, we have <i>retained</i> in the draft ED the requirement to measure concessionary leases based on actual lease payments, and the exclusion of concessionary leases and lease-like arrangements for nil consideration from the scope of PBE IPSAS 23. We note that:</p> <ul style="list-style-type: none"> • If there are PBEs that currently measure concessionary leases and lease-like arrangements for nil consideration at fair value, they will be able to continue doing so until at least 1 January 2027. • By the time PBE IPSAS 43 becomes effective, we expect to have developed requirements for concessionary leases and lease-like arrangements for nil consideration. • Early adopters of PBE IPSAS 43 will be able to measure the ROU asset at fair value in certain circumstances (see the discussion above on paragraphs 35-36). <p>In the Consultation Document, we have added an explanation about the rationale for the above proposals.</p>

Question for the Board

- Q1. Does the Board have any comments on the updated wording of:
- (a) the New Zealand modification to clarify the scope of PBE IPSAS 43 and PBE IPSAS 23 – (as set out in ED paragraphs 4.1–4.2 and in the consequential amendments to PBE IPSAS 23 in Appendix B of the ED); and
 - (b) the explanation of these modifications in the Basis for Conclusions of the ED and in the Consultation Documents?

Other New Zealand modifications included in the ED

6. In addition to the abovementioned modification to clarify the scope of PBE IPSAS 43, we have also made the following New Zealand modifications to the text of IPSAS 43.
- (a) Edits for New Zealand PBE Standards terminology and New Zealand spelling (e.g. replacing ‘accumulated surplus or deficit’ with ‘accumulated comprehensive revenue and expense’, updating PBE Standard names so that they start with ‘PBE IPSAS’ and not just ‘IPSAS’, replacing American spelling with New Zealand spelling, etc.).
 - (b) RDR concessions for Tier 2 PBEs: These concessions, which are based on the RDR concessions in NZ IFRS 16, were discussed with the Board at the June 2022 meeting. Brief descriptions of the RDR concessions are provided in the draft Consultation Document.
 - (c) Other modifications as explained in [Table 3 below \(not yet seen by the Board\)](#) – including modifications to incorporate references and amendments to IFRS-based PBE Standards for which there was no equivalent IPSAS when IPSAS 43 was issued.

Table 3 Other minor New Zealand modifications to the text of IPSAS 43

ED ref	Description of modification
Core text: Paragraph 78 (Also: Appendix B, Amendments to PBE IPSAS 16)	<u>PBE IFRS 5 reference:</u> In paragraph 78, replaced the reference to ‘relevant national or international accounting standards dealing with non-current assets held for sale’ with a reference to PBE IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i> . In Appendix B, in the consequential amendments to PBE IPSAS 16 <i>Investment Property</i> , paragraph 65: Added sub-paragraph 65(b), to retain the existing requirement to measure investment property held for sale in accordance with PBE IFRS 5. There was no IPSAS equivalent to IFRS 5 when the IPSASB issued IPSAS 43.
Core text: Paragraphs 48, 49, 64, 105, 124, 125, 126	<u>COVID-19-related rent concessions:</u> Deleted the following IPSAS 43 paragraphs: 48, 49, 64, 105, 124, 124 and 126. These paragraphs included an optional practical expedient for lessees in relation to COVID-19-related rent concessions, and the related effective date paragraph and transitional provisions. These paragraphs were based on the IASB’s <i>COVID-19-Related Rent Concessions</i> amendments, which amended IFRS 16. The deleted paragraphs are reproduced in Appendix A of this memo. We have deleted these paragraphs for the following reasons:

ED ref	Description of modification
	<ul style="list-style-type: none"> • The practical expedient will not be applicable in New Zealand when PBE IPSAS 43 becomes effective (or when early-adopters are likely to adopt the Standard). <ul style="list-style-type: none"> ○ Like the IASB’s <i>COVID-19-Related Rent Concessions</i>, the equivalent practical expedient in IPSAS 43 is limited to lease payments that would have been due <i>on or before 30 June 2022</i>. ○ We have considered whether to extend the practical expedient to lease payments due later than 30 June 2022. However, we note that neither the IPSASB nor the IASB provided such extensions. We also note that COVID-19-related rent concessions are likely to become less common in New Zealand in the coming years. We did not identify a New Zealand-specific reason to extend the limit of the practical expedient beyond 30 June 2022. ○ PBE IPSAS 43 is expected to be finalised around April 2023. The effective date is proposed to be 1 January 2027. Early adopters are unlikely to apply the Standard any earlier than years ending 30 June 2024. By that time, the practical expedient for COVID-19-related rent concessions will not be applicable even to the comparative period. • We think that the paragraphs relating to the COVID-19-related practical expedient may confuse preparers. <ul style="list-style-type: none"> ○ Including paragraphs 48 and 49 – which provide a practical expedient that is not applicable in New Zealand by the time the Standard is adopted (see above) – might confuse preparers. ○ In IPSAS 43, paragraph 105 says that the COVID-19-related practical expedient can be applied early to financial statements that are not yet authorised on 1 January 2022. The equivalent IASB wording made sense in <i>COVID-19-Related Rent Concessions</i>. However, we think that this paragraph is confusing in the context of IPSAS 43, and would be confusing in the context of PBE IPSAS 43 – as it is not possible to apply the COVID-19-related paragraphs earlier than the rest of the Standard. ○ In IPSAS 43, paragraphs 124–126 include transitional provisions for the COVID-19-related practical expedient. We think most of these paragraphs might confuse preparers. For example, in IPSAS 43, paragraph 126 says that the COVID-19-related practical expedient is applied to similar eligible contracts “irrespective of whether the contract became eligible for the practical expedient as a result of applying the COVID-19-Related Rent Concessions requirements”. This implies that it is possible to apply the COVID-19-related expedient to rent concessions that are not related to COVID-19 – which is inconsistent with the paragraphs that set out the practical expedient (paragraphs 48-49) and with the IPSASB’s Basis for Conclusions.
<p>Core text: Paragraphs 102A–102C</p>	<p><u>Interest rate benchmark reforms</u></p> <p>Added paragraphs 102A–102C, which provide a temporary practical expedient for lease modifications arising from interest rate benchmark reforms (‘IBOR’ reforms). These paragraphs are based on the for-profit amending standard <i>Interest Rate Benchmark Reforms – Phase 2</i>, which amended NZ IFRS 16 <i>Leases</i>, among other NZ IFRS. The other amendments in <i>Interest Rate Benchmark Reforms – Phase 2</i> have already been incorporated into PBE Standards, via the amending standard <i>PBE Interest Rate Benchmark Reforms – Phase 2</i>.</p> <p>The IPSASB has also incorporated <i>Interest Rate Benchmark Reforms – Phase 2</i> into IPSAS, except for the lease-related parts of that amendment (due to the timing of issuing IPSAS 43). The IPSASB is expected to consider amendments to IPSAS 43 based</p>

ED ref	Description of modification
	<p>on <i>Interest Rate Benchmark Reforms – Phase 2</i> as part of <i>Improvements to IPSAS, 2023</i>.</p> <p>We acknowledge that PBEs are unlikely to be affected by IBOR reforms, and that by the time PBE IPSAS 43 becomes effective, relief relating to IBOR reforms is unlikely to be relevant. However, it is possible that some PBEs may early adopt PBE IPSAS 43, and that such PBEs may be affected by IBOR reforms. Including the IBOR-related relief is consistent with <i>PBE Interest Rate Benchmark Reforms – Phase 2</i> and will increase alignment between PBE IPSAS 43 and NZ IFRS 16 (and between PBE IPSAS 43 and IPSAS 43, if the IPSASB introduces similar amendments as expected).</p> <p>We note that our recommendation to include the IBOR-related practical expedient are different to our recommendation to delete the COVID-19-related practical expedient, for the following reasons.</p> <ul style="list-style-type: none"> • By 30 June 2024 (the earliest time we expect early adopters to apply PBE IPSAS 43), the COVID-19-related expedient will clearly not be applicable, but we are unsure as to whether the IBOR-related expedient could still be applicable. • Unlike the COVID-19-related paragraphs in IPSAS 43, we do not think that the IBOR-related paragraphs (based on NZ IFRS 16) will be confusing for preparers.
Core text: Paragraph 104	<p><u>Effective date – first time adoption of IPSAS via IPSAS 33</u></p> <p>Deleted IPSAS 43 paragraph 104, which said:</p> <p>"When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, <i>First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)</i> for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs".</p> <p>IPSAS 33 is not included in PBE Standards. There was no equivalent paragraph in NZ IFRS 16 for first-time adopters of NZ IFRS. Consequential amendments to PBE FRS 47 <i>First-time Adoption of PBE Standards</i> are already included in Appendix B of the ED.</p>
Appendix B – Amendments to Other Standards	<p><u>Amendments to NZ IFRS-based PBE Standards:</u></p> <p>Added amendments to PBE Standards that are based on NZ IFRS, for which there is no equivalent IPSAS. The proposed amendments are mainly based on the consequential amendments of NZ IFRS 16. The following NZ IFRS-based PBE Standards are amended.</p> <ul style="list-style-type: none"> • Appendix A of PBE IPSAS 19 <i>Provisions, Contingent Liabilities and Contingent Assets</i> (Appendix A of PBE IPSAS 19 is based on NZ IFRIC 1 <i>Changes in Existing Decommissioning, Restoration and Similar Liabilities</i> and is not included in IPSAS): Amendments based on the NZ IFRS 16 consequential amendments to NZ IFRIC 1. • PBE IFRS 4 <i>Insurance Contracts</i> (still effective for public sector PBEs): Amendments based on NZ IFRS 16 consequential amendments to NZ IFRS 4. • PBE IFRS 17 <i>Insurance Contracts</i> (for not-for-profit PBEs): Amendments reflect the relevant paragraphs of NZ IFRS 17 that relate to leases. • PBE IAS 12 <i>Income Taxes</i>: Amendments to the paragraphs added by 2022 <i>Omnibus Amendments to PBE Standards</i> (based on the IASB's <i>Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction</i>) – to refer to ROU assets and lease liabilities, instead of using finance lease terminology. • PBE FRS 45 <i>Service Concession Arrangements: Operator</i>: Amendments based on the NZ IFRS 16 consequential amendments to IFRIC 12 <i>Service Concession Arrangements: Operator</i> and NZ SIC-29 <i>Service Concession Arrangements: Disclosures</i> (PBE FRS 45 is based on NZ IFRIC 12 and NZ SIC-29).

ED ref	Description of modification
	<ul style="list-style-type: none"> • PBE FRS 47 <i>First-time Adoption of PBE Standards</i>: <ul style="list-style-type: none"> ○ Amendments based on the NZ IFRS 16 consequential amendments to <i>NZ IFRS 1 First-time Adoption of NZ IFRS</i> (PBE FRS 47 is based on NZ IFRS 1); and ○ Amendments to the paragraphs added by <i>2022 Omnibus Amendments to PBE Standards</i> (based on the IASB’s <i>Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction</i>) – to refer to ROU assets and lease liabilities, instead of using finance lease terminology.
<p>Appendix B – Amendments to Other Standards</p>	<p><u>Consequential amendment to PBE IPSAS 16 <i>Investment Property</i></u></p> <p>The consequential amendments in IPSAS 43 include the addition of paragraph 41A–41C to IPSAS 16 <i>Investment Property</i>. These paragraphs note that an entity may choose the cost model or fair value model separately for:</p> <ul style="list-style-type: none"> • investment properties that back liabilities that pay returns that are directly linked to the fair value of investment properties, and; • the rest of the entity’s investment properties. <p>These paragraphs are based on equivalent paragraphs in IAS 40 <i>Investment Property</i>. However, these paragraphs do not relate to leases and were not a consequential amendment of IFRS 16 <i>Leases</i>. On this basis, we have excluded these paragraphs from the ED, as we think it is more appropriate to consider them as part of the next PBE omnibus amendments project, rather than as part of PBE IPSAS 43.</p>
<p>Illustrative Examples</p>	<p><u>Amendments to ‘New Zealand-ise’ or ‘un-internationalise’ the examples</u></p> <p>To make the examples more relevant to New Zealand PBEs, we have made the following minor amendments to the Illustrative Examples.</p> <ul style="list-style-type: none"> • Examples 3, 5 and 6: Replaced references to Tokyo, San Francisco and other international cities with a more generic ‘City A’. • Examples 22A–22C: Replaced ‘City XYZ’ with ‘Crown Entity XYZ’ (IPSAS 43 referred to ‘City XYZ having leases for tourism outlets – whereas in New Zealand, we understand that facilities like ‘i-Sites’ are operated by Tourism NZ, which is a Crown Entity). • Example 23B: Replaced ‘City XYZ’ with ‘City Council XYZ’ (the example in IPSAS 43 said that City XYZ has multiple property leases – but in New Zealand, it would be more common to say that the city council has leases, rather than the city itself). <p><u>Deletion of references to IPSAS 18 <i>Segment Reporting</i></u></p> <ul style="list-style-type: none"> • There is no PBE Standard based on IPSAS 18, so we have deleted references to that standard in Examples 22A and 23B.

Question for the Board

Q2. Does the Board have any comments on the New Zealand modifications listed in Table 3?

New Zealand modifications that were considered but *not* included in the ED

7. The table below summarises those areas of IPSAS 43 where the Board considered possible New Zealand modifications, but ultimately agreed to *retain the approach taken by the IPSASB* in IPSAS 43. The table also explains whether and how these matters are covered in the Basis for Conclusions of the ED and in the Consultation Document. Information that is new since the June 2022 meeting is highlighted in blue.

Table 4 New Zealand modifications that were considered but *not* included in the ED

Topic	IPSAS 43 requirement	New Zealand amendment considered	Outcome
Leases of low-value assets	<p>The assessment of whether an underlying asset is of ‘low value’ is performed on an <i>absolute value basis</i> and <i>individual asset basis</i>. This is consistent with NZ IFRS 16, except that the Basis for Conclusions of NZ IFRS 16 provides a monetary threshold for ‘low value’.</p>	<p>Whether the assessment of ‘low value’ should be performed on the basis of materiality and/or in aggregate for a group of leased assets.</p>	<p>In the ED, we have:</p> <ul style="list-style-type: none"> retained the IPSAS 43 requirements for leases of low value assets; and explained in the BC the rationale for retaining the IPSAS 43 requirements (see paragraphs BC15–BC17). <p>In the Consultation Document, we have:</p> <ul style="list-style-type: none"> explained the rationale of retaining the IPSAS 43 requirements (this is done in a more concise way as compared to the draft Consultation Document that the Board saw in June 2022); and asked constituents whether they would prefer the ‘low value leased asset assessment’ to be performed in a different way (without specifying what way that different way might be – as per the Board’s comments in June 2022).
References to NZ IFRS 15 <i>Revenue from Contracts with Customers</i>	<p>IPSAS 43 refers preparers to IFRS 15 in the following circumstances:</p> <ul style="list-style-type: none"> allocating consideration to components of a contract (lessor); and accounting for sale and leaseback transactions. <p>This is a temporary solution until the IPSASB finalises its project on Revenue.</p>	<p>Whether to include the relevant NZ IFRS 15 paragraphs in PBE IPSAS 43 – to avoid PBE preparers having to refer to a for-profit standard.</p>	<p>The ED refers preparers to NZ IFRS 15 <i>Revenue from Contracts with Customers</i> in the same circumstances as IPSAS 43.</p> <p>As discussed with the Board in June 2022, it was not practicable to include relevant NZ IFRS 15 paragraphs in PBE IPSAS 43 without either including a large portion of NZ IFRS 15 in PBE IPSAS 43, or risking unintended consequences.</p> <p>The references to NZ IFRS 15 will be updated when the IPSASB issues a new standard on Revenue. Therefore, only early adopters of PBE IPSAS 43 are expected to have to refer to NZ IFRS 15.</p> <p>We explain the above in the ED Basis for Conclusions (see paragraphs BC20–BC26) and in the Consultation Document.</p> <p><i>We note that the TRG supported our approach to the NZ IFRS 15 references.</i></p>

Topic	IPSAS 43 requirement	New Zealand amendment considered	Outcome
Discount rates	<p>The requirements for discounting lease payments in IPSAS 43 are aligned with IFRS 16. No additional guidance is provided on how to determine the discount rate in the public sector.</p> <p>The IPSASB’s Basis for Conclusions notes that the incremental borrowing rate can be determined by considering the lease’s terms and conditions, referring to a rate that is readily observable (e.g. the interest rate to borrow money to purchase the type of asset being leased), and adjust the observable rate as needed to meet the definition of ‘incremental borrowing rate’.</p>	<p>Whether to develop guidance on discount rates for the PBE context – given that during the consultation on the IPSASB’s EDs on leases, some New Zealand constituents noted that determining the discount rate for leases could be challenging for PBEs.</p>	<p>The Consultation Document notes the explanation in the IPSASB’s Basis for Conclusions on how the lessee’s incremental borrowing rate can be determined.</p> <p>To date, we have not had sufficient resources to consider the development of guidance on the determination of the discount rate under PBE IPSAS 43. We plan to consider the development of such guidance (if it is feasible) after publishing the ED. We note the PBE IPSAS 43 will have a long implementation period.</p> <p>The Consultation Document no longer notes that we plan to consider the development of guidance on discount rates. development of guidance. In June, a Board Member recommended not mention this unless we are fairly certain that we can develop useful guidance in this area. We are yet to determine whether we would be able to issue useful guidance on this topic that would not amount to a local interpretation of IPSAS and IFRS Accounting Standards.</p> <p>We have not included a discussion on discount rates in the Basis for Conclusions of the ED.</p>

Question for the Board

Q3. Does the Board have any comments on how the matters listed in Table 4 are explained in the Basis for Conclusions and/or in the Consultation Document?

Approval to issue the ED and Consultation Document

8. The draft ED and accompanying Consultation Document are attached as Agenda Item 5.2 and Agenda Item 5.3 respectively. Most of the changes made to these documents since the June 2022 meeting are covered in the previous sections.
9. In addition to the updates mentioned in the previous sections, we have deleted the following question in the Consultation Document, in response to Board feedback in June 2022:

“Do you agree that the proposed requirements in ED 2022-X are appropriate for a new PBE Standard? If you disagree, please explain why not and outline any alternative proposals.”

10. We note that when we consulted on IPSASB ED 64 *Leases*, constituents broadly supported the lessee accounting proposals in that ED (except for concessionary leases) – and ED PBE IPSAS 43 is ultimately based on those proposals (without specific requirements for concessionary leases).
11. We also note that if constituents have comments on the appropriateness of the ED proposals that are based directly on IPSAS 43 (as opposed to the New Zealand modifications to IPSAS 43) for New Zealand PBEs, they would be able to express such views under the ‘catch all’ question at the end of the Consultation Document: “Do you have any other comments on the ED?”
12. As agreed by the Board at the June 2022 meeting, the consultation period indicated in the Consultation Document is around 90 days – with feedback due by 25 November 2022.

Question for the Board

- Q4. Does the Board have any other comments on:
 - (a) the draft ED PBE IPSAS 43 *Leases* (Agenda Item 5.2); and
 - (b) the accompanying draft Consultation Document (Agenda Item 5.3)?
- Q5. Does the Board APPROVE to issue for public consultation:
 - (a) the draft ED PBE IPSAS 43 *Leases* (Agenda Item 5.2); and
 - (b) the accompanying draft Consultation Document (Agenda Item 5.3)?

Outreach plan and project timeline

13. We discussed a preliminary high-level outreach plan with the Board at its June 2022 meeting. The table below includes an updated outreach plan, as well as a general timeline for the remaining stages of this project.
14. In considering the outreach plan, we have taken into account the fact that we have carried out broad consultation with New Zealand constituents on IPSASB ED 64 *Leases* in 2018. Feedback from constituents indicated broad support for the ED proposals, except for the proposals relating to concessionary leases and the proposals to introduce the ROU model for lessors. We then consulted with constituents in 2021 on IPSASB ED 75, which was based on the ED 64 proposals excluding the proposals for concessionary leases and for lessors. ED PBE IPSAS 43 is largely consistent with IPSASB ED 75.
15. We also note that New Zealand constituents broadly supported the lessee accounting proposals in the previous IPSASB EDs on leases. While some constituents expressed concerns relating to concessionary leases and lease-like arrangements for nil considerations, we note that such arrangements will be addressed at a later stage, when the IPSASB finalises its project on *Other Lease-type Arrangements*. Under the proposals of ED PBE IPSAS 43, an entity does not measure the concessionary portion concessionary leases and lease-like arrangements for nil considerations at fair value. We will ensure that we emphasise this message in our outreach.

Table 5 PBE IPSAS 43 outreach plan and next steps

Date	Outreach activities
11 August 2022	NZASB approves to issue ED PBE IPSAS 43 <i>Leases</i> and the accompanying Consultation Document for public consultation (assuming the Board agrees to do so)
25 August 2022 (May be earlier or later – depending on the Board’s comments at the August 2022 meeting)	ED PBE IPSAS 43 <i>Leases</i> and accompanying Consultation Document are published on the website (with the usual ‘landing page – which will summarise the proposals, encourage feedback and provide access to the ED and Consultation Document).
Week beginning 29 August 2022	Notify constituents about the ED in an XRB Accounting Alert (and possibly in the XRB-wide newsletter Pitopito Korero)
Week beginning 5 September 2022	<p>Email the following New Zealand constituents who submitted comments to the NZASB and/or IPSASB on IPSASB ED 75 <i>Leases</i> and IPSASB ED 64 <i>Leases</i> – to seek their feedback on ED PBE IPSAS 43 <i>Leases</i> (we plan to encourage them to make a formal submission – and/or to discuss their feedback informally via email/meeting/phone call):</p> <ul style="list-style-type: none"> • Auckland Council • Quadrent Limited • Ministry of Education • Office of the Auditor-General • The Treasury • CA ANZ • CPA Australia • BDO • Cornwall Park Trust Board • Emerge Aotearoa
Early September 2022 (a day during the period of 12–23 September)	<ul style="list-style-type: none"> • Record a short webinar to describe the ED proposals and encourage submissions – and make the webinar available on the website • Notify constituents through an XRB Accounting Alert that the webinar is available on the website
20 September 2022	TRG meeting – seek feedback on the ED from TRG Members
September – November 2022	Staff to attend meetings/calls with those constituents who wish to discuss the ED proposals.
25 November 2022	Comments due to the NZASB
December 2022 – January 2023	Staff analyse submissions and other feedback received on the ED
15 February 2023	NZASB meeting – Board discussion on ED submissions received and whether to make any changes to the ED proposals
February – March 2023	Staff update the draft standard based on Board feedback from the February 2023 meeting
4 April 2023	NZASB meeting – PBE IPSAS 43 <i>Leases</i> approved as final standard

Questions for the Board

Q6. Does the Board have any feedback on the proposed outreach plan?

Next steps

Finalisation of ED and Consultation Document

16. If the Board approves the ED and Consultation Document subject to changes identified at this meeting, we propose to finalise such changes through a final review and approval by the Chair.

Attachments

Agenda item 5.2: Draft ED PBE IPSAS 43 *Leases*

Agenda item 5.3: Draft Consultation Document – PBE IPSAS 43 *Leases*

Appendix A: Deleted paragraphs relating to COVID-19-related rent concessions

As explained in the main body of this memo, in the draft ED we have deleted and marked as 'not used' the following COVID-19-related paragraphs.

Paragraphs that set out the COVID-19-related practical expedient (deleted in draft ED):

48. As a practical expedient, a lessee may elect not to assess whether a rent concession that meets the conditions in paragraph 49 is a lease modification. A lessee that makes this election shall account for any change in lease payments resulting from the rent concession the same way it would account for the change applying this Standard if the change were not a lease modification.
49. The practical expedient in paragraph 48 applies only to rent concessions occurring as a direct consequence of the COVID-19 pandemic and only if all of the following conditions are met:
- (a) The change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
 - (b) Any reduction in lease payments affects only payments originally due on or before June 30, 2022 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before June 30, 2022 and increased lease payments that extend beyond June 30, 2022); and
 - (c) There is no substantive change to other terms and conditions of the lease.
- ...
64. If a lessee applies the practical expedient in paragraph 48, the lessee shall disclose:
- (a) That it has applied the practical expedient to all rent concessions that meet the conditions in paragraph 49 or, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient (see paragraph 2); and
 - (b) The amount recognised in surplus or deficit for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient in paragraph 48.

Effective date and transition paragraphs relating to the COVID-19 practical expedient (deleted in draft ED)

105. If a lessee elects to apply this Standard early, a lessee shall apply paragraphs 48, 49, 64, 124, 125 and 126 for annual financial statements covering periods beginning on or after February 1, 2022. Earlier application is permitted, including in financial statements not authorized for issue at January 31, 2022.
- ...
124. A lessee shall apply paragraphs 48, 49, and 64 retrospectively, recognizing the cumulative effect of initially applying that amendment as an adjustment to the opening balance of accumulated surpluses/(deficits) (or other component of net assets/equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.
125. In the reporting period in which a lessee first applies paragraph 48, 49, and 64, a lessee is not required to disclose the information required by paragraph 33(f) of PBE IPSAS 3.
126. Applying paragraph 2 of this Standard, a lessee shall apply the practical expedient in paragraph 48 consistently to eligible contracts with similar characteristics and in similar circumstances, irrespective of whether the contract became eligible for the practical expedient as a result of the lessee applying the COVID-19-Related Rent Concessions requirements.

Proposed new lease accounting standard

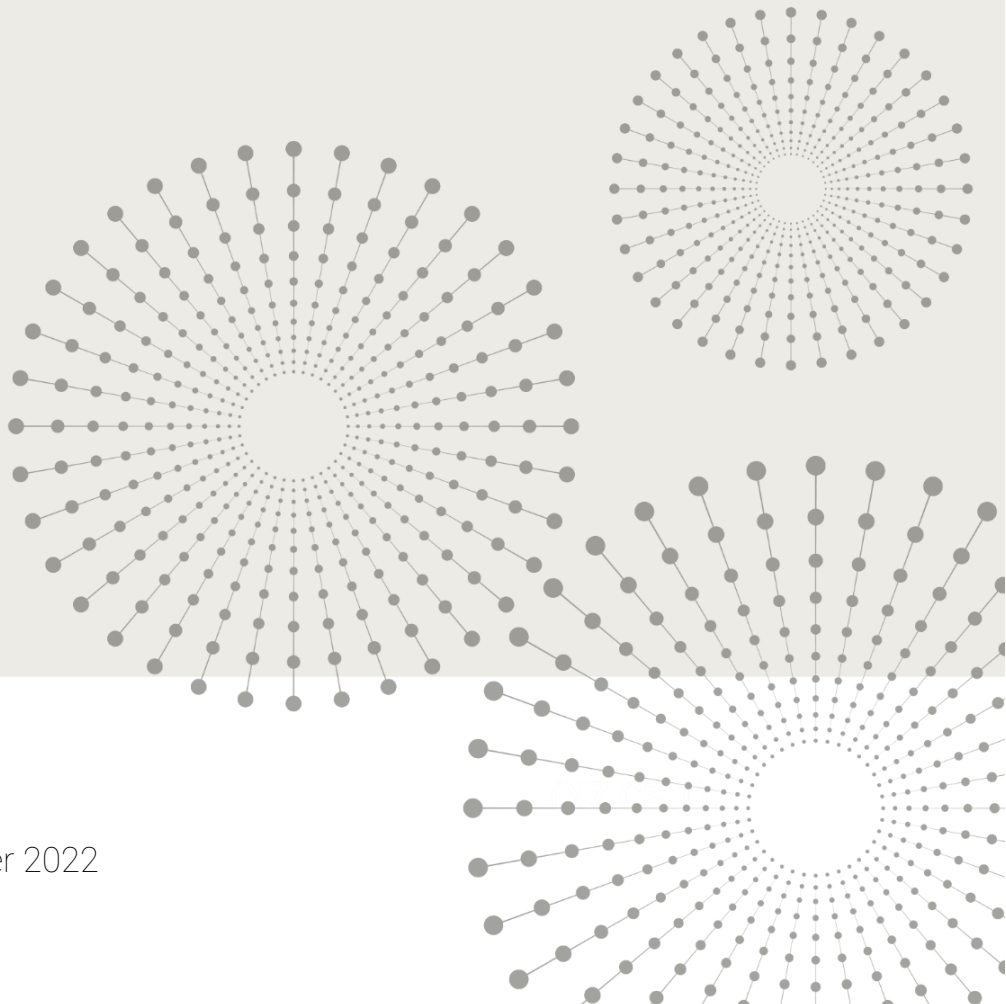
Tier 1 & 2 Public Benefit Entities

PBE IPSAS 43 Leases

Exposure Draft (ED)

August 2022

Comment period closes 25 November 2022





EXPOSURE DRAFT NZASB 2022-11

**PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING
STANDARD 43 LEASES (PBE IPSAS 43)**

Issued [date]

This [draft] 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 secondary legislation 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 the [draft] Standard in accordance with the effective date set out in paragraph 103.

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 has been issued as a result of a new International Public Sector Accounting Standard – IPSAS 43 *Leases*. This Standard, when applied, supersedes PBE IPSAS 13 *Leases*.

PBE IPSAS 43 LEASES

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The following is available on the XRB website as additional material

IPSASB Basis for Conclusions

Public Benefit Entity International Public Sector Accounting Standard 43 *Leases* is set out in paragraphs 1–127 and Appendices A and B. All the paragraphs have equal authority. PBE IPSAS 43 should be read in the context of its objective, the NZASB’s Basis for Conclusions on PBE IPSAS 43, the IPSASB’s Basis for Conclusions on IPSAS 43, the *Public Benefit Entities’ Conceptual Framework* and Standard XRB A1 *Application of the Accounting Standards Framework*. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. This Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.
2. An entity shall consider the terms and conditions of contracts and all relevant facts and circumstances when applying this Standard. An entity shall apply this Standard consistently to contracts with similar characteristics and in similar circumstances.

Scope

- 2.1. **This Standard applies to Tier 1 and Tier 2 public benefit entities**
- 2.2. **A Tier 2 entity is not required to comply with the requirements in this Standard denoted with an asterisk (*). Where a Tier 2 entity elects to apply a disclosure concession it shall comply with any RDR paragraphs associated with that concession.**
3. An entity shall apply this Standard to all leases, including leases of right-of-use assets in a sublease, except for:
 - (a) Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
 - (b) Leases of biological assets within the scope of PBE IPSAS 27 *Agriculture* held by a lessee;
 - (c) Service concession arrangements within the scope of PBE IPSAS 32 *Service Concession Arrangements: Grantor* and PBE FRS 45 *Service Concession Arrangements: Operator*; and
 - (d) Rights held by a lessee under licensing agreements within the scope of PBE IPSAS 31 *Intangible Assets* for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.
4. A lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in paragraph 3(d).
 - 4.1 Leases with below-market terms, sometimes described as concessionary leases, are in the scope of this Standard (provided that they are not excluded from the scope of this Standard under paragraph 3). Arrangements where no consideration is paid for the right to use an asset over a specified period of time do not meet the definition of a lease in this Standard.
 - 4.2 In applying the measurement requirements in this Standard, an entity takes into account the amount of lease payments as per the lease agreement, and not the amount of lease payments that would have been charged had the lease been on market terms, except that:
 - (a) An entity measures a right-of-use asset at fair value after initial recognition if it is required to do so under paragraph 35 or if it chooses to do so under paragraph 36; and
 - (b) In accordance with PBE FRS 47 *First-time Adoption of PBE Standards*, a lessee that is a first-time adopter of PBE Standards may elect to measure a right-of-use asset at fair value, or using a previous GAAP revaluation that is equivalent to fair value, cost or depreciated cost, on the date of transition to PBE Standards (see PBE FRS 47).

Definitions

5. **The following terms are used in this Standard with the meanings specified:**

The commencement date of the lease (commencement date) is the date on which a lessor makes an underlying asset available for use by a lessee.

A contract, for the purpose of this Standard, is an agreement between two or more parties that creates enforceable rights and obligations.

Economic life is either:

- (a) The period over which an asset is expected to be economically usable by one or more users; or
- (b) The number of production or similar units expected to be obtained from an asset by one or more users.

The **effective date of the modification** is the date when both parties agree to a lease modification.

Fair value, for the purpose of applying the lessor accounting requirements in this Standard, is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.

Fixed payments are payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.

Gross investment in the lease is the sum of:

- (a) The lease payments receivable by a lessor under a finance lease; and
- (b) Any unguaranteed residual value accruing to the lessor.

The **inception date of the lease** (inception date) is the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.

Initial direct costs are incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained.

The **interest rate implicit in the lease** is the rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor.

A **lease** is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Lease incentives are payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee.

Lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

Lease payments are payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

- (a) Fixed payments (including in-substance fixed payments), less any lease incentives;
- (a) Variable lease payments that depend on an index or a rate;
- (b) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- (c) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees. Lease payments do not include payments allocated to non-lease components of a contract, unless the lessee elects to combine non-lease components with a lease component and to account for them as a single lease component.

For the lessor, lease payments also include any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of

discharging the obligations under the guarantee. Lease payments do not include payments allocated to non-lease components.

The **lease term** is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both:

- (a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

A **lessee** is an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

The **lessee's incremental borrowing rate** is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

A **lessor** is an entity that provides the right to use an underlying asset for a period of time in exchange for consideration.

Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease.

Operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Optional lease payments are payments to be made by a lessee to a lessor for the right to use an underlying asset during periods covered by an option to extend or terminate a lease that are not included in the lease term.

Period of use is the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time).

The **residual value guarantee** is a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

A **right-of-use asset** is an asset that represents a lessee's right to use an underlying asset for the lease term.

A **short-term lease** is a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

A **sublease** is a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.

Underlying asset is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.

Unearned finance revenue is the difference between:

- (a) The gross investment in the lease; and
- (b) The net investment in the lease.

Unguaranteed residual value is that portion of the residual value of the underlying asset, the realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

Variable lease payments are the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

Terms defined in other PBE Standards are used in this Standard with the same meaning as in those Standards and are reproduced in the *Glossary of Defined Terms* published separately. The defined term

useful life is used in this Standard with the same meaning as in PBE IPSAS 17 *Property, Plant, and Equipment*.

Recognition Exemptions (see paragraphs AG4–AG9)

6. A lessee may elect not to apply the requirements in paragraphs 23–52 to:
 - (a) Short-term leases; and
 - (b) Leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9).
7. If a lessee elects not to apply the requirements in paragraphs 23–52 to either short-term leases or leases for which the underlying asset is of low value, the lessee shall recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee’s benefit.
8. If a lessee accounts for short-term leases applying paragraph 7, the lessee shall consider the lease to be a new lease for the purposes of this Standard if:
 - (a) There is a lease modification; or
 - (b) There is any change in the lease term (for example, the lessee exercises an option not previously included in its determination of the lease term).
9. The election for short-term leases shall be made by class of underlying asset to which the right of use relates. A class of underlying asset is a grouping of underlying assets of a similar nature and use in an entity’s operations. The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.

Identifying a Lease (see paragraphs AG10–AG34)

10. **At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs AG10–AG32 set out guidance on the assessment of whether a contract is, or contains, a lease.**
11. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).
12. An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.

Separating Components of a Contract

13. For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in paragraph 16. Paragraphs AG33–AG34 set out guidance on separating components of a contract.

Lessee

14. For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.
15. The relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximising the use of observable information.
16. As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. A lessee shall not apply this practical expedient to embedded derivatives that meet the criteria in paragraph 49 of PBE IPSAS 41 *Financial Instruments*.

17. Unless the practical expedient in paragraph 16 is applied, a lessee shall account for non-lease components applying other applicable Standards.

Lessor

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 NZ IFRS 15 *Revenue from Contracts with Customers*.

Lease Term (see paragraphs AG35–AG42)

19. An entity shall determine the lease term as the non-cancellable period of a lease, together with both:
- (a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
 - (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
20. In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs AG38–AG41.
21. A lessee shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that:
- (a) Is within the control of the lessee; and
 - (b) Affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term (as described in paragraph AG42).
22. An entity shall revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if:
- (a) The lessee exercises an option not previously included in the entity’s determination of the lease term;
 - (b) The lessee does not exercise an option previously included in the entity’s determination of the lease term;
 - (c) An event occurs that contractually obliges the lessee to exercise an option not previously included in the entity’s determination of the lease term; or
 - (d) An event occurs that contractually prohibits the lessee from exercising an option previously included in the entity’s determination of the lease term.

Lessee

Recognition

23. **At the commencement date, a lessee shall recognise a right-of-use asset and a lease liability.**

Measurement

Initial Measurement

Initial Measurement of the Right-of-Use Asset

24. **At the commencement date, a lessee shall measure the right-of-use asset at cost.**

25. The cost of the right-of-use asset shall comprise:

- (a) The amount of the initial measurement of the lease liability, as described in paragraph 27;
 - (b) Any lease payments made at or before the commencement date, less any lease incentives received;
 - (c) Any initial direct costs incurred by the lessee; and
 - (d) An estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.
26. A lessee shall recognise the costs described in paragraph 25(d) as part of the cost of the right-of-use asset when it incurs an obligation for those costs. A lessee applies PBE IPSAS 12 *Inventories* to costs that are incurred during a particular period as a consequence of having used the right-of-use asset to produce inventories during that period. The obligations for such costs accounted for applying this Standard or PBE IPSAS 12 are recognised and measured applying PBE IPSAS 19 *Provisions, Contingent Liabilities, and Contingent Assets*.

Initial Measurement of the Lease Liability

27. **At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.**
28. At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:
- (a) Fixed payments (including in-substance fixed payments as described in paragraph AG43), less any lease incentives receivable;
 - (b) Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (as described in paragraph 29);
 - (c) Amounts expected to be payable by the lessee under residual value guarantees;
 - (d) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs AG38–AG41); and
 - (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.
29. Variable lease payments that depend on an index or a rate described in paragraph 28(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates.

Subsequent Measurement

Subsequent Measurement of the Right-of-Use Asset

30. **After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies either of the measurement models described in paragraphs 35 and 36.**

Cost Model

31. To apply a cost model, a lessee shall measure the right-of-use asset at cost:
- (a) Less any accumulated depreciation and any accumulated impairment losses; and

- (b) Adjusted for any remeasurement of the lease liability specified in paragraph 37(c).
32. A lessee shall apply the depreciation requirements in PBE IPSAS 17 in depreciating the right-of-use asset, subject to the requirements in paragraph 33.
33. If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the useful life of the underlying asset. Otherwise, the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term.
34. A lessee shall apply PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets* or PBE IPSAS 26 *Impairment of Cash-Generating Assets*, as appropriate, to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.

Other Measurement Models

35. If a lessee applies the fair value model in PBE IPSAS 16 *Investment Property* to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in PBE IPSAS 16.
36. If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in PBE IPSAS 17, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

Subsequent Measurement of the Lease Liability

37. **After the commencement date, a lessee shall measure the lease liability by:**
- (a) **Increasing the carrying amount to reflect interest on the lease liability;**
 - (b) **Reducing the carrying amount to reflect the lease payments made; and**
 - (c) **Remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 40–47, or to reflect revised in-substance fixed lease payments (see paragraph AG43).**
38. Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. The periodic rate of interest is the discount rate described in paragraph 27, or if applicable the revised discount rate described in paragraph 42, paragraph 44 or paragraph 46(c).
39. After the commencement date, a lessee shall recognise in surplus or deficit, unless the costs are included in the carrying amount of another asset applying other applicable Standards, both:
- (a) Interest on the lease liability; and
 - (b) Variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.

Reassessment of the Lease Liability

40. After the commencement date, a lessee shall apply paragraphs 41–44 to remeasure the lease liability to reflect changes to the lease payments. A lessee shall recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee shall recognise any remaining amount of the remeasurement in surplus or deficit.
41. A lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate, if either:

- (a) There is a change in the lease term, as described in paragraphs 21–22. A lessee shall determine the revised lease payments on the basis of the revised lease term; or
 - (b) There is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraphs 21–22 in the context of a purchase option. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.
42. In applying paragraph 41, a lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee’s incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined.
43. A lessee shall remeasure the lease liability by discounting the revised lease payments, if either:
- (a) There is a change in the amounts expected to be payable under a residual value guarantee. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee.
 - (b) There is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review. The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (i.e. when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments.
44. In applying paragraph 43, a lessee shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessee shall use a revised discount rate that reflects changes in the interest rate.

Lease Modifications

45. A lessee shall account for a lease modification as a separate lease if both:
- (a) The modification increases the scope of the lease by adding the right to use one or more underlying assets; and
 - (b) The consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.
46. For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessee shall:
- (a) Allocate the consideration in the modified contract applying paragraphs 14–17;
 - (b) Determine the lease term of the modified lease applying paragraphs 19–20; and
 - (c) Remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee’s incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.
47. For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:
- (a) Decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee shall recognise in surplus or deficit any gain or loss relating to the partial or full termination of the lease.
 - (b) Making a corresponding adjustment to the right-of-use asset for all other lease modifications.
48. [Not used]

49. [Not used]

Presentation

50. A lessee shall either present in the statement of financial position, or disclose in the notes:
- (a) Right-of-use assets separately from other assets. If a lessee does not present right-of-use assets separately in the statement of financial position, the lessee shall:
 - (i) Include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and
 - (ii) Disclose which line items in the statement of financial position include those right-of-use assets.
 - (b) Lease liabilities separately from other liabilities. If the lessee does not present lease liabilities separately in the statement of financial position, the lessee shall disclose which line items in the statement of financial position include those liabilities.
51. The requirement in paragraph 50(a) does not apply to right-of-use assets that meet the definition of investment property, which shall be presented in the statement of financial position as investment property.
52. In the statement of financial performance, a lessee shall present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset. Interest expense on the lease liability is a component of finance costs, which paragraph 99.1(b) of PBE IPSAS 1 *Presentation of Financial Reports* requires to be presented separately in the statement of financial performance.
53. In the cash flow statement, a lessee shall classify:
- (a) Cash payments for the principal portion of the lease liability within financing activities;
 - (b) Cash payments for the interest portion of the lease liability applying the requirements in PBE IPSAS 2 *Cash Flow Statement* for interest paid; and
 - (c) Short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

Disclosure

54. **The objective of the disclosures is for lessees to disclose information in the notes that, together with the information provided in the statement of financial position, statement of financial performance and cash flow statement, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee. Paragraphs 55–64 specify requirements on how to meet this objective.**
55. A lessee shall disclose information about its leases for which it is a lessee in a single note or separate section in its financial statements. However, a lessee need not duplicate information that is already presented elsewhere in the financial statements, provided that the information is incorporated by cross-reference in the single note or separate section about leases.
56. A lessee shall disclose the following amounts for the reporting period:
- (a) Depreciation charge for right-of-use assets by class of underlying asset;
 - (b) Interest expense on lease liabilities;
 - (c) The expense relating to short-term leases accounted for applying paragraph 7. This expense need not include the expense relating to leases with a lease term of one month or less;
 - (d) The expense relating to leases of low-value assets accounted for applying paragraph 7. This expense shall not include the expense relating to short-term leases of low-value assets included in paragraph 56(c);
 - (e) The expense relating to variable lease payments not included in the measurement of lease liabilities;
 - (f) Revenue from subleasing right-of-use assets;

- (g) Total cash outflow for leases;
 - (h) Additions to right-of-use assets;
 - (i) Gains or losses arising from sale and leaseback transactions; and
 - (j) The carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset.
- *57. A lessee shall provide the disclosures specified in paragraph 56 in a tabular format, unless another format is more appropriate. The amounts disclosed shall include costs that a lessee has included in the carrying amount of another asset during the reporting period.
- RDR 57.1 The amounts disclosed in accordance with paragraph 56 shall include costs that a Tier 2 lessee has included in the carrying amount of another asset during the reporting period
58. A lessee shall disclose the amount of its lease commitments for short-term leases accounted for applying paragraph 7 if the portfolio of short-term leases to which it is committed at the end of the reporting period is dissimilar to the portfolio of short-term leases to which the short-term lease expense disclosed applying paragraph 56(c) relates.
59. If right-of-use assets meet the definition of investment property, a lessee shall apply the disclosure requirements in PBE IPSAS 16. In that case, a lessee is not required to provide the disclosures in paragraph 56(a), 56(f), 56(h) or 56(j) for those right-of-use assets.
60. If a lessee measures right-of-use assets at revalued amounts applying PBE IPSAS 17, the lessee shall disclose the information required by paragraph 92 of PBE IPSAS 17 for those right-of-use assets.
- *61. A lessee shall disclose a maturity analysis of lease liabilities applying paragraphs 46 and AG12 of PBE IPSAS 30 *Financial Instruments: Disclosures* separately from the maturity analyses of other financial liabilities.
62. In addition to the disclosures required in paragraphs 56–61, a lessee shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 54 (as described in paragraph AG49). This additional information may include, but is not limited to, information that helps users of financial statements to assess:
- (a) The nature of the lessee’s leasing activities;
 - (b) Future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This includes exposure arising from:
 - (i) Variable lease payments (as described in paragraph AG50);
 - (ii) Extension options and termination options (as described in paragraph AG51);
 - (iii) Residual value guarantees (as described in paragraph AG52); and
 - (iv) Leases not yet commenced to which the lessee is committed.
 - (c) Restrictions or covenants imposed by leases; and
 - (d) Sale and leaseback transactions (as described in paragraph AG53).
63. A lessee that accounts for short-term leases or leases of low-value assets applying paragraph 7 shall disclose that fact.
64. [Not used]

Lessor

Classification of Leases (see paragraphs AG54–AG59)

65. **A lessor shall classify each of its leases as either an operating lease or a finance lease.**

66. **A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.**
67. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
- (a) The lease transfers ownership of the underlying asset to the lessee by the end of the lease term;
 - (b) The lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;
 - (c) The lease term is for the major part of the economic life of the underlying asset even if title is not transferred;
 - (d) At the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and
 - (e) The underlying asset is of such a specialised nature that only the lessee can use it without major modifications.
68. Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
 - (b) Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
 - (c) The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
69. The examples and indicators in paragraphs 67–68 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset, the lease is classified as an operating lease. For example, this may be the case if ownership of the underlying asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are variable lease payments, as a result of which the lessor does not transfer substantially all such risks and rewards.
70. Lease classification is made at the inception date and is reassessed only if there is a lease modification. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the underlying asset), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

Finance Leases

Recognition and Measurement

71. **At the commencement date, a lessor shall recognise assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the net investment in the lease.**

Initial Measurement

72. The lessor shall use the interest rate implicit in the lease to measure the net investment in the lease. In the case of a sublease, if the interest rate implicit in the sublease cannot be readily determined, an intermediate lessor may use the discount rate used for the head lease (adjusted for any initial direct costs associated with the sublease) to measure the net investment in the sublease.

73. Initial direct costs are included in the initial measurement of the net investment in the lease and reduce the amount of revenue recognised over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease; there is no need to add them separately.

Initial Measurement of the Lease Payments Included in the Net Investment in the Lease

74. At the commencement date, the lease payments included in the measurement of the net investment in the lease comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:
- (a) Fixed payments (including in-substance fixed payments as described in paragraph AG43), less any lease incentives payable;
 - (b) Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
 - (c) Any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;
 - (d) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraph AG38); and
 - (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Subsequent Measurement

75. **A lessor shall recognise finance revenue over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.**
76. A lessor aims to allocate finance revenue over the lease term on a systematic and rational basis. A lessor shall apply the lease payments relating to the period against the gross investment in the lease to reduce both the principal and the unearned finance revenue.
77. A lessor shall apply the derecognition and impairment requirements in PBE IPSAS 41 to the net investment in the lease. A lessor shall regularly review estimated unguaranteed residual values used in computing the gross investment in the lease. If there has been a reduction in the estimated unguaranteed residual value, the lessor shall revise the revenue allocation over the lease term and recognise immediately any reduction in respect of amounts accrued.
78. A lessor that classifies an asset under a finance lease as held for sale (or includes it in a disposal group that is classified as held for sale) applying PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* shall account for the asset in accordance with that Standard.

Lease Modifications

79. A lessor shall account for a modification to a finance lease as a separate lease if both:
- (a) The modification increases the scope of the lease by adding the right to use one or more underlying assets; and
 - (b) The consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.
80. For a modification to a finance lease that is not accounted for as a separate lease, a lessor shall account for the modification as follows:
- (a) If the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:

- (i) Account for the lease modification as a new lease from the effective date of the modification; and
 - (ii) Measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
- (b) Otherwise, the lessor shall apply the requirements of PBE IPSAS 41.

Operating Leases

Recognition and Measurement

81. **A lessor shall recognise lease payments from operating leases as revenue on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.**
82. A lessor shall recognise costs, including depreciation, incurred in earning the lease revenue as an expense.
83. A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the lease revenue.
84. The depreciation policy for depreciable underlying assets subject to operating leases shall be consistent with the lessor's normal depreciation policy for similar assets. A lessor shall calculate depreciation in accordance with PBE IPSAS 17 and PBE IPSAS 31.
85. A lessor shall apply PBE IPSAS 21 or PBE IPSAS 26, as appropriate, to determine whether an underlying asset subject to an operating lease is impaired and to account for any impairment loss identified.

Lease Modifications

86. A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Presentation

87. A lessor shall present underlying assets subject to operating leases in its statement of financial position according to the nature of the underlying asset.

Disclosure

88. **The objective of the disclosures is for lessors to disclose information in the notes that, together with the information provided in the statement of financial position, statement of financial performance and cash flow statement, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor. Paragraphs 89–96 specify requirements on how to meet this objective.**
89. A lessor shall disclose the following amounts for the reporting period:
- (a) For finance leases:
 - (i) Selling surplus or deficit;
 - (ii) Finance revenue on the net investment in the lease; and
 - (iii) Revenue relating to variable lease payments not included in the measurement of the net investment in the lease.
 - *(b) For operating leases, lease revenue, separately disclosing revenue relating to variable lease payments that do not depend on an index or a rate.

RDR 89.1 For operating leases, a Tier 2 entity shall disclose lease income.

- *90 A lessor shall provide the disclosures specified in paragraph 89 in a tabular format, unless another format is more appropriate.
91. A lessor shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 88. This additional information includes, but is not limited to, information that helps users of financial statements to assess:
- (a) The nature of the lessor's leasing activities; and
 - (b) How the lessor manages the risk associated with any rights it retains in underlying assets. In particular, a lessor shall disclose its risk management strategy for the rights it retains in underlying assets, including any means by which the lessor reduces that risk. Such means may include, for example, buy-back agreements, residual value guarantees or variable lease payments for use in excess of specified limits.

Finance Leases

92. A lessor shall provide a qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in finance leases.
93. A lessor shall disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall reconcile the undiscounted lease payments to the net investment in the lease. The reconciliation shall identify the unearned finance revenue relating to the lease payments receivable and any discounted unguaranteed residual value.

Operating Leases

94. For items of property, plant and equipment subject to an operating lease, a lessor shall apply the disclosure requirements of PBE IPSAS 17. In applying the disclosure requirements in PBE IPSAS 17, a lessor shall disaggregate each class of property, plant and equipment into assets subject to operating leases and assets not subject to operating leases. Accordingly, a lessor shall provide the disclosures required by PBE IPSAS 17 for assets subject to an operating lease (by class of underlying asset) separately from owned assets held and used by the lessor.
95. A lessor shall apply the disclosure requirements in PBE IPSAS 16, PBE IPSAS 21 or PBE IPSAS 26, as appropriate, PBE IPSAS 27 and PBE IPSAS 31 for assets subject to operating leases.
96. A lessor shall disclose a maturity analysis of lease payments, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

Sale and Leaseback Transactions

97. If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer contract and the lease applying paragraphs 98–102.

Assessing Whether the Transfer of the Asset is a Sale

98. An entity shall apply the requirements for determining when a performance obligation is satisfied in NZ IFRS 15 to determine whether the transfer of an asset is accounted for as a sale of that asset.

Transfer of the Asset is a Sale

99. If the transfer of an asset by the seller-lessee satisfies the requirements of NZ 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.

Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

- (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.
100. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:
- (a) Any below-market terms shall be accounted for as a prepayment of lease payments; and
 - (b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.
101. The entity shall measure any potential adjustment required by paragraph 100 on the basis of the more readily determinable of:
- (a) The difference between the fair value of the consideration for the sale and the fair value of the asset; and
 - (b) The difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

Transfer of the Asset is not a Sale

102. If the transfer of an asset by the seller-lessee does not satisfy the requirements of NZ IFRS 15 to be accounted for as a sale of the asset:
- (a) The seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying PBE IPSAS 41.
 - (b) The buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying PBE IPSAS 41.

Temporary exception arising from interest rate benchmark reform

- 102A A lessee shall apply paragraphs 102B–102C to all lease modifications that change the basis for determining future lease payments as a result of interest rate benchmark reform (see paragraphs 72.2 and 72.4 of PBE IPSAS 41). These paragraphs apply only to such lease modifications. For this purpose, the term ‘interest rate benchmark reform’ refers to the market-wide reform of an interest rate benchmark as described in paragraph 155.2 of PBE IPSAS 41.
- 102B As a practical expedient, a lessee shall apply paragraph 43 to account for a lease modification required by interest rate benchmark reform. This practical expedient applies only to such modifications. For this purpose, a lease modification is required by interest rate benchmark reform if, and only if, both of these conditions are met:
- (a) the modification is necessary as a direct consequence of interest rate benchmark reform; and
 - (b) the new basis for determining the lease payments is economically equivalent to the previous basis (i.e. the basis immediately preceding the modification).
- 102C However, if lease modifications are made in addition to those lease modifications required by interest rate benchmark reform, a lessee shall apply the applicable requirements in this Standard to account for all lease modifications made at the same time, including those required by interest rate benchmark reform.

Effective Date and Transition

Effective Date

103. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 January 2027. Earlier application is permitted. If an entity applies this Standard earlier, it shall disclose that fact.**
104. [Not used]

105. [Not used]

Transition

106. For the purposes of the requirements in paragraphs 103–123, the date of initial application is the beginning of the annual reporting period in which an entity first applies this Standard.

Definition of a Lease

107. As a practical expedient, an entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:

- (a) To apply this Standard to contracts that were previously identified as leases applying PBE IPSAS 13, *Leases*. The entity shall apply the transition requirements in paragraphs 109–122 to those leases.
- (b) To not apply this Standard to contracts that were not previously identified as containing a lease applying PBE IPSAS 13.

108. If an entity chooses the practical expedient in paragraph 107, it shall disclose that fact and apply the practical expedient to all of its contracts. As a result, the entity shall apply the requirements in paragraphs 10–12 only to contracts entered into (or changed) on or after the date of initial application.

Lessees

109. A lessee shall apply this Standard to its leases either:

- (a) Retrospectively to each prior reporting period presented applying PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*; or
- (b) Retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application in accordance with paragraphs 111–117.

110. A lessee shall apply the election described in paragraph 109 consistently to all of its leases in which it is a lessee.

111. If a lessee elects to apply this Standard in accordance with paragraph 109(b), the lessee shall not restate comparative information. Instead, the lessee shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) at the date of initial application.

Leases Previously Classified as Operating Leases

112. If a lessee elects to apply this Standard in accordance with paragraph 109(b), the lessee shall:

- (a) Recognise a lease liability at the date of initial application for leases previously classified as an operating lease applying PBE IPSAS 13. The lessee shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.
- (b) Recognise a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying PBE IPSAS 13. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:
 - (i) Its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application; or
 - (ii) An amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.
- (c) Apply PBE IPSAS 21 or PBE IPSAS 26, as appropriate, to right-of-use assets at the date of initial application, unless the lessee applies the practical expedient in paragraph 114(b).

113. Notwithstanding the requirements in paragraph 112, for leases previously classified as operating leases applying PBE IPSAS 13, a lessee:
- (a) Is not required to make any adjustments on transition for leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9) that will be accounted for applying paragraph 7. The lessee shall account for those leases applying this Standard from the date of initial application.
 - (b) Is not required to make any adjustments on transition for leases previously accounted for as investment property using the fair value model in PBE IPSAS 16. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying PBE IPSAS 16 and this Standard from the date of initial application.
 - (c) Shall measure the right-of-use asset at fair value at the date of initial application for leases previously accounted for as operating leases applying PBE IPSAS 13 and that will be accounted for as investment property using the fair value model in PBE IPSAS 16 from the date of initial application. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying PBE IPSAS 16 and this Standard from the date of initial application.
114. A lessee may use one or more of the following practical expedients when applying this Standard retrospectively in accordance with paragraph 109(b) to leases previously classified as operating leases applying PBE IPSAS 13. A lessee is permitted to apply these practical expedients on a lease-by-lease basis:
- (a) A lessee may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).
 - (b) A lessee may rely on its assessment of whether leases are onerous applying PBE IPSAS 19 immediately before the date of initial application as an alternative to performing an impairment review. If a lessee chooses this practical expedient, the lessee shall adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognised in the statement of financial position immediately before the date of initial application.
 - (c) A lessee may elect not to apply the requirements in paragraph 112 to leases for which the lease term ends within 12 months of the date of initial application. In this case, a lessee shall:
 - (i) Account for those leases in the same way as short-term leases as described in paragraph 7; and
 - (ii) Include the cost associated with those leases within the disclosure of short-term lease expense in the annual reporting period that includes the date of initial application.
 - (d) A lessee may exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.
 - (e) A lessee may use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

Leases Previously Classified as Finance Leases

115. If a lessee elects to apply this Standard in accordance with paragraph 109(b), for leases that were classified as finance leases applying PBE IPSAS 13, the carrying amount of the right-of-use asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying PBE IPSAS 13. For those leases, a lessee shall account for the right-of-use asset and the lease liability applying this Standard from the date of initial application.

Disclosure

116. If a lessee elects to apply this Standard in accordance with paragraph 109(b), the lessee shall disclose information about initial application required by paragraph 33 of PBE IPSAS 3, except for the information specified in paragraph 33(f) of PBE IPSAS 3. Instead of the information specified in paragraph 33(f) of PBE IPSAS 3, the lessee shall disclose:

- (a) The weighted average lessee's incremental borrowing rate applied to lease liabilities recognised in the statement of financial position at the date of initial application; and
- (b) An explanation of any difference between:
 - (i) Operating lease commitments disclosed applying PBE IPSAS 13 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the incremental borrowing rate at the date of initial application as described in paragraph 112(a); and
 - (ii) Lease liabilities recognised in the statement of financial position at the date of initial application.

117. If a lessee uses one or more of the specified practical expedients in paragraph 114, it shall disclose that fact.

Lessors

118. Except as described in paragraph 119, a lessor is not required to make any adjustments on transition for leases in which it is a lessor and shall account for those leases applying this Standard from the date of initial application.

119. An intermediate lessor shall:

- (a) Reassess subleases that were classified as operating leases applying PBE IPSAS 13 and are ongoing at the date of initial application, to determine whether each sublease should be classified as an operating lease or a finance lease applying this Standard. The intermediate lessor shall perform this assessment at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sublease at that date.
- (b) For subleases that were classified as operating leases applying PBE IPSAS 13 but finance leases applying this Standard, account for the sublease as a new finance lease entered into at the date of initial application.

Sale and Leaseback Transactions Before the Date of Initial Application

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 NZ IFRS 15 to be accounted for as a sale.

121. If a sale and leaseback transaction was accounted for as a sale and a finance lease applying PBE IPSAS 13, the seller-lessee shall:

- (a) Account for the leaseback in the same way as it accounts for any other finance lease that exists at the date of initial application; and
- (b) Continue to amortise any gain on sale over the lease term.

122. If a sale and leaseback transaction was accounted for as a sale and operating lease applying PBE IPSAS 13, the seller-lessee shall:

- (a) Account for the leaseback in the same way as it accounts for any other operating lease that exists at the date of initial application; and
- (b) Adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognised in the statement of financial position immediately before the date of initial application.

Amounts Previously Recognised in Respect of PBE Combinations

123. If a lessee previously recognised an asset or a liability applying PBE IPSAS 40 *PBE Combinations* or PBE IFRS 3 *Business Combinations* relating to favourable or unfavourable terms of an operating lease acquired as part of a PBE combination, the lessee shall derecognise that asset or liability and adjust the carrying amount of the right-of-use asset by a corresponding amount at the date of initial application.

124. [Not used]

125. [Not used]

126. [Not used]

Interest Rate Benchmark Reform—Phase 2

- 126A An entity shall apply paragraphs 102A–102C retrospectively in accordance with PBE IPSAS 3, except as specified in paragraph 126B.
- 126B An entity is not required to restate prior periods to reflect the application of paragraphs 102A–102C. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of paragraphs 102A–102C in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application of these paragraphs.

Withdrawal and Replacement of PBE IPSAS 13

127. This Standard supersedes PBE IPSAS 13 issued in 2014. PBE IPSAS 13 remains applicable until this Standard is applied or becomes effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of PBE IPSAS 43.

Portfolio Application

AG1. This Standard specifies the accounting for an individual lease. However, as a practical expedient, an entity may apply this Standard to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual leases within that portfolio. If accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

Combination of Contracts

AG2. In applying this Standard, an entity shall combine two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty), and account for the contracts as a single contract if one or more of the following criteria are met:

- (a) The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together;
- (b) The amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- (c) The rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component as described in paragraph AG33.

Definitions (see paragraph 5)

AG3. An entity considers the substance rather than the legal form of an arrangement in determining whether it is a "contract" for the purposes of this Standard. Contracts, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- Contracts involve willing parties entering into an arrangement;
- The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party; and
- The remedy for non-performance is enforceable by law.

Recognition Exemption: Leases for Which the Underlying Asset is of Low Value (paragraphs 6–9)

AG4. Except as specified in paragraph AG8, this Standard permits a lessee to apply paragraph 7 to account for leases for which the underlying asset is of low value. A lessee shall assess the value of an underlying asset based on the value of the asset when it is new, regardless of the age of the asset being leased.

AG5. The assessment of whether an underlying asset is of low value is performed on an absolute basis. Leases of low-value assets qualify for the accounting treatment in paragraph 7 regardless of whether those leases are material to the lessee. The assessment is not affected by the size, nature or circumstances of the lessee. Accordingly, different lessees are expected to reach similar conclusions about whether a particular underlying asset is of low value.

AG6. An underlying asset can be of low value only if:

- (a) The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
- (b) The underlying asset is not highly dependent on, or highly interrelated with, other assets.

- AG7. A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.
- AG8. If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset.
- AG9. Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

Identifying a Lease (paragraphs 10–12)

- AG10. To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs AG14–AG21) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:
- (a) The right to obtain substantially all of the economic benefits or service potential from use of the identified asset (as described in paragraphs AG22–AG24); and
 - (b) The right to direct the use of the identified asset (as described in paragraphs AG25–AG31).
- AG11. If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.
- AG12. A contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement, as defined in PBE IPSAS 37 *Joint Arrangements*. In this case, the joint arrangement is considered to be the customer in the contract. Accordingly, in assessing whether such a contract contains a lease, an entity shall assess whether the joint arrangement has the right to control the use of an identified asset throughout the period of use.
- AG13. An entity shall assess whether a contract contains a lease for each potential separate lease component. Refer to paragraph AG33 for guidance on separate lease components.

Identified Asset

- AG14. An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer.

Substantive Substitution Rights

- AG15. Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:
- (a) The supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
 - (b) The supplier would benefit economically from the exercise of its right to substitute the asset (i.e. the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).
- AG16. If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.
- AG17. An entity's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception of the contract, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include:

- (a) An agreement by a future customer to pay an above market rate for use of the asset;
- (b) The introduction of new technology that is not substantially developed at inception of the contract;
- (c) A substantial difference between the customer's use of the asset, or the performance of the asset, and the use or performance considered likely at inception of the contract; and
- (d) A substantial difference between the market price of the asset during the period of use, and the market price considered likely at inception of the contract.

AG18. If the asset is located at the customer's premises or elsewhere, the costs associated with substitution are generally higher than when located at the supplier's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset.

AG19. The supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.

AG20. If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

Portions of Assets

AG21. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits or service potential from use of the asset.

Right to Obtain Economic Benefits or Service Potential from Use

AG22. To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits or service potential from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits or service potential from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset. The economic benefits or service potential from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits or service potential from using the asset that could be realised from a commercial transaction with a third party.

AG23. When assessing the right to obtain substantially all of the economic benefits or service potential from use of an asset, an entity shall consider the economic benefits or service potential that result from use of the asset within the defined scope of a customer's right to use the asset (see paragraph AG31). For example:

- (a) If a contract limits the use of a motor vehicle to only one particular territory during the period of use, an entity shall consider only the economic benefits or service potential from use of the motor vehicle within that territory, and not beyond.
- (b) If a contract specifies that a customer can drive a motor vehicle only up to a particular number of miles during the period of use, an entity shall consider only the economic benefits or service potential from use of the motor vehicle for the permitted mileage, and not beyond.

AG24. If a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the customer obtains from use of the asset. For example, if the customer is required to pay the supplier a percentage of sales from use of space as consideration for that use, that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the space. This is because the cash flows arising from those sales are considered to be economic benefits that the customer obtains from use of the space, a portion of which it then pays to the supplier as consideration for the right to use that space.

Right to Direct the Use

AG25. A customer has the right to direct the use of an identified asset throughout the period of use only if either:

- (a) The customer has the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs AG26–AG31); or
- (b) The relevant decisions about how and for what purpose the asset is used are predetermined and:
 - (i) The customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
 - (ii) The customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

How and For What Purpose the Asset is Used

AG26. A customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits or service potential to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

AG27. Examples of decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used, within the defined scope of the customer's right of use, include:

- (a) Rights to change the type of output that is produced by the asset (for example, to decide whether to use a shipping container to transport goods or for storage, or to decide upon the mix of products sold from a tourism outlet);
- (b) Rights to change when the output is produced (for example, to decide when an item of machinery or a power plant will be used);
- (c) Rights to change where the output is produced (for example, to decide upon the destination of a truck or a ship, or to decide where an item of equipment is used); and
- (d) Rights to change whether the output is produced, and the quantity of that output (for example, to decide whether to produce energy from a power plant and how much energy to produce from that power plant).

AG28. Examples of decision-making rights that do not grant the right to change how and for what purpose the asset is used include rights that are limited to operating or maintaining the asset. Such rights can be held by the customer or the supplier. Although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and are often dependent on the decisions about how and for what purpose the asset is used. However, rights to operate an asset may grant the customer the right to direct the use of the asset if the relevant decisions about how and for what purpose the asset is used are predetermined (see paragraph AG25(b)(i)).

Decisions Determined During and Before the Period of Use

AG29. The relevant decisions about how and for what purpose the asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

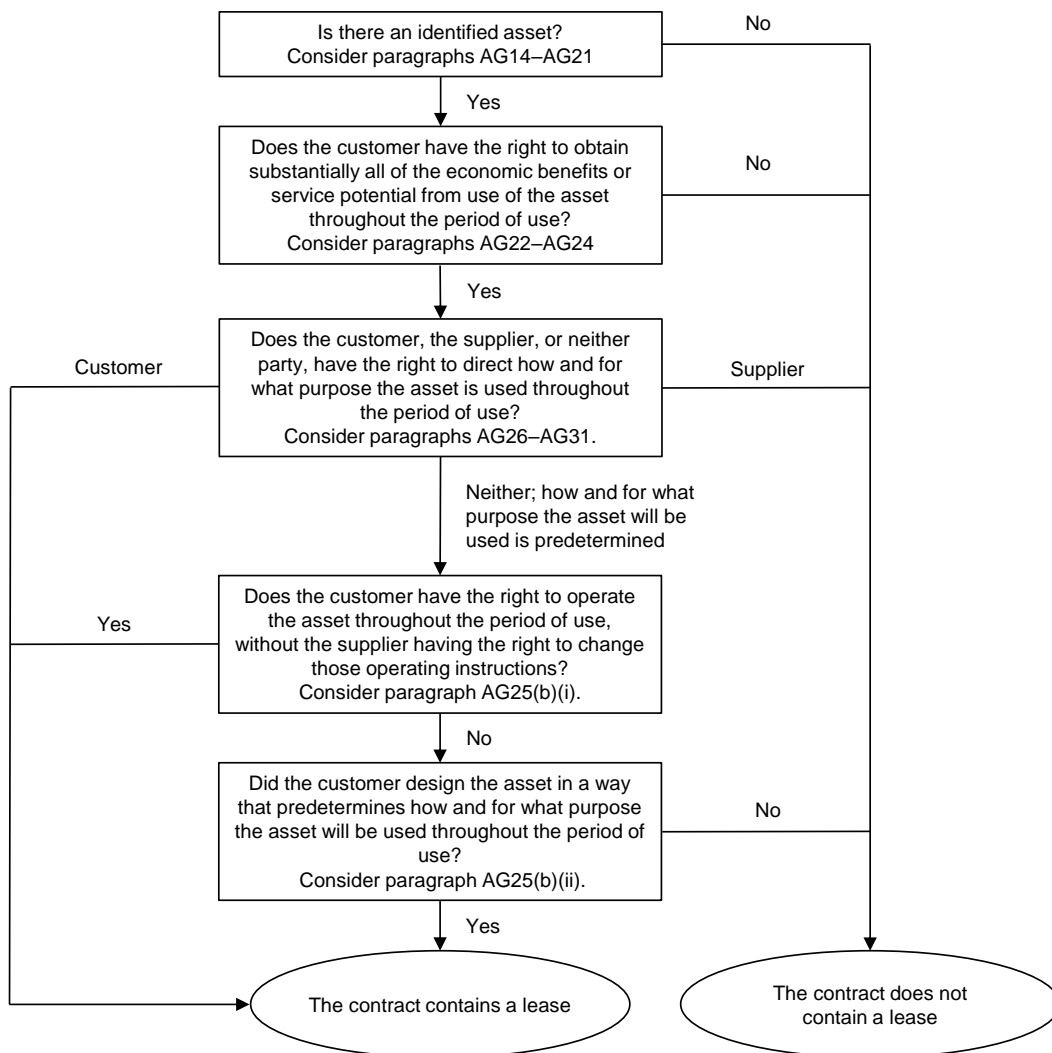
AG30. In assessing whether a customer has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use, unless the customer designed the asset (or specific aspects of the asset) as described in paragraph AG25(b)(ii). Consequently, unless the conditions in paragraph AG25(b)(ii) exist, an entity shall not consider decisions that are predetermined before the period of use. For example, if a customer is able only to specify the output of an asset before the period of use, the

customer does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases goods or services.

Protective Rights

AG31. A contract may include terms and conditions designed to protect the supplier’s interest in the asset or other assets, to protect its personnel, or to ensure the supplier’s compliance with laws or regulations. These are examples of protective rights. For example, a contract may (i) specify the maximum amount of use of an asset or limit where or when the customer can use the asset, (ii) require a customer to follow particular operating practices, or (iii) require a customer to inform the supplier of changes in how an asset will be used. Protective rights typically define the scope of the customer’s right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset.

AG32. The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.



Separating Components of a Contract (paragraphs 13–18)

AG33. The right to use an underlying asset is a separate lease component if both:

- (a) The lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events); and
- (b) The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract. For example, the fact that a lessee could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets.

AG34. A contract may include an amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee. For example, a lessor may include in the total amount payable a charge for administrative tasks, or other costs it incurs associated with the lease, that do not transfer a good or service to the lessee. Such amounts payable do not give rise to a separate component of the contract, but are considered to be part of the total consideration that is allocated to the separately identified components of the contract.

Lease Term (paragraphs 19–22)

AG35. In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

AG36. If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term. If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease.

AG37. The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.

AG38. At the commencement date, an entity assesses whether the lessee is reasonably certain to exercise an option to extend the lease or to purchase the underlying asset, or not to exercise an option to terminate the lease. The entity considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option. Examples of factors to consider include, but are not limited to:

- (a) Contractual terms and conditions for the optional periods compared with market rates, such as:
 - (i) The amount of payments for the lease in any optional period;
 - (ii) The amount of any variable payments for the lease or other contingent payments, such as payments resulting from termination penalties and residual value guarantees; and
 - (iii) The terms and conditions of any options that are exercisable after initial optional periods (for example, a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).

- (b) Significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
- (c) Costs relating to the termination of the lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee's needs, costs of integrating a new asset into the lessee's operations, or termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;
- (d) The importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialised asset, the location of the underlying asset and the availability of suitable alternatives; and
- (e) Conditionality associated with exercising the option (i.e. when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist.

AG39. An option to extend or terminate a lease may be combined with one or more other contractual features (for example, a residual value guarantee) such that the lessee guarantees the lessor a minimum or fixed cash return that is substantially the same regardless of whether the option is exercised. In such cases, and notwithstanding the guidance on in-substance fixed payments in paragraph AG43, an entity shall assume that the lessee is reasonably certain to exercise the option to extend the lease, or not to exercise the option to terminate the lease.

AG40. The shorter the non-cancellable period of a lease, the more likely a lessee is to exercise an option to extend the lease or not to exercise an option to terminate the lease. This is because the costs associated with obtaining a replacement asset are likely to be proportionately higher the shorter the non-cancellable period.

AG41. A lessee's past practice regarding the period over which it has typically used particular types of assets (whether leased or owned), and its economic reasons for doing so, may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. For example, if a lessee has typically used particular types of assets for a particular period of time or if the lessee has a practice of frequently exercising options on leases of particular types of underlying assets, the lessee shall consider the economic reasons for that past practice in assessing whether it is reasonably certain to exercise an option on leases of those assets.

AG42. Paragraph 21 specifies that, after the commencement date, a lessee reassesses the lease term upon the occurrence of a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. Examples of significant events or changes in circumstances include:

- (a) Significant leasehold improvements not anticipated at the commencement date that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
- (b) A significant modification to, or customisation of, the underlying asset that was not anticipated at the commencement date;
- (c) The inception of a sublease of the underlying asset for a period beyond the end of the previously determined lease term; and

- (d) A decision of the lessee that is directly relevant to exercising, or not exercising, an option (for example, a decision to extend the lease of a complementary asset, to dispose of an alternative asset or to dispose of an operation within which the right-of-use asset is employed).

In-Substance Fixed Lease Payments (paragraphs 28(a), 37(c) and 74(a))

AG43. Lease payments include any in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable. In-substance fixed lease payments exist, for example, if:

- (a) Payments are structured as variable lease payments, but there is no genuine variability in those payments. Those payments contain variable clauses that do not have real economic substance. Examples of those types of payments include:
- (i) Payments that must be made only if an asset is proven to be capable of operating during the lease, or only if an event occurs that has no genuine possibility of not occurring; or
 - (ii) Payments that are initially structured as variable lease payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term. Those payments become in-substance fixed payments when the variability is resolved.
- (b) There is more than one set of payments that a lessee could make, but only one of those sets of payments is realistic. In this case, an entity shall consider the realistic set of payments to be lease payments.
- (c) There is more than one realistic set of payments that a lessee could make, but it must make at least one of those sets of payments. In this case, an entity shall consider the set of payments that aggregates to the lowest amount (on a discounted basis) to be lease payments.

Lessee Involvement with the Underlying Asset before the Commencement Date

Costs of the Lessee relating to the Construction or Design of the Underlying Asset

AG44. An entity may negotiate a lease before the underlying asset is available for use by the lessee. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the contract, a lessee may be required to make payments relating to the construction or design of the asset.

AG45. If a lessee incurs costs relating to the construction or design of an underlying asset, the lessee shall account for those costs applying other applicable Standards, such as PBE IPSAS 17. Costs relating to the construction or design of an underlying asset do not include payments made by the lessee for the right to use the underlying asset. Payments for the right to use an underlying asset are payments for a lease, regardless of the timing of those payments.

Legal Title to the Underlying Asset

AG46. A lessee may obtain legal title to an underlying asset before that legal title is transferred to the lessor and the asset is leased to the lessee. Obtaining legal title does not in itself determine how to account for the transaction.

AG47. If the lessee controls (or obtains control of) the underlying asset before that asset is transferred to the lessor, the transaction is a sale and leaseback transaction that is accounted for applying paragraphs 97–102.

AG48. However, if the lessee does not obtain control of the underlying asset before the asset is transferred to the lessor, the transaction is not a sale and leaseback transaction. For example, this may be the case if a producer, a lessor

and a lessee negotiate a transaction for the purchase of an asset from the producer by the lessor, which is in turn leased to the lessee. The lessee may obtain legal title to the underlying asset before legal title transfers to the lessor. In this case, if the lessee obtains legal title to the underlying asset but does not obtain control of the asset before it is transferred to the lessor, the transaction is not accounted for as a sale and leaseback transaction, but as a lease.

Lessee Disclosures (paragraph 62)

AG49. In determining whether additional information about leasing activities is necessary to meet the disclosure objective in paragraph 54, a lessee shall consider:

- (a) Whether that information is relevant to users of financial statements. A lessee shall provide additional information specified in paragraph 62 only if that information is expected to be relevant to users of financial statements. In this context, this is likely to be the case if it helps those users to understand:
 - (i) The flexibility provided by leases. Leases may provide flexibility if, for example, a lessee can reduce its exposure by exercising termination options or renewing leases with favourable terms and conditions.
 - (ii) Restrictions imposed by leases. Leases may impose restrictions, for example, by requiring the lessee to maintain particular financial ratios.
 - (iii) Sensitivity of reported information to key variables. Reported information may be sensitive to, for example, future variable lease payments.
 - (iv) Exposure to other risks arising from leases.
 - (v) Deviations from industry practice. Such deviations may include, for example, unusual or unique lease terms and conditions that affect a lessee's lease portfolio.
- (b) Whether that information is apparent from information either presented in the primary financial statements or disclosed in the notes. A lessee need not duplicate information that is already presented elsewhere in the financial statements.

AG50. Additional information relating to variable lease payments that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 could include information that helps users of financial statements to assess, for example:

- (a) The lessee's reasons for using variable lease payments and the prevalence of those payments;
- (b) The relative magnitude of variable lease payments to fixed payments;
- (c) Key variables upon which variable lease payments depend and how payments are expected to vary in response to changes in those key variables; and
- (d) Other operational and financial effects of variable lease payments.

AG51. Additional information relating to extension options or termination options that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 could include information that helps users of financial statements to assess, for example:

- *(a) The lessee's reasons for using extension options or termination options and the prevalence of those options;
- *(b) The relative magnitude of optional lease payments to lease payments;

(c) The prevalence of the exercise of options that were not included in the measurement of lease liabilities; and

* (d) Other operational and financial effects of those options.

AG52. Additional information relating to residual value guarantees that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 could include information that helps users of financial statements to assess, for example:

* (a) The lessee's reasons for providing residual value guarantees and the prevalence of those guarantees;

* (b) The magnitude of a lessee's exposure to residual value risk;

(c) The nature of underlying assets for which those guarantees are provided; and

* (d) Other operational and financial effects of those guarantees.

*AG53 Additional information relating to sale and leaseback transactions that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 could include information that helps users of financial statements to assess, for example:

(a) The lessee's reasons for sale and leaseback transactions and the prevalence of those transactions;

(b) Key terms and conditions of individual sale and leaseback transactions;

(c) Payments not included in the measurement of lease liabilities; and

(d) The cash flow effect of sale and leaseback transactions in the reporting period.

Lessor Lease Classification (paragraphs 65–70)

AG53. The classification of leases for lessors in this Standard is based on the extent to which the lease transfers the risks and rewards incidental to ownership of an underlying asset. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of service potential or profitable operation over the underlying asset's economic life and of gain from appreciation in value or realisation of a residual value.

AG54. A lease contract may include terms and conditions to adjust the lease payments for particular changes that occur between the inception date and the commencement date (such as a change in the lessor's cost of the underlying asset or a change in the lessor's cost of financing the lease). In that case, for the purposes of classifying the lease, the effect of any such changes shall be deemed to have taken place at the inception date.

AG55. When a lease includes both land and buildings elements, a lessor shall assess the classification of each element as a finance lease or an operating lease separately applying paragraphs 66–70 and AG54–AG55. In determining whether the land element is an operating lease or a finance lease, an important consideration is that land normally has an indefinite economic life.

AG56. Whenever necessary in order to classify and account for a lease of land and buildings, a lessor shall allocate lease payments (including any lump-sum upfront payments) between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the

lease at the inception date. If the lease payments cannot be allocated reliably¹ between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.

AG57. For a lease of land and buildings in which the amount for the land element is immaterial to the lease, a lessor may treat the land and buildings as a single unit for the purpose of lease classification and classify it as a finance lease or an operating lease applying paragraphs 66–70 and AG54–AG55. In such a case, a lessor shall regard the economic life of the buildings as the economic life of the entire underlying asset.

Sublease Classification

AG58. In classifying a sublease, an intermediate lessor shall classify the sublease as a finance lease or an operating lease as follows:

- (a) If the head lease is a short-term lease that the entity, as a lessee, has accounted for applying paragraph 6, the sublease shall be classified as an operating lease.
- (b) Otherwise, the sublease shall be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset (for example, the item of property, plant or equipment that is the subject of the lease).

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of PBE IPSAS 1 discusses the transitional approach to the explanation of reliability.

Appendix B**Amendments to Other Standards**

An entity shall apply the amendments in this appendix when it applies PBE IPSAS 43.

The amendments to other standards in this appendix are based on the text of those other standards, including any amendments to those standards approved when PBE IPSAS 43 was issued in [Date].

Amended paragraphs are shown with deleted text struck through and new text is underlined.

PBE IPSAS 2 Cash Flow Statements

Paragraphs 26 and 55 are amended. Paragraph 63.5 is added. New text is underlined and deleted text is struck through.

Presentation of a Cash Flow Statement

...

Financing Activities

26. The separate disclosure of cash flows arising from financing activities is important, because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

- (a) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages, and other short or long-term borrowings;
- (b) Cash repayments of amounts borrowed; and
- (c) Cash payments by a lessee for the reduction of the outstanding liability relating to a ~~finance~~ lease.

...

Noncash Transactions

...

55. Many investing and financing activities do not have a direct impact on current cash flows, although they do affect the capital and asset structure of an entity. The exclusion of noncash transactions from the cash flow statement is consistent with the objective of a cash flow statement, as these items do not involve cash flows in the current period. Examples of noncash transactions are:

- (a) The acquisition of assets through the exchange of assets, the assumption of directly related liabilities, or by means of a ~~finance~~ lease; and
- (b) The conversion of debt to equity.

...

Effective Date

63.5. PBE IPSAS 43 Leases, issued in [Date], amended paragraphs 26 and 55. An entity shall apply these amendments when it applies PBE IPSAS 43.

PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates*

Paragraph 17 is amended. Paragraph 72.7 is added. New text is underlined and deleted text is struck through.

Definitions

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Monetary Items

17. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: social obligations and other employee benefits to be paid in cash; provisions that are to be settled in cash; lease liabilities; and cash dividends or similar distributions that are recognised as a liability. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (~~e.g., prepaid rent~~); goodwill; intangible assets; inventories; property, plant and equipment; right-of-use assets; and provisions that are to be settled by the delivery of a non-monetary asset.

...

Effective Date

...

- 72.7. **PBE IPSAS 43 *Leases*, issued in [Date], amended paragraph 17. An entity shall apply this amendment when it applies PBE IPSAS 43.**

PBE IPSAS 5 *Borrowing Costs*

Paragraph 6 is amended. Paragraph 43.6 is added. New text is underlined and deleted text is struck through.

Definitions

Borrowing Costs

...

6. Borrowing costs may include:
- (a) Interest expense calculated using the effective interest method as described in PBE IPSAS 41 *Financial Instruments*;
 - (b)–(c) [Deleted by IPSASB]
 - (d) ~~Finance charges~~ Interest in respect of ~~finance leases~~ liabilities and service concession arrangements; and
 - (e) Exchange differences arising from foreign currency borrowings, to the extent that they are regarded as an adjustment to interest costs.

...

Effective Date

...

- 43.6. **PBE IPSAS 43 Leases, issued in [Date], amended paragraph 6. An entity shall apply this amendment when it applies PBE IPSAS 43.**

PBE IPSAS 12 Inventories

Paragraph 20 is amended. Paragraph 52.7 is added. New text is underlined and deleted text is struck through.

Measurement of Inventories

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Cost of Inventories

...

Costs of Conversion

20. The costs of converting work-in-progress inventories into finished goods inventories are incurred primarily in a manufacturing environment. The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of (a) the volume of production, such as depreciation and maintenance of factory buildings, ~~and equipment~~ and right-of-use assets used in the production process, and (b) the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

...

Effective date

- 52.7. PBE IPSAS 43 Leases, issued in [Date], amended paragraph 20. An entity shall apply this amendment when it applies PBE IPSAS 43.**

PBE IPSAS 16 Investment Property

Paragraphs 7, 10, 12, 13, 20, 26, 27, 39, 49, 50, 59, 62, 62A, 63, 65, 71, 72, 73, 78, 80, 85, 86, 88, and 89 are amended. Paragraphs 25A, 38A, 49A, 100D and its related heading and paragraph 102.10 are added. Paragraphs 5, 8, 34, 35 and 43 are deleted. New text is underlined and deleted text is struck through.

Scope

...

5. ~~[Deleted by IPSASB] This Standard applies to accounting for investment property, including (a) the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease, and (b) the measurement in a lessor's financial statements of investment property~~

~~provided to a lessee under an operating lease. This Standard does not deal with matters covered in PBE IPSAS 13 *Leases* including:~~

- ~~(a) — Classification of leases as finance leases or operating leases;~~
- ~~(b) — Recognition of lease revenue from investment property (see also PBE IPSAS 9 *Revenue from Exchange Transactions*);~~
- ~~(c) — Measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;~~
- ~~(d) — Measurement in a lessor's financial statements of its net investment in a finance lease;~~
- ~~(e) — Accounting for sale and leaseback transactions; and~~
- ~~(f) — Disclosure about finance leases and operating leases.~~

...

Definitions

7. The following terms are used in this Standard with the meanings specified:

...

Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation, or both, rather than for:

- (a) Use in the production or supply of goods or services, or for administrative purposes; or
- (b) Sale in the ordinary course of operations.

Owner-occupied property is property held (by the owner or by the lessee ~~under a finance lease as a right-of-use asset~~) for use in the production or supply of goods or services, or for administrative purposes.

...

Classification of Property as Investment Property or Owner-Occupied Property

8. ~~[Deleted by IPSASB] A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, (a) the property would otherwise meet the definition of an investment property, and (b) the lessee uses the fair value model set out in paragraphs 42–64 for the asset recognised. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 85–89.~~

...

10. Investment property is held to earn rentals or for capital appreciation, or both. Therefore, investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from other land or buildings controlled by an entity, including owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) can also generate cash flows. For example, entities may use a building to provide goods and services to recipients in return for full or partial cost recovery. However, the building is held to facilitate the production of goods and services, and the cash flows are attributable not only to the building, but also to other assets used in the production or

supply process. PBE IPSAS 17 *Property, Plant and Equipment* applies to owned owner-occupied property and PBE IPSAS 43 *Leases* applies to owner-occupied property held by a lessee as a right-of-use asset.

...

12. The following are examples of investment property:

...

(c) A building owned by the entity (or a right-of-use asset relating to a building held by the entity ~~under a finance lease~~) and leased out (or subleased) under one or more operating leases on a commercial basis. For example, a university may own a building that it leases on a commercial basis to external parties.

...

13. The following are examples of items that are not investment property and are therefore outside the scope of this Standard:

...

(c) Owner-occupied property (see PBE IPSAS 17 and PBE IPSAS 43), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees such as housing for military personnel or religious ministers or priests (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.

...

...

Recognition

20. **An owned ~~Investment~~ investment property shall be recognised as an asset when, and only when:**

- (a) **It is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity; and**
- (b) The cost or fair value of the investment property can be measured reliably

...

25A. An investment property held by a lessee as a right-of-use asset shall be recognised in accordance with PBE IPSAS 43.

Measurement at Recognition

26. **An owned ~~Investment~~ investment property shall be measured initially at its cost (transaction costs shall be included in this initial measurement).**

27. **Where an owned investment property is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.**

...

34. [Deleted by IPSASB] ~~The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 28 of PBE IPSAS 13, i.e., the asset shall be recognised at the lower of the fair value of the property and the present value of the minimum lease payments. An equivalent amount shall be recognised as a liability in accordance with that same paragraph.~~

35. ~~[Deleted by IPSASB] Any premium paid for a lease is treated as part of the minimum lease payments for this purpose, and is therefore included in the cost of the asset, but is excluded from the liability. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Guidance on determining the fair value of a property interest is set out for the fair value model in paragraphs 42–61. That guidance is also relevant to the determination of fair value when that value is used as cost for initial recognition purposes.~~

...

- 38A. An investment property held by a lessee as a right-of-use asset shall be measured initially in accordance with PBE IPSAS 43.

Measurement after Recognition

Accounting Policy

39. ~~With the exception noted in paragraph 43, an~~ **An entity shall choose as its accounting policy either the fair value model in paragraphs 42–64 or the cost model in paragraph 65, and shall apply that policy to all of its investment property.**

...

Fair Value Model

...

43. ~~[Deleted by IPSASB] When a property interest held by a lessee under an operating lease is classified as an investment property under paragraph 8, paragraph 39 is not elective; the fair value model shall be applied.~~

...

49. The fair value of investment property reflects, among other things, rental revenue from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental revenue from future leases in the light of current conditions. It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the property. ~~Some of those outflows are reflected in the liability whereas others relate to outflows that are not recognised in the financial statements until a later date (e.g. periodic payments such as contingent rents).~~

- 49A. When a lessee uses the fair value model to measure an investment property that is held as a right-of-use asset, it shall measure the right-of-use asset, and not the underlying asset, at fair value.

50. ~~Paragraph 34 PBE IPSAS 43 specifies the basis for initial recognition of the cost of an interest in a leased property an investment property held by a lessee as a right-of-use asset. Paragraph 42 requires the interest in the leased property investment property held by a lessee as a right-of-use asset to be remeasured, if necessary, to fair value if the entity chooses the fair value model. In a lease negotiated~~ When lease payments are at market rates, the fair value of an interest in a leased property an investment property held by a lessee as a right-of-use asset at acquisition, net of all expected lease payments (including those relating to recognised lease liabilities), should be zero. This fair value does not change regardless of whether, for accounting purposes, a leased asset and liability are recognised at fair value or at the present value of minimum lease payments, in accordance with paragraph 28 of PBE IPSAS 13. Thus, remeasuring a leased right-of-use asset from cost in accordance with paragraph 34 PBE IPSAS 43 to fair value in accordance with paragraph 42 (taking into account the

requirements in paragraph 59) should not give rise to any initial gain or loss, unless fair value is measured at different times. This could occur when an election to apply the fair value model is made after initial recognition.

...

59. In determining the carrying amount of investment property under the fair value model, an entity does not double-count assets or liabilities that are recognised as separate assets or liabilities. For example:

...

- (c) The fair value of investment property excludes prepaid or accrued ~~operating~~ lease revenue, because the entity recognises it as a separate liability or asset.
- (d) The fair value of investment property held by a lessee as a right-of-use asset ~~under a lease~~ reflects expected cash flows (including ~~contingent rent that is~~ variable lease payments that are expected to become payable). Accordingly, if a valuation obtained for a property is net of all payments expected to be made, it will be necessary to add back any recognised lease liability, to arrive at the carrying amount of the investment property using the fair value model.

...

Inability to Determine Fair Value Reliably

62. **There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it shall measure that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier). If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model in PBE IPSAS 17 for owned investment property or in accordance with PBE IPSAS 43 for investment property held by a lessee as a right-of-use asset. The residual value of the investment property shall be assumed to be zero. The entity shall continue to apply PBE IPSAS 17 or PBE IPSAS 43 until disposal of the investment property.**

- 62A. Once an entity becomes able to measure reliably the fair value of an investment property under construction that has previously been measured at cost, it shall measure that property at its fair value. Once construction of that property is complete, it is presumed that fair value can be measured reliably. If this is not the case, in accordance with paragraph 62, the property shall be accounted for using the cost model in accordance with PBE IPSAS 17 for owned assets or PBE IPSAS 43 for investment property held by a lessee as a right-of-use asset.

...

63. In the exceptional cases when an entity is compelled, for the reason given in paragraph 62, to measure an investment property using the cost model in accordance with PBE IPSAS 17 or PBE IPSAS 43, it measures at fair value all its other investment property, including investment property under construction. In these cases, although an entity may use the cost model for one investment property, the entity shall continue to account for each of the remaining properties using the fair value model.

Cost Model

65. ~~After initial recognition, an entity that chooses the cost model shall measure all of its investment property in accordance with PBE IPSAS 17's requirements for that model, other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with PBE IFRS 5.~~

After initial recognition, an entity that chooses the cost model shall measure investment property:

- (a) In accordance with PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* if it meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale)
- (b) In accordance with PBE IPSAS 43 if it is held by a lessee as a right-of-use asset and is not held for sale in accordance with PBE IFRS 5; and
- (c) In accordance with the requirements in PBE IPSAS 17 for the cost model in all other cases.

...

Transfers

...

71. For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's cost for subsequent accounting in accordance with PBE IPSAS 17, PBE IPSAS 43 or PBE IPSAS 12, shall be its fair value at the date of change in use.
72. If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply PBE IPSAS 17 for owned property and PBE IPSAS 43 for property held by a lessee as a right-of-use asset up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with PBE IPSAS 17 or PBE IPSAS 43, and its fair value in the same way as a revaluation in accordance with PBE IPSAS 17.
73. Up to the date when an owner-occupied property (including a right-of-use asset held by a lessee that meets the definition of an owner-occupied property) becomes an investment property carried at fair value, an entity depreciates the property (or right-of-use asset) and recognises any impairment losses that have occurred. The entity treats any difference at that date between the carrying amount of the property in accordance with PBE IPSAS 17 or PBE IPSAS 43, and its fair value in the same way as a revaluation in accordance with PBE IPSAS 17. In other words:
- (a) Any resulting decrease in the carrying amount of the property is recognised in surplus or deficit. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is recognised in other comprehensive revenue and expense and reduces the revaluation surplus within net assets/equity.
 - (b) Any resulting increase in the carrying amount is treated as follows:
 - (i) To the extent that the increase reverses a previous impairment loss for that property, the increase is recognised in surplus or deficit. The amount recognised in surplus or deficit does not exceed the amount needed to restore the carrying amount to the carrying amount that would have been determined (net of depreciation) if no impairment loss had been recognised.
 - (ii) Any remaining part of the increase is recognised in other comprehensive revenue and expense and increases the revaluation surplus within net assets/equity. On subsequent disposal of the

investment property, the revaluation surplus included in net assets/equity may be transferred to accumulated comprehensive revenue and expense. The transfer from revaluation surplus to accumulated comprehensive revenue and expense is not made through surplus or deficit.

...

Disposals

...

78. The disposal of an investment property may be achieved by sale or by entering into a finance lease. In determining the date of disposal for investment property that is sold, an entity applies the criteria in PBE IPSAS 9 for recognising revenue from the sale of goods and considers the related guidance in the Implementation Guidance to PBE IPSAS 9. ~~PBE IPSAS 13~~ PBE IPSAS 43 applies to a disposal effected by entering into a finance lease and to a sale and leaseback.

...

80. **Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset, and shall be recognised in surplus or deficit (unless ~~PBE IPSAS 13~~ PBE IPSAS 43 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.**

...

Disclosure

Fair Value Model and Cost Model

85. The disclosures below apply in addition to those in ~~PBE IPSAS 13~~ PBE IPSAS 43. In accordance with ~~PBE IPSAS 13~~ PBE IPSAS 43, the owner of an investment property provides lessors' disclosures about leases into which it has entered. ~~An entity~~ A lessee that holds an investment property under a finance lease or operating lease as a right-of-use asset provides lessees' disclosures for finance leases as required by PBE IPSAS 43 and lessors' disclosures as required by PBE IPSAS 43 for any operating leases into which it has entered.

86. **An entity shall disclose:**

(a) **Whether it applies the fair value or the cost model;**

~~*(b) [Deleted by IPSASB] If it applies the fair value model, whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property;~~

...

Fair Value Model

...

- *88. **When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, for example to avoid double-counting of assets or liabilities that are recognised as separate assets and liabilities as described in paragraph 59, the entity shall disclose a reconciliation between the valuation obtained and the adjusted valuation included in the financial statements, showing separately the aggregate amount of any recognised lease ~~obligations~~ liabilities that have been added back, and any other significant adjustments.**
89. **In the exceptional cases referred to in paragraph 62, when an entity measures investment property using the cost model in PBE IPSAS 17 or in accordance with PBE IPSAS 43, the reconciliation required by**

paragraph 87 shall disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an entity shall disclose:

- (a) A description of the investment property;
- (b) An explanation of why fair value cannot be determined reliably;
- (c) If possible, the range of estimates within which fair value is highly likely to lie; and
- (d) On disposal of investment property not carried at fair value:
 - (i) The fact that the entity has disposed of investment property not carried at fair value;
 - (ii) The carrying amount of that investment property at the time of sale; and
 - (iii) The amount of gain or loss recognised.

Transitional Provisions

...

Fair Value Model

...

PBE IPSAS 43 Leases

100D. An entity applying PBE IPSAS 43, and its related amendments to this Standard, for the first time shall apply the transition requirements in PBE IPSAS 43 to its investment property held as a right-of-use asset.

...

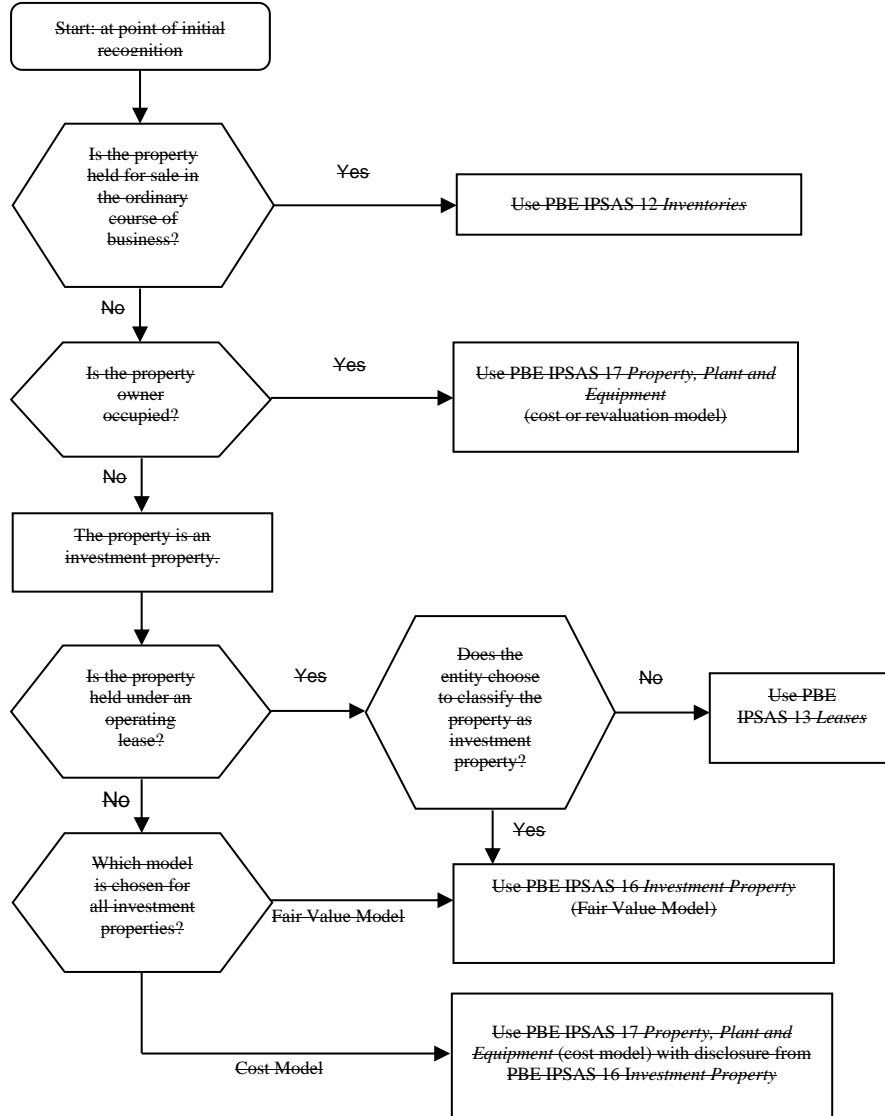
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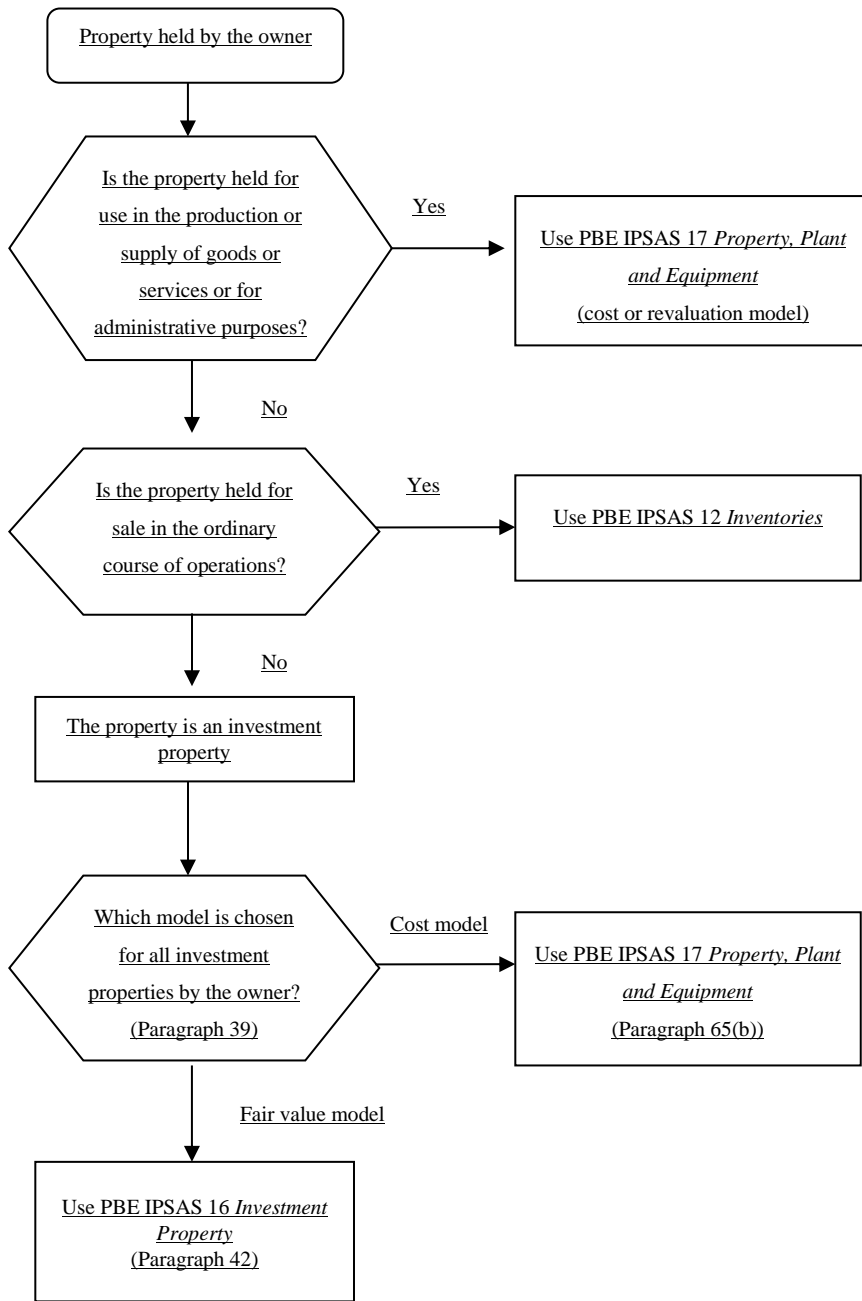
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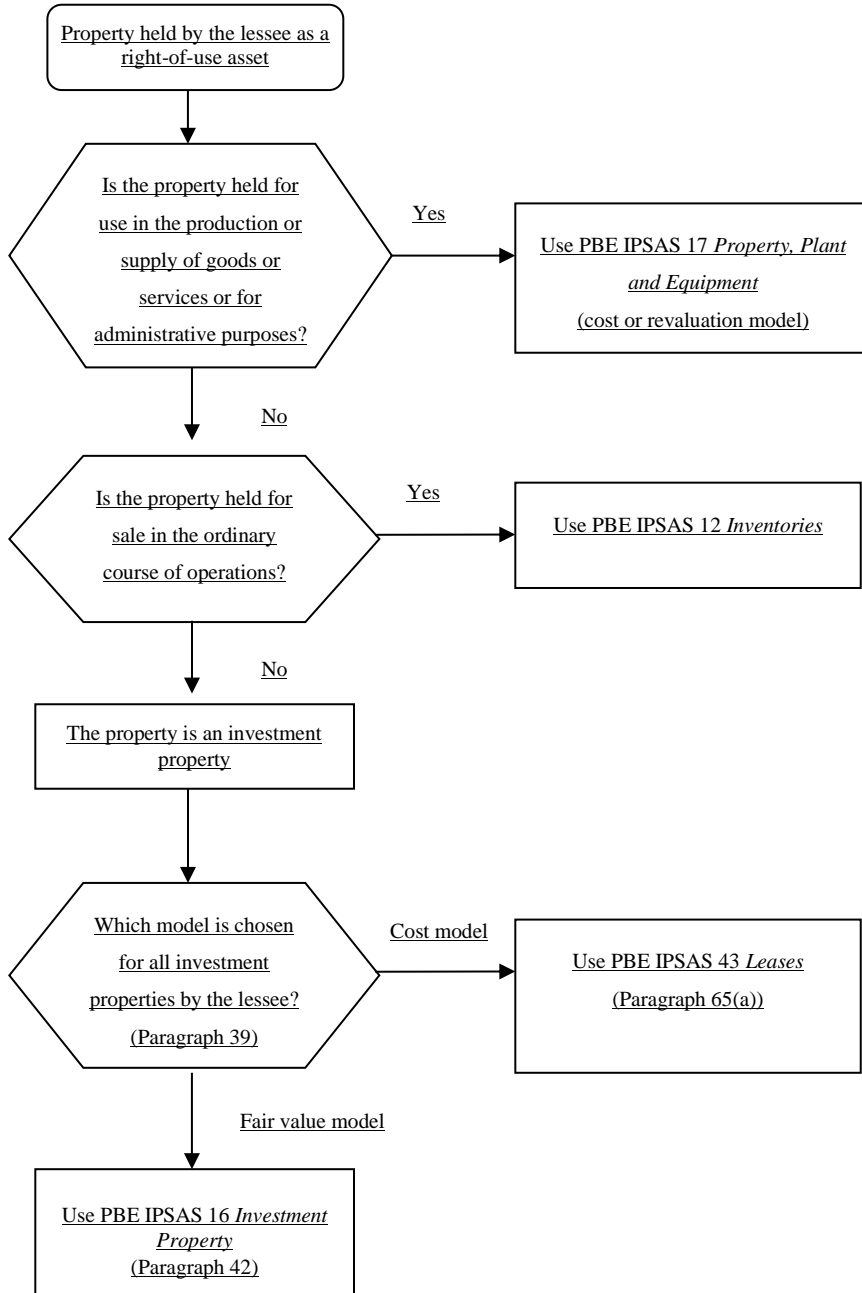
102.10. PBE IPSAS 43, issued in [Date], amended the scope of PBE IPSAS 16 by defining investment property to include both owned investment property and property held by a lessee as a right-of-use asset. Paragraphs 7, 10, 12, 13, 14, 20, 26, 27, 39, 49, 50, 59, 62, 62A, 63, 65, 71, 72, 73, 78, 80, 85, 86, 88, and 89 were amended, paragraphs 25A, 38A, , 49A and 100D and its related heading were added, and paragraphs 5, 8, 34, 35 and 43 were deleted by PBE IPSAS 43. An entity shall apply these amendments when it applies PBE IPSAS 43.

Illustrative Decision Trees

~~This~~ These decision trees ~~accompanies~~ accompany, but ~~is~~ are not part of, PBE IPSAS 16.







PBE IPSAS 17 *Property, Plant, and Equipment*

Paragraphs 8, 19, 60, 83, 84 are amended. Paragraph 107T is added. Paragraphs 7 and 41 are deleted. New text is underlined and deleted text is struck through.

Scope

...

7. ~~[Deleted by IPSASB] Other PBE Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, PBE IPSAS 13 *Leases* requires an entity to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. PBE IPSAS 32 requires an entity to evaluate the recognition of an item of property, plant and equipment used in a service concession arrangement on the basis of control of the asset. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.~~
8. An entity using the cost model for investment property in accordance with PBE IPSAS 16 *Investment Property* shall use the cost model in this Standard for owned investment property.

Recognition

...

19. An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. The cost of an item of property, plant, and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment, such as depreciation of right-of-use assets.

Measurement at Recognition

...

Measurement of Cost

...

41. ~~[Deleted by IPSASB] The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with PBE IPSAS 13.~~

Measurement after Recognition

...

Depreciation

...

60. An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, in most cases, it would be required to depreciate separately the pavements, formation, kerbs and channels, footpaths, bridges, and lighting within a road system. Similarly, it may be appropriate to depreciate separately the airframe and engines of an aircraft, ~~whether owned or subject to a finance lease~~. If an entity acquires property, plant and equipment subject to an operating lease in which it is the lessor, it may also be appropriate to depreciate separately amounts reflected in the cost of that item that are attributable to favourable or unfavourable lease terms relative to market terms.

...

Derecognition

...

83. **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in surplus or deficit when the item is derecognised (unless ~~PBE IPSAS 13~~ PBE IPSAS 43 Leases requires otherwise on a sale and leaseback).**

...

84. The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g., by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in PBE IPSAS 9 for recognising revenue from the sale of goods. ~~PBE IPSAS 13~~ PBE IPSAS 43 applies to disposal by a sale and leaseback

...

Effective Date

...

- 106C. **PBE IPSAS 43, issued in [Date], amended paragraphs 8, 19, 60, 83, 84 and deleted paragraphs 7 and 41. An entity shall apply these amendments when it applies PBE IPSAS 43.**

PBE IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets

Paragraph 13 and paragraph A2 are amended. Paragraph 112.12 is added. New text is underlined and deleted text is struck through.

Scope

...

13. Where another PBE Standard deals with a specific type of provision, contingent liability, or contingent asset, an entity applies that standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:
- (a) Construction contracts (see PBE IPSAS 11 *Construction Contracts*); and
 - (b) Leases (see ~~PBE IPSAS 13~~ PBE IPSAS 43 Leases). However, ~~as PBE IPSAS 13 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases~~ this Standard applies to any lease that becomes onerous before the commencement date of the lease as defined in PBE IPSAS 43. This Standard also applies to short-term leases and leases for which the underlying asset is of low value accounted for in accordance with paragraph 7 of PBE IPSAS 43 and that have become onerous.

...

Appendix A

Application Guidance Changes in Existing Decommissioning, Restoration and Similar Liabilities

This Appendix is an integral part of PBE IPSAS 19.

- A2. This Appendix applies to changes in the measurement of any existing decommissioning, restoration or similar liability that is both:
- (a) Recognised as part of the cost of an item of property, plant and equipment in accordance with PBE IPSAS 17 *Property, Plant and Equipment* or as part of the cost of a right-of-use asset in accordance with PBE IPSAS 43 *Leases*; and
 - (b) Recognised as a liability in accordance with this Standard.

Effective Date

...

112.12. PBE IPSAS 43, issued in [Date], amended paragraph 13 and paragraph A2. An entity shall apply these amendments when it applies PBE IPSAS 43.

Implementation Guidance

This guidance accompanies, but is not part of, PBE IPSAS 19.

...

An Onerous Contract

IG13. ~~[Deleted by IPSASB] A hospital laundry operates from a building that the hospital (the reporting entity) has leased under an operating lease. During December 2004, the laundry relocates to a new building. The lease on the old building continues for the next four years; it cannot be cancelled. The hospital has no alternative use for the building and the building cannot be re-let to another user.~~

Analysis

~~Present obligation as a result of a past obligating event — The obligating event is the signing of the lease contract, which gives rise to a legal obligation.~~

~~An outflow of resources embodying economic benefits or service potential in settlement — When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the hospital accounts for the lease under PBE IPSAS 13 *Leases*).~~

Conclusion

~~A provision is recognised for the best estimate of the unavoidable lease payments (see paragraphs 13(b), 22 and 76).~~

PBE IPSAS 23 Revenue from Non-exchange Transactions

Paragraphs 2.1 and 125.7 are added. New text is underlined. Paragraph 2 is not amended but is included for context.

Scope

2. An entity that prepares and presents financial statements shall apply this Standard in accounting for revenue from non-exchange transactions. This Standard does not apply to a PBE combination that is a non-exchange transaction.

2.1 Leases within the scope of PBE IPSAS 43 *Leases*, including concessionary leases, are excluded from the scope of this Standard. For the avoidance of doubt, arrangements that confer the right to use an asset for a specified period of time for no consideration are also excluded from the scope of this Standard.

...

Effective Date

...

125.7. PBE IPSAS 43, issued in [Date], added paragraph 2.1. An entity shall apply this amendment when it applies PBE IPSAS 43.

...

In the Basis for Conclusions of PBE IPSAS 23, paragraphs BC25–BC 27 and the preceding heading are added. New text is underlined.

Basis for Conclusion

...

Scope clarification: concessionary leases and leases for no consideration

BC25. In January 2022, the IPSASB issued IPSAS 43 *Leases*. In [Date], the NZASB issued PBE IPSAS 43 *Leases*, based on IPSAS 43.

BC26. Concessionary leases (described as leases that meet the definition of a lease in PBE IPSAS 43 but have below-market terms) are within the scope of PBE IPSAS 43. However, PBE IPSAS 43 does not include specific accounting requirements for the ‘concessionary portion’ of concessionary leases. Furthermore, arrangements to use an asset for a specified period of time for no consideration are outside the scope of PBE IPSAS 43, and there are currently no accounting requirements for such arrangements in PBE Standards. The IPSASB is developing accounting requirements for concessionary leases and the abovementioned arrangements as a separate project. 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 arrangements to use an asset for a specified period of time for no consideration.

BC27. Therefore, on issuing PBE IPSAS 43 on [Date], the NZASB clarified that leases within the scope of PBE IPSAS 43 (including concessionary leases) and arrangements that confer the right to use an asset for a specified period of time for no consideration are 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.

PBE IPSAS 27 *Agriculture*

Paragraph 3 is amended. Paragraph 57.7 is added. New text is underlined and deleted text is struck through.

Scope

...

3. This Standard does not apply to:

...

- (c) Intangible assets related to agricultural activity (see PBE IPSAS 31 *Intangible Assets*); ~~and~~
- (d) Biological assets held for the provision or supply of services; and
- (e) Right-of-use assets arising from a lease of land related to agricultural activity (see PBE IPSAS 43 *Leases*).

Effective Date

...

57.7. PBE IPSAS 43, issued in [Date], amended paragraph 3. An entity shall apply this amendment when it applies PBE IPSAS 43.

PBE IPSAS 28 *Financial Instruments: Presentation*

Paragraphs AG16 and AG17 are amended. Paragraph 62.8 is added. New text is underlined and deleted text is struck through.

Effective Date

...

62.8. PBE IPSAS 43 *Leases*, issued in [Date], amended paragraphs AG16 and AG17. An entity shall apply these amendments when it applies PBE IPSAS 43.

Definitions (paragraphs 9 and 10)

Financial Assets and Financial Liabilities

...

AG16. ~~Under PBE IPSAS 13 *Leases*, a finance lease is regarded as primarily~~ A lease typically creates an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the a finance lease contract rather than the leased underlying asset itself that is subject to the finance lease. Accordingly, a lessor regards a finance lease as a financial instrument. Under PBE IPSAS 43 *Leases* a lessor does not recognise its entitlement to receive lease payments under an operating lease. An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased underlying asset itself rather than any amount receivable in the future under the contract. Accordingly, a lessor finance lease is regarded as a financial

~~instrument and does not regard an operating lease is not regarded as a financial instrument, (except as regards individual payments currently due and payable by the lessee).~~

AG17. Physical assets (such as inventories, property, plant and equipment), ~~leased~~ right-of-use assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical assets, right-of-use assets and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

PBE IPSAS 30 *Financial Instruments: Disclosures*

Paragraphs 35 and AG16 are amended. Paragraph 53.14 is added. New text is underlined and deleted text is struck through.

Significance of Financial Instruments for Financial Position and Financial Performance

...

Other Disclosures

...

Fair Value

...

35. Disclosures of fair value are not required:

(a) When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables; or

...

(d) For lease liabilities.

...

Effective Date and Transition

...

53.14. **PBE IPSAS 43 *Leases*, issued in [Date], amended paragraphs 35 and AG16. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Application Guidance

This Appendix is an integral part of PBE IPSAS 30

...

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49)

...

Quantitative Liquidity Risk Disclosures (paragraphs 41(a), and 46(a) and (b))

...

*AG16. The contractual amounts disclosed in the maturity analyses as required by paragraph 46(a) and (b) are the contractual undiscounted cash flows, for example:

(a) Gross ~~finance lease obligations~~ liabilities (before deducting finance charges);

...

PBE IPSAS 31 *Intangible Assets*

Paragraphs 6, 9, 112, 113 and AG6 are amended. Paragraph 133.10 is added. New text is underlined and deleted text is struck through.

Scope

...

6. If another PBE Standard prescribes the accounting for a specific type of intangible asset, an entity applies that PBE Standard instead of this Standard. For example, this Standard does not apply to:
- (a) Intangible assets held by an entity for sale in the ordinary course of operations (see PBE IPSAS 11 *Construction Contracts* and PBE IPSAS 12 *Inventories*);
 - (b) Leases that are within the scope of PBE IPSAS 13 *Leases* of intangible assets accounted for in accordance with PBE IPSAS 43 *Leases*;

...

9. ~~In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard. Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights are excluded from the scope of PBE IPSAS 13 and are within the scope of this Standard and are excluded from the scope of PBE IPSAS 43.~~

...

Retirements and Disposals

...

112. **The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in surplus or deficit when the asset is derecognised (unless ~~PBE IPSAS 13~~ PBE IPSAS 43 requires otherwise on a sale and leaseback).**
113. The disposal of an intangible asset may occur in a variety of ways (e.g., by sale, by entering into a finance lease or through a non-exchange transaction). In determining the date of disposal of such an asset, an entity applies the criteria in PBE IPSAS 9 *Revenue from Exchange Transactions* for recognising revenue from the sale of goods. ~~PBE IPSAS 13~~ PBE IPSAS 43 applies to disposal by a sale and leaseback

...

Effective Date

...

- 133.10. PBE IPSAS 43, issued in [Date], amended paragraphs 6, 9, 112, 113 and AG6. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Application Guidance

This Appendix is an integral part of PBE IPSAS 31

...

Website costs

...

AG6. PBE IPSAS 31 does not apply to intangible assets held by an entity for sale in the ordinary course of operations (see PBE IPSAS 11 and PBE IPSAS 12) or leases ~~that fall within the scope of PBE IPSAS 13 of intangible assets accounted for in accordance with PBE IPSAS 43.~~ Accordingly, this Application Guidance does not apply to expenditure on the development or operation of a website (or website software) for sale to another entity or that is accounted for in accordance with PBE IPSAS 43. ~~When a website is leased under an operating lease, the lessor applies this Application Guidance. When a website is leased under a finance lease, the lessee applies this Application Guidance after initial recognition of the leased asset.~~

PBE IPSAS 32 Service Concession Arrangements: Grantor

Paragraphs AG13 and AG17 are amended. Paragraph 37.7 is added. New text is underlined and deleted text is struck through.

Effective Date

...

37.7. **PBE IPSAS 43 Leases, issued in [Date], amended paragraphs AG13 and AG17. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Application Guidance

This Appendix is an integral part of PBE IPSAS 32

...

AG13. The operator may have a right to use the separable asset described in paragraph AG12(a), or the facilities used to provide ancillary unregulated services described in paragraph AG12(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it is accounted for in accordance with ~~PBE IPSAS 13~~ PBE IPSAS 43.

...

AG17. If the asset no longer meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor follows the derecognition principles in PBE IPSAS 17 or PBE IPSAS 31, as appropriate. For example, if the asset is transferred to the operator on a permanent basis, it is derecognised. If the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognised. In such cases, the grantor also considers whether the arrangement is a lease transaction or a sale and leaseback transaction that should be accounted for in accordance with ~~PBE IPSAS 13~~ PBE IPSAS 43.

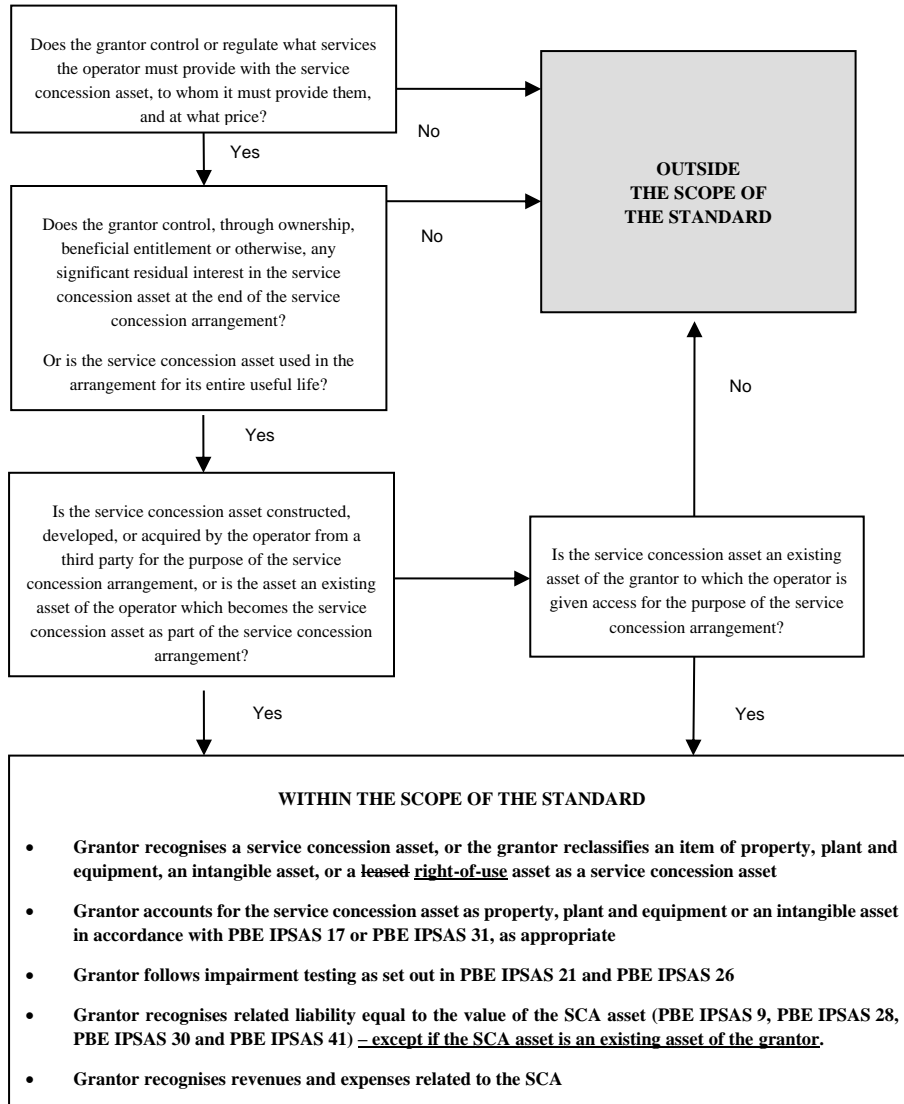
Implementation Guidance

This guidance accompanies, but is not part of, PBE IPSAS 32.

...

Accounting Framework for Service Concession Arrangements

IG2. The diagram below summarises the accounting for service concession arrangements established by PBE IPSAS 32.



References to IPSASs that Apply to Typical Types of Arrangements Involving an Asset Combined with Provision of a Service

(...)

IG4. Shaded text shows arrangements within the scope of PBE IPSAS 32.

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (e.g., operator leases asset from grantor)	Service and/or maintenance contract (specific tasks e.g., debt collection, facility management)	Rehabilitate-operate-transfer	Build-operate-transfer	Build-own-operate	100% Divestment/ Privatisation/ Corporation
Asset ownership	Grantor				Operator	
Capital investment	Grantor		Operator			
Demand risk	Shared	Grantor	Grantor and/or Operator		Operator	
Typical duration	8–20 years	1–5 years	25–30 years		Indefinite (or may be limited by binding arrangement or licence)	
Residual interest	Grantor				Operator	
Relevant PBE Standards	PBE IPSAS 13 PBE IPSAS 43	PBE IPSAS 1	This Standard/PBE IPSAS 17/ PBE IPSAS 31/ PBE FRS 45		PBE IPSAS 17/PBE IPSAS 31 (derecognition) PBE IPSAS 9 (revenue recognition)	

PBE IPSAS 40 PBE Combinations

Paragraphs 68, 71, 120, AG76, and AG89 are amended. Paragraphs AG72–AG74 and their related heading are deleted. Paragraphs 82A, 82B, and 126.3 are added. The heading before paragraph 82A is added. New text is underlined and deleted text is struck through.

The Acquisition Method of Accounting

...

Recognising and Measuring the Identifiable Assets Acquired, the Liabilities Assumed and any Non-Controlling Interest in the Acquired Operation

Recognition Principle

...

Recognition Conditions

...

68. Paragraphs ~~AG72–AG84~~ AG75–AG84 provide guidance on recognising ~~operating leases and~~ intangible assets. Paragraphs ~~76–82D~~ specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the recognition principle and conditions.

...

Classifying or Designating Identifiable Assets Acquired and Liabilities Assumed in an Acquisition

...

71. This Standard provides an exception to the principle in paragraph 69:
- (a) Classification of a lease ~~arrangement~~ contract in which the acquiree is the lessor as either an operating lease or a finance lease in accordance with ~~PBE IPSAS 13 Leases~~ PBE IPSAS 43, Leases; and (...)

...

Exceptions to the Recognition or Measurement Principles

...

Exceptions to both the Recognition and Measurement Principles

...

Leases in Which the Acquiree is the Lessee

82A. The acquirer shall recognise right-of-use assets and lease liabilities for leases identified in accordance with PBE IPSAS 43 in which the acquiree is the lessee. The acquirer is not required to recognise right-of-use assets and lease liabilities for:

- (a) Leases for which the lease term (as defined in PBE IPSAS 43) ends within 12 months of the acquisition date; or
- (b) Leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9 of PBE IPSAS 43).

82B. The acquirer shall measure the lease liability at the present value of the remaining lease payments (as defined in PBE IPSAS 43) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure

the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.

...

Disclosures

...

120. To meet the objective in paragraph 119, the acquirer shall disclose the following information for each acquisition that occurs during the reporting period:

...

* (h) For acquired receivables:

- (i) The fair value of the receivables;
- (ii) The gross amounts receivable in accordance with a binding arrangement; and
- (iii) The best estimate at the acquisition date of the cash flows in accordance with a binding arrangement not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, ~~direct finance~~ leases and any other class of receivables.

...

Effective Date and Transition

Effective Date

...

126.3. PBE IPSAS 43, issued in [Date], amended paragraphs 68, 71, 120, AG76 and AG89, deleted paragraphs AG72–AG74 and their related heading, and added paragraphs 82A and 82B and the related heading. An entity shall apply these amendments when it applies PBE IPSAS 43.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 40.

...

Recognising Particular Assets Acquired and Liabilities Assumed in an Acquisition (see paragraphs 64–68)

~~Operating leases~~

AG72. ~~[Deleted by IPSASB] The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquired operation is the lessee except as required by paragraphs AG73–AG74.~~

AG73. ~~[Deleted by IPSASB] The acquirer shall determine whether the terms of each operating lease in which the acquired operation is the lessee are favourable or unfavourable. The acquirer shall recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms. Paragraph AG89 provides guidance on measuring the acquisition date fair value of assets subject to operating leases in which the acquired operation is the lessor.~~

AG74. ~~[Deleted by IPSASB] An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For~~

~~example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits or service potential that qualify as identifiable intangible assets, for example, as a relationship with users of a service. In that situation, the acquirer shall recognise the associated identifiable intangible asset(s) in accordance with paragraph AG75.~~

...

Intangible Assets

...

AG76. An intangible asset that meets the binding arrangement criterion is identifiable even if the asset is not transferable or separable from the acquired operation or from other rights and obligations. For example:

- (a) ~~[Deleted by IPSASB] An acquired operation leases a facility under an operating lease that has terms that are favourable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favourable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease arrangement.~~
- (b) An acquired operation owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.
- (c) An acquired operation owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related licence agreement meet the binding arrangement criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement separately from one another would not be practical.

...

Assets Subject to Operating Leases in Which the Acquired Operation is the Lessor

AG89. In measuring the acquisition-date fair value of an asset such as a building that is subject to an operating lease in which the acquired operation is the lessor, the acquirer shall take into account the terms of the lease. ~~In other words, the~~ The acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms ~~as paragraph AG73 requires for leases in which the acquired operation is the lessee.~~

...

Illustrative Examples

These examples accompany, but are not part of, PBE IPSAS 40

...

Identifiable Intangible Assets in an Acquisition

...

Binding Arrangement-Based Intangible Assets

IE224. Binding arrangement-based intangible assets represent the value of rights that arise from binding arrangements. Binding arrangements with customers are one type of binding arrangement-based intangible

asset. If the terms of a binding arrangement give rise to a liability (for example, if the terms of ~~an operating lease or a~~ binding arrangement with a customer are unfavourable relative to market terms), the acquirer recognises it as a liability assumed in the acquisition. Examples of binding arrangement-based intangible assets are:

Class	Basis
Licensing, royalty and standstill agreements	Binding arrangement
Advertising, construction, management, service or supply binding arrangements	Binding arrangement
Lease agreements (whether the acquired operation is the lessee or the lessor)	Binding arrangement
Construction permits	Binding arrangement
(...)	

PBE IPSAS 41 *Financial Instruments*

Paragraphs 2, 87, AG198, and AG210 are amended. Paragraph 156.7 is added. New text is underlined and deleted text is struck through.

Scope

2. **This Standard shall be applied by all entities to all types of financial instruments except:**

...

(b) **Rights and obligations under leases to which ~~PBE IPSAS 13 Leases~~ PBE IPSAS 43 Leases applies. However:**

- (i) **Finance lease receivables (i.e., net investments in finance leases) and operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of this Standard;**
- (ii) **Lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraph 35 of this Standard; and**
- (iii) **Derivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard.**

...

Simplified Approach for Receivables

87. **Despite paragraphs 75 and 77, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:**

- (a) **Receivables that result from exchange transactions that are within the scope of PBE IPSAS 9 and non-exchange transactions within the scope of PBE IPSAS 23.**
- (b) **Lease receivables that result from transactions that are within the scope of ~~PBE IPSAS 13~~ PBE IPSAS 43, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables.**

...

Effective Date and Transition

Effective Date

...

156.7. **PBE IPSAS 43, issued in [Date], amended paragraphs 2, 87, AG198 and AG210. An entity shall apply these amendments when it applies PBE IPSAS 43.**

...

Appendix A

Application Guidance

This Appendix is an integral part of PBE IPSAS 41.

...

Measurement of Expected Credit Losses

Expected Credit Losses

...

AG198. When measuring a loss allowance for a lease receivable, the cash flows used for determining the expected credit losses should be consistent with the cash flows used in measuring the lease receivable in accordance with ~~PBE IPSAS 13 Leases~~ PBE IPSAS 43 Leases.

...

Time Value of Money

...

AG210. Expected credit losses on lease receivables shall be discounted using the same discount rate used in the measurement of the lease receivable in accordance with ~~PBE IPSAS 13~~ PBE IPSAS 43 Leases.

PBE IFRS 4 *Insurance Contracts* (superseded on adoption of PBE IFRS 17 for not-for-profit PBEs)

The amendments to PBE IFRS 4 do not apply to an entity that applies PBE IFRS 17 *Insurance Contracts*. PBE IFRS 17 applies to Tier 1 and Tier 2 not-for-profit public benefit entities for reporting periods beginning on or after 1 January 2023. Early application is permitted. PBE IFRS 4 continues to apply to public sector public benefit entities after 1 January 2023.

Paragraphs 4 and D2.2 are amended and paragraph 45.10 is added. New text is underlined and deleted text is struck through.

Scope

...

4. An entity shall not apply this Standard to:

...

- (c) Contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, ~~contingent variable~~ lease payments and similar items), as well as a lessee's residual value guarantee embedded in a ~~finance~~ lease (see ~~PBE IPSAS 13~~ PBE IPSAS 43 *Leases*, PBE IPSAS 9 and PBE IPSAS 31 *Intangible Assets*).

...

Effective Date and Transition

...

45.10. PBE IPSAS 43, issued in [Date], amended paragraphs 2 and D2.2. An entity shall apply these amendments when it applies PBE IPSAS 43.

...

Appendix D

Financial Reporting of Insurance Activities

This Appendix is an integral part of the Standard.

...

Application

Transactions Outside the Scope of this Appendix

D2.2 This Appendix does not apply to:

...

- (e) **Contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, ~~contingent variable~~ lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see ~~PBE IPSAS 13~~ PBE IPSAS 43 *Leases*, PBE IPSAS 9 and PBE IPSAS 31 *Intangible Assets*);**

...

PBE IFRS 17 *Insurance Contracts* (not-for-profit entities)

The amendments to PBE IFRS 17 do not apply to an entity that applies PBE IFRS 4 *Insurance Contracts*. PBE IFRS 17 applies to Tier 1 and Tier 2 not-for-profit public benefit entities for reporting periods beginning on or after 1 January 2023. Early application is permitted. PBE IFRS 4 continues to apply to public sector public benefit entities after 1 January 2023.

Paragraph 7 is amended and paragraph 132.2B is added. New text is underlined and deleted text is struck through.

Scope

...

7. An entity shall not apply PBE IFRS 17 to:

...

- (c) Contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item (for example, some licence fees, royalties, variable and other contingent lease payments and similar items: see PBE IPSAS 9, ~~PBE IPSAS 13~~ PBE IPSAS 43 Leases and PBE IPSAS 31 *Intangible Assets*).
- (d) Residual value guarantees provided by a manufacturer, dealer or retailer and a lessee's residual value guarantees when they are embedded in a lease (see ~~PBE IPSAS 13~~ PBE IPSAS 43).

...

Effective Date and Transition

Effective Date

...

132.2B PBE IPSAS 43, issued in [Date], amended paragraph 7. An entity shall apply this amendment when it applies PBE IPSAS 43.

PBE IAS 12 *Income Taxes*

Paragraphs 20, 22A and 98.13 are amended and paragraph 98.14 is added. New text is underlined and deleted text is struck through.

Recognition of Deferred Tax Liabilities and Deferred Tax Assets

Taxable Temporary Differences

Assets Carried at Fair Value

20. PBE Standards permit or require certain assets to be carried at fair value or to be revalued (see, for example, PBE IPSAS 17 *Property, Plant and Equipment*, PBE IPSAS 31 *Intangible Assets*, PBE IPSAS 16 *Investment Property* ~~and~~ PBE IPSAS 41 *Financial Instruments* and PBE IPSAS 43 Leases). The revaluation or other

restatement of an asset used in a taxable activity to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

...

- 22A A transaction that is not a PBE combination may lead to the initial recognition of an asset and a liability and, at the time of the transaction, affect neither accounting profit nor taxable profit. For example, at the commencement date of a lease ~~classified as a finance lease~~, a lessee typically recognises ~~assets acquired under finance leases as assets and the associated lease obligations as liabilities in their statements of financial position~~ a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction. The exemption provided by paragraphs 15 and 24 does not apply to such temporary differences and an entity recognises any resulting deferred tax liability and asset.

...

Effective Date

...

- 98.13 An entity applying *2022 Omnibus Amendments to PBE Standards* shall also, at the beginning of the earliest comparative period presented:
- (a) Recognise a deferred tax asset—to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised—and a deferred tax liability for all deductible and taxable temporary differences associated with:
 - (i) ~~Assets acquired under finance leases and liability for the associated lease obligations~~ Right-of-use assets and lease liabilities; and
 - (ii) Decommissioning, restoration and similar liabilities and the corresponding amounts recognised as part of the cost of the related asset; and
 - (b) Recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) at that date.

- 98.14 **PBE IPSAS 43, issued in [Date], amended paragraphs 20 and 22A. An entity shall apply these amendments when it applies PBE IPSAS 43. PBE IPSAS 43 also amended paragraph 98.13, which relate to the first-time application of 2022 Omnibus Amendments to PBE Standards. An entity shall apply the amendment to paragraph 98.13 when it applies PBE IPSAS 43 if the entity applies 2022 Omnibus Amendments to PBE Standards at the same time.**

PBE FRS 45 Service Concession Arrangements: Operator

Paragraphs 26 and AG8 are amended and paragraph 30.3 is added. New text is underlined and deleted text is struck through.

Disclosure

26. Certain aspects and disclosures relating to some service concession arrangements are already addressed by other PBE Standards (e.g., PBE IPSAS 32 *Service Concession Arrangements: Grantor* prescribes the accounting by

the grantor, PBE IPSAS 17 applies to acquisitions of items of property, plant and equipment, ~~PBE IPSAS 13~~ PBE IPSAS 43 *Leases* applies to leases of assets, and PBE IPSAS 31 applies to acquisitions of intangible assets). However, a service concession arrangement may involve executory contracts that are not addressed in PBE Standards, unless the contracts are onerous, in which case PBE IPSAS 19 applies. Therefore, this Standard addresses additional disclosures of service concession arrangements by operators.

...

Effective Date

...

30.3 PBE IPSAS 43, issued in [Date], amended paragraphs 26 and AG8. An entity shall apply these amendments when it applies PBE IPSAS 43.

Application Guidance

This Appendix is an integral part of PBE FRS 45.

Scope (paragraph 4)

AG8. The operator may have a right to use the separable infrastructure described in paragraph AG7(a), or the facilities used to provide ancillary unregulated services described in paragraph AG7(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it shall be accounted for in accordance with ~~PBE IPSAS 13~~ PBE IPSAS 43.

PBE FRS 47 *First-time Adoption of PBE Standards*

Paragraphs 37, A1, A11, B4, B8, C1, C4, C6, are amended, paragraph 42.16 and paragraphs C7A–C7D are added, and paragraph C7 is deleted. Paragraphs C2 and C3 are not amended but are included for context. New text is underlined and deleted text is struck through.

Presentation and Disclosure

Use of Fair Value as Deemed Cost

- *37. **If an entity uses fair value in its opening statement of financial position under PBE Standards as deemed cost for an item of property, plant and equipment, an investment property, ~~or~~ an intangible asset or a right-of-use asset (see paragraphs C2 and C4), the entity's first set of financial statements shall disclose, for each line item in the opening statement of financial position under PBE Standards:**
- (a) **The aggregate of those fair values; and**
 - (b) **The aggregate adjustment to the carrying amounts reported under previous GAAP.**

...

Effective Date

42.16 PBE IPSAS 43, issued in [Date], amended paragraphs 37, A1, A11, B4, B8, C1, C4 and C6, added paragraphs C7A–C7D and deleted paragraph C7. An entity shall apply these amendments when it applies PBE IPSAS 43.

...

Appendix A

Exceptions to the Retrospective Application of other PBE Standards

This Appendix is an integral part of PBE FRS 47.

A1. An entity shall apply the following exceptions:

...

- (h) Deferred tax related to ~~finance~~ leases and decommissioning, restoration and similar liabilities (paragraph A11).

...

Deferred tax related to leases and decommissioning, restoration and similar liabilities

A11. Paragraphs 15 and 24 of PBE IAS 12 *Income Taxes* exempt an entity from recognising a deferred tax asset or liability in particular circumstances. Despite this exemption, at the date of transition to PBE Standards, a first-time adopter shall recognise a deferred tax asset—to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised—and a deferred tax liability for all deductible and taxable temporary differences associated with:

- (a) ~~Assets acquired under finance leases and liability for the associated lease obligations~~ Right-of-use assets and lease liabilities; and
- (b) Decommissioning, restoration and similar liabilities and the corresponding amounts recognised as part of the cost of the related asset.

...

Appendix B

Exemptions for PBE Combinations

This Appendix is an integral part of PBE FRS 47. An entity shall apply the following requirements to PBE combinations that the entity recognised before the date of transition to PBE Standards.

...

B4. If a first-time adopter does not apply PBE IPSAS 40 retrospectively to a past PBE combination, this has the following consequences for that PBE combination:

...

- (f) If an asset acquired, or liability assumed, in a past PBE combination was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening statement of financial position under PBE Standards. Instead, the acquirer shall recognise and measure it in its consolidated statement of financial position on the basis that PBE Standards would require in the statement of financial position of the acquired operation. To illustrate: if the acquirer had not, in accordance with its previous GAAP, ~~recognised capitalised finance~~ recognised capitalised finance leases acquired in a past PBE combination in which the acquiree was a lessee, it shall ~~recognise capitalise~~ recognise capitalise those leases in its consolidated financial statements, as ~~PBE IPSAS 13~~ PBE IPSAS 43 *Leases* would require the acquiree to do in its statement of financial position under PBE Standards. (...)

...

B8. If a first-time adopter does not apply PBE IPSAS 40 retrospectively to a past amalgamation, this has the following consequences for that PBE combination:

...

- (f) If an asset received, or liability assumed, in a past amalgamation was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening statement of financial position

under PBE Standards. Instead, the resulting entity shall recognise and measure it in its statement of financial position on the basis that PBE Standards would require in the statement of financial position of the combining operation. To illustrate: if the resulting entity had not, in accordance with its previous GAAP, ~~recognised capitalised finance~~ leases assumed in a past amalgamation in which the acquiree was a lessee, it shall recognise capitalise those leases in its first set of financial statements under PBE Standards, as ~~PBE IPSAS 13~~ PBE IPSAS 43 would require the combining operation to do in its statement of financial position under PBE Standards. (...)

...

Appendix C

Exemptions from other PBE Standards

This Appendix is an integral part of PBE FRS 47.

C1. An entity may elect to use one or more of the following exemptions:

- (a) Deemed cost (paragraphs C2–C5);
- (b) Leases (paragraphs C6 and C7A–C7D);

...

...

Deemed Cost

C2. An entity may elect to measure an item of property, plant and equipment at the date of transition to PBE Standards at its fair value and use that fair value as its deemed cost at that date.

C3. A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to PBE Standards as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

- (a) Fair value; or
- (b) Cost or depreciated cost in accordance with PBE Standards, adjusted to reflect, for example, changes in a general or specific price index.

C4. The elections in paragraphs C2 and C3 are also available for:

- (a) Investment property, if an entity elects to use the cost model in PBE IPSAS 16 *Investment Property*; ~~and~~
- (aa) Right-of-use assets; and
- (b) Intangible assets that meet: (...)

...

Leases

C6. ~~In applying the provisions in Appendix C Application Guidance *Determining whether an Arrangement contains a Lease* in PBE IPSAS 13 *Leases*, a first time adopter may determine whether an arrangement existing at the date of transition to PBE Standards contains a lease on the basis of facts and circumstances existing at that date. A first-time adopter may assess whether a contract existing at the date of transition to PBE Standards contains a lease by applying paragraphs 10–12 of PBE IPSAS 43 to those contracts on the basis of facts and circumstances existing at that date.~~

C7. ~~[Deleted by NZASB] If a first time adopter made the same determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by Appendix C of PBE IPSAS 13 but at a date other than the date of transition to PBE Standards, the first time adopter need not reassess that determination when it adopts PBE Standards. For an entity to have made the same determination of whether the arrangement contained~~

~~a lease in accordance with previous GAAP, that determination would have to have given the same outcome as that resulting from applying PBE IPSAS 13, including Appendix C.~~

C7A. When a first-time adopter that is a lessee recognises lease liabilities and right-of-use assets, it may apply the following approach to all of its leases (subject to the practical expedients described in paragraph C7C):

- (a) Measure a lease liability at the date of transition to PBE Standards. A lessee following this approach shall measure that lease liability at the present value of the remaining lease payments (see paragraph C7D), discounted using the lessee's incremental borrowing rate (see paragraph C7D) at the date of transition to PBE Standards.
- (b) Measure a right-of-use asset at the date of transition to PBE Standards. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:
 - (i) Its carrying amount as if PBE IPSAS 43 had been applied since the commencement date of the lease (see paragraph C7D), but discounted using the lessee's incremental borrowing rate at the date of transition to PBE Standards; or
 - (ii) An amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of transition to PBE Standards;
- (c) Apply PBE IPSAS 21 or PBE IPSAS 26 to right-of-use assets at the date of transition to PBE Standards.

C7B. Notwithstanding the requirements in paragraph C7A, a first-time adopter that is a lessee shall measure the right-of-use asset at fair value at the date of transition to PBE Standards for leases that meet the definition of investment property in PBE IPSAS 16 and are measured using the fair value model in PBE IPSAS 16 from the date of transition to PBE Standards.

C7C. A first-time adopter that is a lessee may do one or more of the following at the date of transition to PBE Standards, applied on a lease-by-lease basis:

- (a) Apply a single discount rate to a portfolio of leases with reasonably similar characteristics (for example, a similar remaining lease term for a similar class of underlying asset in a similar economic environment).
- (b) Elect not to apply the requirements in paragraph C7A to leases for which the lease term (see paragraph C7A) ends within 12 months of the date of transition to PBE Standards. Instead, the entity shall account for (including disclosure of information about) these leases as if they were short-term leases accounted for in accordance with paragraph 7 of PBE IPSAS 43.
- (c) Elect not to apply the requirements in paragraph C7A to leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9 of PBE IPSAS 43). Instead, the entity shall account for (including disclosure of information about) these leases in accordance with paragraph 7 of PBE IPSAS 43.
- (d) Exclude initial direct costs (see paragraph C7D) from the measurement of the right-of-use asset at the date of transition to PBE Standards.
- (e) Use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

C7D. Lease payments, lessor, lessee, lessee's incremental borrowing rate, commencement date of the lease, initial direct costs and lease term are defined terms in PBE IPSAS 43 and are used in this Standard with the same meaning.

XRB A1 *Application of the Accounting Standards Framework*

The accounting standards table in Appendix C is amended. New text is underlined.

APPENDIX C

Tier 1 PBE Accounting Requirements and Tier 2 PBE Accounting Requirements to be applied by public benefit entities

This appendix forms an integral part of XRB A1 Application of the Accounting Standards Framework.

This appendix lists the accounting standards and authoritative notices that contain the Tier 1 PBE Accounting Requirements for Tier 1 PBEs and the Tier 2 PBE Accounting Requirements for Tier 2 PBEs.

Accounting standards

(...)

PBE IPSAS 41 *Financial Instruments*

PBE IPSAS 43 *Leases*

PBE IFRS 4 *Insurance Contracts* (superseded on adoption of PBE IFRS 17 for not-for-profit entities)

(...)

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, PBE IPSAS 43 Leases.

Background: IPSAS 43 Leases

- BC1. In January 2022, the IPSASB issued IPSAS 43 *Leases*. IPSAS 43 is based on IFRS 16 *Leases*, issued by the International Accounting Standards Board (IASB) in January 2016. IPSAS 43 supersedes IPSAS 13 *Leases*. IPSAS 13 was based on the IASB standard IAS 17 *Leases*, which was superseded by IFRS 16.
- BC2. IPSAS 43 sets out the accounting requirements for leases. Consistently with IFRS 16, IPSAS 43 introduces a new lease accounting model for lessees – the ‘right-of-use’ model. The right-of-use model is based on the foundational principle that leases are financings of the right to use an underlying asset. Under the right-of-use model, a lessee recognises a ‘right-of-use asset’ and a lease liability related to the future lease payments. Lessees are required to apply the right-of-use model to all leases, with limited exemptions. By contrast, under IPSAS 13, lessees classified leases as operating leases or finance leases. Operating leases were recognised as an expense over the lease term, whereas finance leases were recognised as assets and liabilities in the statement of financial position.
- BC3. When developing IPSAS 43 *Leases*, the IPSASB considered that there were no public sector issues that warranted a departure from the right-of-use model for lessee accounting in IFRS 16, for the following reasons.
- (a) The right-of-use asset satisfies the definition of, and recognition criteria for, an asset in the IPSASB’s *Conceptual Framework*. The right-of-use asset is recognised when the lessee controls the asset, which is consistent with the IPSASB’s *Conceptual Framework*.
 - (b) The information reported under the single right-of-use lessee accounting model specified in IFRS 16 would provide the most useful information to the broadest range of users of financial statements.
 - (c) The right-of-use model prevents accounting arbitrage and information asymmetry. It improves comparability between public sector entities that lease assets and public sector entities that purchase assets.
 - (d) The IPSASB acknowledged that there would be costs for lessees associated with implementing the right-of-use model in the public sector. However, the IPSASB considered that the benefits outweigh the costs, particularly if the IPSASB also adopted the exemptions in IFRS 16.
- BC4. IPSAS 43 does not introduce significant changes to lessor accounting as compared to IPSAS 13. This is consistent with IFRS 16.
- BC5. IPSAS 43 does not contain specific accounting requirements for leases at below-market terms, often referred to as concessionary leases. However, such leases are not excluded from the scope of IPSAS 43. IPSAS 43 also does not contain accounting requirements for arrangements that confer a right to use an asset for a specified period of time for no consideration. Accounting requirements for concessionary leases and the abovementioned arrangements for no consideration are being considered by the IPSASB separately, as part of the project *Other Lease-type Arrangements*.

NZASB decision to develop PBE IPSAS 43 Leases

- BC6. Following the issue of IPSAS 43, the NZASB decided to develop a PBE Standard based on IPSAS 43, which would supersede PBE IPSAS 13 *Leases*. The NZASB noted that developing a PBE Standard based on IPSAS 43 would be in accordance with New Zealand’s Accounting Standards Framework. The NZASB also noted the following.
- (a) The IPSASB’s reasons for developing IPSAS 43 based on IFRS 16, as described in paragraph BC3 above, also justify the introduction of these requirements into PBE Standards.
 - (b) New Zealand constituents who commented on the proposals in IPSASB ED 75 *Leases* – on which IPSAS 43 is based – broadly supported the proposals in that ED.

- (c) Developing a PBE Standard based on IPSAS 43 would substantially align the requirements in PBE Standards with the most recent IPSAS (and IFRS Accounting Standards), allowing New Zealand public benefit entities to benefit from the latest international thinking on lease accounting.
 - (b) Developing a PBE Standard based on IPSAS 43 substantially aligns the requirements in PBE Standards with the equivalent requirements in NZ IFRS and minimises mixed group issues.
- BC7. The NZASB considered whether to wait for the IPSASB to finalise its project on *Other Lease-type Arrangements* – which covers concessionary leases and lease-like arrangements for no consideration – before developing a PBE Standard based on IPSAS 43. The NZASB decided to develop a PBE Standard based on IPSAS 43 without waiting for the IPSASB to finalise the abovementioned project – but to allow a long implementation period before the Standard becomes effective, with early application permitted. The rationale for this decision was as follows.
- (a) Issuing a PBE Standard based on IPSAS 43, without waiting for the IPSASB to finalise its project on *Other Lease-type Arrangements*, would make the benefits noted in paragraph BC6 available to public benefit entities in New Zealand.
 - (b) At the same time, the long effective date would allow public benefit entities sufficient time to prepare for the implementation of the Standard before it becomes mandatory.
 - (c) Furthermore, it is expected that the IPSASB will finalise its project on *Other Lease-type Arrangements* before the effective date of PBE IPSAS 43 – therefore, the NZASB will be able to consider the development of requirements for concessionary leases and lease-like arrangements for nil consideration before PBE IPSAS 43 becomes effective.
- BC8. The NZASB decided not to add specific requirements for concessionary leases and lease-like arrangements for nil considerations into PBE IPSAS 43, but rather to consider the development of such requirements when the IPSASB finalises its project on *Other Lease-type Arrangements*. However, the NZASB decided to clarify that concessionary leases (that meet the definition of a lease) are in the scope of PBE IPSAS 43, and that the concessionary component of concessionary leases or of lease-like arrangements for nil consideration is not be recognised at fair value (see below). These scope clarifications will be reconsidered after the IPSASB finalises its project on *Other Lease-type Arrangements*.
- BC9. The NZASB considered that the requirements of IPSAS 43 were generally appropriate for application by public benefit entities and followed its usual processes in modifying IPSAS 43 for application by Tier 1 and Tier 2 public benefit entities. Most of the changes made to IPSAS 43 were to ensure coherence within the suite of PBE Standards (in terms of aligning terminology and requirements with other PBE Standards). In the case of disclosure requirements, the NZASB identified disclosure concessions for Tier 2 entities and aligned these with the disclosure concessions in NZ IFRS 16 *Leases*. The NZASB issued ED 2022-11 PBE IPSAS 43 *Leases* in August 2022 with comments due by 25 November 2022.
- BC10. The specific modifications made by the NZASB in developing PBE IPSAS 43, as well as modifications that were considered but ultimately not included in PBE IPSAS 43, are outlined below.

Scope clarification: concessionary leases and leases for no consideration

- BC11. The NZASB added paragraphs 4.1–4.2 to clarify the scope of the Standard with respect to concessionary leases. A concessionary lease that meets the definition of a lease in this Standard is within the scope of this Standard (provided that it is not specifically excluded from the Standard’s scope under paragraph 3).
- BC12. However, there are no accounting requirements in this Standard (or in other PBE Standards) for the ‘concessionary component’ of a concessionary lease, or for arrangements to use an asset for a specified period of time for no consideration. The NZASB will consider the development of such requirements after the IPSASB finalises its project on concessionary leases and other public sector-specific lease-like arrangements. Until such requirements are considered by the NZASB, this 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.

- BC13. Furthermore, paragraph 4.1 clarifies that 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 this Standard.
- BC14. The abovementioned scope clarifications will be reconsidered after the IPSASB completes its project on concessionary leases and other public sector-specific lease-type arrangements.

Leases of low-value underlying assets

- BC15. IPSAS 43 provides a recognition exemption for ‘leases for which the underlying asset is of low value’. This means that an entity need not recognise a right-of-use asset and a lease liability for leases of low-value assets. Instead, the lease payments relating to such leases may be accounted for as expenses on either a straight-line basis or another systematic basis. IPSAS 43 requires an entity to determine whether a leased asset is of ‘low value’ on an absolute basis – not based on whether the asset is material to the entity. Paragraph AG9 lists examples of low value underlying assets.
- BC16. The NZASB considered whether to retain the IPSASB’s approach of performing the ‘low value underlying asset’ assessment based on the asset’s absolute value on an individual asset basis – or whether to require the assessment to be performed on the basis of materiality and/or in aggregate for similar leased assets. The NZASB noted the following.
- (a) Performing the assessment on an absolute basis for each individual asset is more likely to ensure that the cost of applying PBE IPSAS 43 do not outweigh the benefits. The Basis for Conclusions of IFRS 16 *Leases* notes the following with respect to exemption for leases of low-value underlying assets: “[...] in the light of feedback received from preparers of financial statements, the IASB concluded that the exemption would provide substantial cost relief to many lessees (and, in particular, smaller entities) by removing the burden of justifying that such leases would not be material in the aggregate”. The NZASB considered that similar cost-benefit considerations would apply to public benefit entities in New Zealand.
 - (b) The NZASB did not identify a New Zealand-specific reason to depart from the requirements in IPSAS 43, or a public benefit entity-specific reason to depart from the requirements for for-profit entities in NZ IFRS 16.
- BC17. Consequently, the NZASB decided to retain the requirement to perform the ‘low-value underlying asset’ assessment based on absolute value on an individual asset basis.

Materiality – concessionary leases

- BC18. The NZASB noted that for leases at below-market terms, often referred to as concessionary leases, the lease payments may not be material. However, if the underlying leased asset is not of low value, the recognition exemption for leases of low-value underlying assets in PBE IPSAS 43 would not apply. Nevertheless, if the lease payments are low, the right-of-use asset and lease liability that would arise from applying the right-of-use model to a concessionary lease may not be material to the entity. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* notes that the accounting policies set out in PBE Standards “need not be applied when the effect of applying them is immaterial”.
- BC19. The NZASB considered whether to include in PBE IPSAS 43 specific requirements or guidance on the application of materiality, particularly with respect to leases where the lease payments are not material. The NZASB noted that PBE Standards generally do not include materiality guidance about specific transactions or events. As with all PBE Standards, the application of the requirements of PBE IPSAS 43 are subject to materiality considerations. General guidance on the application of materiality is included in PBE IPSAS 1, PBE IPSAS 3 and the *PBE Conceptual Framework*.

References to NZ IFRS 15 Revenue from Contracts with Customers

- BC20. IFRS 16 *Leases* contains references to IFRS 15 *Revenue from Contracts with Customers*. The IPSASB’s project to develop a new IPSAS on Revenue, which includes alignment with IFRS 15, was ongoing when the IPSASB issued IPSAS 43. Therefore, the IPSASB included references to IFRS 15 in IPSAS 43, with a view to updating these references when the new IPSAS on Revenue is issued.

BC21. Consistent with IFRS 16, IPSAS 43 refers preparers to IFRS 15 in the following circumstances:

- (a) Allocating consideration to lease and/or non-lease 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 determine whether the transfer is accounted for as a sale by applying the requirements in IFRS 15 for determining when a performance obligation is satisfied.

BC22. In developing PBE IPSAS 43, the NZASB considered whether the relevant requirements in NZ IFRS 15 *Revenue from Contracts with Customers* could be included in PBE IPSAS 43 – instead of requiring public benefit entities to refer to a for-profit standard.

BC23. The NZASB identified the paragraphs of NZ IFRS 15 that relate directly to the circumstances outlined in BC27 above. However, the NZASB noted that these paragraphs are interrelated with several other paragraphs in NZ IFRS 15, as explained below.

- (a) With respect to allocating consideration to the separate components of a contract (lessor): Paragraphs 73–90 of NZ IFRS 15 cover the allocation of the transaction price to performance obligations and changes in the transaction price. However, these paragraphs then include references to several other paragraphs within NZ IFRS 15, which in turn refer to other paragraphs.
- (b) With respect to sale and leaseback transactions: Paragraphs 31–45 of NZ IFRS 15 deal with the satisfaction of performance obligations. However, these paragraphs may not be understood without an explanation of what performance obligations are and how to identify them, which is explained in paragraphs 22–30 of NZ IFRS 15. Both sets of paragraphs include references to the application guidance in Appendix B of NZ IFRS 15.

BC24. The NZASB considered that it would not be desirable to include a large portion of NZ IFRS 15 in PBE IPSAS 43. Therefore, NZASB considered including the ‘most essential’ NZ IFRS 15 paragraphs in PBE IPSAS 43, and either:

- (a) referring preparers to further guidance in NZ IFRS 15 via a footnote; or
- (b) describing within PBE IPSAS 43 the relevant key concepts from NZ IFRS 15 when applying the included NZ IFRS 15 paragraphs.

BC25. The NZASB noted that deciding which paragraphs are most essential would require significant judgement. Furthermore, including only those NZ IFRS 15 paragraphs that are considered ‘most essential’ and excluding the other interrelated paragraphs (as explained above) would result in preparers having insufficient context for applying those paragraphs that are included. This could limit the usefulness of the included NZ IFRS 15 paragraphs and lead to application challenges. In addition, under the option described in paragraph BC30(a), preparers would still refer to NZ IFRS 15 for additional guidance. The option described in paragraph BC30(b) above would mean that preparers do not need to refer to NZ IFRS 15. However, this option runs the risk of creating a New Zealand interpretation of IFRS 15, which could have unintended consequences.

BC26. Consequently, the NZASB decided not to add paragraphs from NZ IFRS 15 or descriptions of the requirements of NZ IFRS 15 into PBE IPSAS 43. Instead, PBE IPSAS 43 refers preparers to NZ IFRS 15 in the circumstances listed in paragraph BC23 above. The NZASB will update these references to NZ IFRS 15 when the IPSASB finalises its project on Revenue and the NZASB considers updates to the revenue requirements in PBE Standards based on that project.

COVID-19-related rent concessions

BC27. IPSAS 43 includes paragraphs that provide an optional practical expedient for lessees for the accounting for COVID-19-related rent concessions. These paragraphs are based on *COVID-19-Related Rent Concessions*, issued by the IASB, which amended IFRS 16 *Leases*. Consistent with the IASB amendments, the application of the practical expedient in IPSAS 43 is limited to lease payments that would have been due on or before 30 June 2022. This time limitation is also consistent with the requirements for for-profit entities in NZ IFRS 16

Leases. The NZASB did not identify a New Zealand-specific reason to extend this time limit for public benefit entities. The NZASB also noted that given this time limit, the COVID-19-related practical expedient in IPSAS 43 will not be applicable when PBE IPSAS 43 becomes effective, and is highly unlikely to be applicable by the time any early adopters apply PBE IPSAS 43. To avoid confusion in relation to the applicability of the paragraphs relating to COVID-19-related rent concessions, the NZASB deleted those paragraphs.

Interest Rate Benchmark Reforms – Part 2

BC28. The IASB issued *Interest Rate Benchmark Reforms – Part 2*, which amended IFRS 16 and other IFRS Accounting Standards to provide relief for entities that are affected by the phasing out of interest-rate benchmarks, such as interbank offered rates (IBOR). These amendments were included in the relevant NZ IFRS, including NZ IFRS 16. In 2021, these amendments were then also included in the relevant PBE Standards – except for the amendments to NZ IFRS 16, as PBE Standards did not yet include a standard with requirements that are aligned with NZ IFRS 16. When the NZASB issued PBE IPSAS 43, the NZASB incorporated the parts of *Interest Rate Benchmark Reforms – Part 2* that relate to NZ IFRS 16 into PBE IPSAS 43.

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Illustrative Examples

These examples accompany, but are not part of, PBE IPSAS 43

IE1. These examples portray hypothetical situations illustrating how an entity might apply some of the requirements in PBE IPSAS 43 to particular aspects of a lease (or other contracts) on the basis of the limited facts presented. The analysis in each example is not intended to represent the only manner in which the requirements could be applied, nor are the examples intended to apply only to the specific industry illustrated. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying PBE IPSAS 43.

Identifying a Lease (see paragraphs 10–12 and AG10–AG31)

IE2. The following examples illustrate how an entity determines whether a contract is, or contains, a lease.

Example 1–Rail Cars

Example 1A: a contract between Customer and a freight carrier (Supplier) provides Customer with the use of 10 rail cars of a particular type for five years. The contract specifies the rail cars; the cars are owned by Supplier. Customer determines when, where and which goods are to be transported using the cars. When the cars are not in use, they are kept at Customer's premises. Customer can use the cars for another purpose (for example, storage) if it so chooses. However, the contract specifies that Customer cannot transport particular types of cargo (for example, explosives). If a particular car needs to be serviced or repaired, Supplier is required to substitute a car of the same type. Otherwise, and other than on default by Customer, Supplier cannot retrieve the cars during the five-year period.

The contract also requires Supplier to provide an engine and a driver when requested by Customer. Supplier keeps the engines at its premises and provides instructions to the driver detailing Customer's requests to transport goods. Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers (i.e. if other customers require the transportation of goods to destinations close to the destination requested by Customer and within a similar timeframe, Supplier can choose to attach up to 100 rail cars to the engine).

The contract contains leases of rail cars. Customer has the right to use 10 rail cars for five years.

There are 10 identified cars. The cars are explicitly specified in the contract. Once delivered to Customer, the cars can be substituted only when they need to be serviced or repaired (see paragraph AG19). The engine used to transport the rail cars is not an identified asset because it is neither explicitly specified nor implicitly specified in the contract.

Customer has the right to control the use of the 10 rail cars throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the cars over the five-year period of use. Customer has exclusive use of the cars throughout the period of use, including when they are not being used to transport Customer's goods.
- (b) Customer has the right to direct the use of the cars because the conditions in paragraph AG25(a) exist. The contractual restrictions on the cargo that can be transported by the cars are protective rights of Supplier and define the scope of Customer's right to use the cars. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose the cars are used by being able to decide when and where the rail cars will be used and which goods are

transported using the cars. Customer also determines whether and how the cars will be used when not being used to transport its goods (for example, whether and when they will be used for storage). Customer has the right to change these decisions during the five-year period of use.

Although having an engine and driver (controlled by Supplier) to transport the rail cars is essential to the efficient use of the cars, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the rail cars are used. Consequently, Supplier does not control the use of the cars during the period of use.

Example 1B: the contract between Customer and Supplier requires Supplier to transport a specified quantity of goods by using a specified type of rail car in accordance with a stated timetable for a period of five years. The timetable and quantity of goods specified are equivalent to Customer having the use of 10 rail cars for five years. Supplier provides the rail cars, driver and engine as part of the contract. The contract states the nature and quantity of the goods to be transported (and the type of rail car to be used to transport the goods). Supplier has a large pool of similar cars that can be used to fulfil the requirements of the contract. Similarly, Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers. The cars and engines are stored at Supplier's premises when not being used to transport goods.

The contract does not contain a lease of rail cars or of an engine.

The rail cars and the engines used to transport Customer's goods are not identified assets. Supplier has the substantive right to substitute the rail cars and engine because:

- (a) Supplier has the practical ability to substitute each car and the engine throughout the period of use (see paragraph AG15(a)). Alternative cars and engines are readily available to Supplier and Supplier can substitute each car and the engine without Customer's approval.
- (b) Supplier would benefit economically from substituting each car and the engine (see paragraph AG15(b)). There would be minimal, if any, cost associated with substituting each car or the engine because the cars and engines are stored at Supplier's premises and Supplier has a large pool of similar cars and engines. Supplier benefits from substituting each car or the engine in contracts of this nature because substitution allows Supplier to, for example, (i) use cars or an engine to fulfil a task for which the cars or engine are already positioned to perform (for example, a task at a rail yard close to the point of origin) or (ii) use cars or an engine that would otherwise be sitting idle because they are not being used by a customer.

Accordingly, Customer does not direct the use, nor have the right to obtain substantially all of the economic benefits or service potential from use, of an identified car or an engine. Supplier directs the use of the rail cars and engine by selecting which cars and engine are used for each particular delivery and obtains substantially all of the economic benefits from use of the rail cars and engine. Supplier is only providing freight capacity.

Example 2—Allocated Space

A coffee company (Customer) enters into a contract with an airport operator (Supplier) to use a space in the airport to sell its goods for a three-year period. The contract states the amount of space and that the space may be located at any one of several boarding areas within the airport. Supplier has the right to change the location of the space allocated to Customer at any time during the period of use. There are minimal costs to Supplier associated with changing the space for the Customer: Customer uses a kiosk (that it owns) that can be moved easily to sell its goods. There are many areas in the airport that are available and that would meet the specifications for the space in the contract.

The contract does not contain a lease.

Although the amount of space Customer uses is specified in the contract, there is no identified asset. Customer controls its owned kiosk. However, the contract is for space in the airport, and this space can change at the discretion of Supplier. Supplier has the substantive right to substitute the space Customer uses because:

- (a) Supplier has the practical ability to change the space used by Customer throughout the period of use (see paragraph AG15(a)). There are many areas in the airport that meet the specifications for the space in the contract, and Supplier has the right to change the location of the space to other space that meets the specifications at any time without Customer's approval.
- (b) Supplier would benefit economically from substituting the space (see paragraph AG15(b)). There would be minimal cost associated with changing the space used by Customer because the kiosk can be moved easily. Supplier benefits from substituting the space in the airport because substitution allows Supplier to make the most effective use of the space at boarding areas in the airport to meet changing circumstances.

Example 3–Fibre-Optic Cable

Example 3A: Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use three specified, physically distinct dark fibres within a larger cable connecting City A to City B. Customer makes the decisions about the use of the fibres by connecting each end of the fibres to its electronic equipment (i.e., Customer 'lights' the fibres and decides what data, and how much data, those fibres will transport). If the fibres are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibres, but can substitute those for Customer's fibres only for reasons of repairs, maintenance or malfunction (and is obliged to substitute the fibres in these cases).

The contract contains a lease of dark fibres. Customer has the right to use the three dark fibres for 15 years.

There are three identified fibres. The fibres are explicitly specified in the contract and are physically distinct from other fibres within the cable. Supplier cannot substitute the fibres other than for reasons of repairs, maintenance or malfunction (see paragraph AG19).

Customer has the right to control the use of the fibres throughout the 15-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the fibres over the 15-year period of use. Customer has exclusive use of the fibres throughout the period of use.
- (b) Customer has the right to direct the use of the fibres because the conditions in paragraph AG25(a) exist. Customer makes the relevant decisions about how and for what purpose the fibres are used by deciding (i) when and whether to light the fibres and (ii) when and how much output the fibres will produce (i.e., what data, and how much data, those fibres will transport). Customer has the right to change these decisions during the 15-year period of use.

Although Supplier's decisions about repairing and maintaining the fibres are essential to their efficient use, those decisions do not give Supplier the right to direct how and for what purpose the fibres are used. Consequently, Supplier does not control the use of the fibres during the period of use.

Example 3B: Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting City A to City B. The specified amount is equivalent to Customer having the use of the full capacity of three fibre strands within the cable (the cable contains 15 fibres with similar capacities). Supplier makes decisions about the transmission of data (i.e. Supplier lights the fibres, makes

decisions about which fibres are used to transmit Customer's traffic and makes decisions about the electronic equipment that Supplier owns and connects to the fibres).

The contract does not contain a lease.

Supplier makes all decisions about the transmission of its customers' data, which requires the use of only a portion of the capacity of the cable for each customer. The capacity portion that will be provided to Customer is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable (see paragraph AG21). Consequently, Customer does not have the right to use an identified asset.

Example 4—Office Unit

Customer enters into a contract with a property owner (Supplier) to use Office Unit A for a five-year period. Office Unit A is part of a larger office space with many office units.

Customer is granted the right to use Office Unit A. Supplier can require Customer to relocate to another office unit. In that case, Supplier is required to provide Customer with an office unit of similar quality and specifications to Office Unit A and to pay for Customer's relocation costs. Supplier would benefit economically from relocating Customer only if a major new tenant were to decide to occupy a large amount of office space at a rate sufficiently favourable to cover the costs of relocating Customer and other tenants in the office space. However, although it is possible that those circumstances will arise, at inception of the contract, it is not likely that those circumstances will arise.

The contract requires Customer to use Office Unit A to operate its well-known tourist office to sell or provide its services during the hours that the larger office space is open. Customer makes all of the decisions about the use of the office unit during the period of use. For example, Customer decides on the mix of services sold or provided from the unit, the pricing of the services sold or provided and the number of employees working. Customer also controls physical access to the unit throughout the five-year period of use.

The contract requires Customer to make fixed payments to Supplier, as well as variable payments that are a percentage of services sold or provided from Office Unit A.

Supplier provides cleaning and security services as part of the contract.

The contract contains a lease of *office space*. Customer has the right to use Office Unit A for five years.

Office Unit A is an identified asset. It is explicitly specified in the contract. Supplier has the practical ability to substitute the office unit, but could benefit economically from substitution only in specific circumstances. Supplier's substitution right is not substantive because, at inception of the contract, those circumstances are not considered likely to arise (see paragraph AG17).

Customer has the right to control the use of Office Unit A throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of Office Unit A over the five-year period of use. Customer has exclusive use of Office Unit A throughout the period of use. Although a portion of the cash flows derived from services sold or provided from Office Unit A will flow from Customer to Supplier, this represents consideration that Customer pays Supplier for the right to use the office unit. It does not prevent Customer from having the right to obtain substantially all of the economic benefits or service potential from use of Office Unit A.
- (b) Customer has the right to direct the use of Office Unit A because the conditions in paragraph AG25(a) exist. The contractual restrictions on the services that can be provided or sold from Office

Unit A, and when Office Unit A is open, define the scope of Customer's right to use Office Unit A. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose Office Unit A is used by being able to decide, for example, the mix of services that will be provided from or sold in the office unit and the sale price for those services. Customer has the right to change these decisions during the five-year period of use.

Although cleaning, security, and advertising services are essential to the efficient use of Office Unit A, Supplier's decisions in this regard do not give it the right to direct how and for what purpose Office Unit A is used. Consequently, Supplier does not control the use of Office Unit A during the period of use and Supplier's decisions do not affect Customer's control of the use of Office Unit A.

Example 5–Truck Rental

Customer enters into a contract with Supplier for the use of a truck for one week to transport cargo from City A to City B. Supplier does not have substitution rights. Only cargo specified in the contract is permitted to be transported on this truck for the period of the contract. The contract specifies a maximum distance that the truck can be driven. Customer is able to choose the details of the journey (speed, route, rest stops, etc.) within the parameters of the contract. Customer does not have the right to continue using the truck after the specified trip is complete.

The cargo to be transported, and the timing and location of pick-up in City A and delivery in City B, are specified in the contract.

Customer is responsible for driving the truck from City A to City B.

The contract contains a lease of a truck. Customer has the right to use the truck for the duration of the specified trip.

There is an identified asset. The truck is explicitly specified in the contract, and Supplier does not have the right to substitute the truck.

Customer has the right to control the use of the truck throughout the period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the truck over the period of use. Customer has exclusive use of the truck throughout the period of use.
- (b) Customer has the right to direct the use of the truck because the conditions in AG25(b)(i) exist. How and for what purpose the truck will be used (i.e. the transportation of specified cargo from City A to City B within a specified timeframe) is predetermined in the contract. Customer directs the use of the truck because it has the right to operate the truck (for example, speed, route, rest stops) throughout the period of use. Customer makes all of the decisions about the use of the truck that can be made during the period of use through its control of the operations of the truck.

Because the duration of the contract is one week, this lease meets the definition of a short-term lease.

Example 6–Ship

Example 6A: Customer enters into a contract with a ship owner (Supplier) for the transportation of cargo from City A to City B on a specified ship. The ship is explicitly specified in the contract and Supplier does not have substitution rights. The cargo will occupy substantially all of the capacity of the ship. The contract specifies the cargo to be transported on the ship and the dates of pickup and delivery.

Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract.

The contract does not contain a lease.

There is an identified asset. The ship is explicitly specified in the contract and Supplier does not have the right to substitute that specified ship.

Customer has the right to obtain substantially all of the economic benefits or service potential from use of the ship over the period of use. Its cargo will occupy substantially all of the capacity of the ship, thereby preventing other parties from obtaining economic benefits or service potential from use of the ship.

However, Customer does not have the right to control the use of the ship because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the ship is used. How and for what purpose the ship will be used (i.e. the transportation of specified cargo from Rotterdam to Sydney within a specified timeframe) is predetermined in the contract. Customer has no right to change how and for what purpose the ship is used during the period of use. Customer has no other decision-making rights about the use of the ship during the period of use (for example, it does not have the right to operate the ship) and did not design the ship. Customer has the same rights regarding the use of the ship as if it were one of many customers transporting cargo on the ship.

Example 6B: Customer enters into a contract with Supplier for the use of a specified ship for a five-year period. The ship is explicitly specified in the contract and Supplier does not have substitution rights.

Customer decides what cargo will be transported, and whether, when and to which ports the ship will sail, throughout the five-year period of use, subject to restrictions specified in the contract. Those restrictions prevent Customer from sailing the ship into waters at a high risk of piracy or carrying hazardous materials as cargo.

Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship of the contract or operating the ship itself during the term of the contract.

The contract contains a lease. Customer has the right to use the ship for five years.

There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.

Customer has the right to control the use of the ship throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the ship over the five-year period of use. Customer has exclusive use of the ship throughout the period of use.
- (b) Customer has the right to direct the use of the ship because the conditions in paragraph AG25(a) exist. The contractual restrictions about where the ship can sail and the cargo to be transported by the ship define the scope of Customer's right to use the ship. They are protective rights that protect Supplier's investment in the ship and Supplier's personnel. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the ship is used throughout the five-year period of use because it decides whether, where and when the ship sails, as well as the cargo it will transport. Customer has the right to change these decisions throughout the five-year period of use.

Although the operation and maintenance of the ship are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the ship is used.

Example 7–Aircraft

Customer enters into a contract with an aircraft owner (Supplier) for the use of an explicitly specified aircraft for a two-year period. The contract details the interior and exterior specifications for the aircraft.

There are contractual and legal restrictions in the contract on where the aircraft can fly. Subject to those restrictions, Customer determines where and when the aircraft will fly, and which passengers and cargo will be transported on the aircraft. Supplier is responsible for operating the aircraft, using its own crew. Customer is prohibited from hiring another operator for the aircraft or operating the aircraft itself during the term of the contract.

Supplier is permitted to substitute the aircraft at any time during the two-year period and must substitute the aircraft if it is not working. Any substitute aircraft must meet the interior and exterior specifications in the contract. There are significant costs involved in outfitting an aircraft in Supplier's fleet to meet Customer's specifications.

The contract contains a lease. Customer has the right to use the aircraft for two years.

There is an identified asset. The aircraft is explicitly specified in the contract and, although Supplier can substitute the aircraft, its substitution right is not substantive because the conditions in paragraph AG15(b) do not exist. Supplier's substitution right is not substantive because of the significant costs involved in outfitting another aircraft to meet the specifications required by the contract such that Supplier is not expected to benefit economically from substituting the aircraft.

Customer has the right to control the use of the aircraft throughout the two-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the aircraft over the two-year period of use. Customer has exclusive use of the aircraft throughout the period of use.
- (b) Customer has the right to direct the use of the aircraft because the conditions in paragraph AG25(a) exist. The restrictions on where the aircraft can fly define the scope of Customer's right to use the aircraft. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the aircraft is used throughout the two-year period of use because it decides whether, where and when the aircraft travels as well as the passengers and cargo it will transport. Customer has the right to change these decisions throughout the two-year period of use.

Although the operation of the aircraft is essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the aircraft is used. Consequently, Supplier does not control the use of the aircraft during the period of use and Supplier's decisions do not affect Customer's control of the use of the aircraft.

Example 8–Contract for Shirts

Customer enters into a contract with a producer (Supplier) to purchase a particular type, quality and quantity of shirts for a three-year period. The type, quality and quantity of shirts are specified in the contract.

Supplier has only one factory that can meet the needs of Customer. Supplier is unable to supply the shirts from another factory or source the shirts from a third party supplier. The capacity of the factory exceeds the

output for which Customer has contracted (i.e. Customer has not contracted for substantially all of the capacity of the factory).

Supplier makes all decisions about the operations of the factory, including the production level at which to run the factory and which customer contracts to fulfil with the output of the factory that is not used to fulfil Customer's contract.

The contract does not contain a lease.

The factory is an identified asset. The factory is implicitly specified because Supplier can fulfil the contract only through the use of this asset.

Customer does not control the use of the factory because it does not have the right to obtain substantially all of the economic benefits or service potential from use of the factory. This is because Supplier could decide to use the factory to fulfil other customer contracts during the period of use.

Customer also does not control the use of the factory because it does not have the right to direct the use of the factory. Customer does not have the right to direct how and for what purpose the factory is used during the three-year period of use. Customer's rights are limited to specifying output from the factory in the contract with Supplier. Customer has the same rights regarding the use of the factory as other customers purchasing shirts from the factory. Supplier has the right to direct the use of the factory because Supplier can decide how and for what purpose the factory is used (i.e. Supplier has the right to decide the production level at which to run the factory and which customer contracts to fulfil with the output produced).

Either the fact that Customer does not have the right to obtain substantially all of the economic benefits or service potential from use of the factory, or that Customer does not have the right to direct the use of the factory, would be sufficient in isolation to conclude that Customer does not control the use of the factory.

Example 9—Contract for Energy/Power

Example 9A: a public sector entity (Customer) enters into a contract with a power company (Supplier) to purchase all of the electricity produced by a new solar farm for 20 years. The solar farm is explicitly specified in the contract and Supplier has no substitution rights. The solar farm is owned by Supplier and the energy cannot be provided to Customer from another asset. Customer designed the solar farm before it was constructed—Customer hired experts in solar energy to assist in determining the location of the farm and the engineering of the equipment to be used. Supplier is responsible for building the solar farm to Customer's specifications, and then operating and maintaining it. There are no decisions to be made about whether, when or how much electricity will be produced because the design of the asset has predetermined those decisions. Supplier will receive tax credits relating to the construction and ownership of the solar farm, while Customer receives renewable energy credits that accrue from use of the solar farm.

The contract contains a lease. Customer has the right to use the solar farm for 20 years.

There is an identified asset because the solar farm is explicitly specified in the contract, and Supplier does not have the right to substitute the specified solar farm.

Customer has the right to control the use of the solar farm throughout the 20-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the solar farm over the 20-year period of use. Customer has exclusive use of the solar farm; it takes all of the electricity produced by the farm over the 20-year period of use as well as the renewable energy credits that are a by-product from use of the solar farm. Although Supplier will receive economic benefits from the solar farm in the form of tax credits, those economic benefits relate to the

ownership of the solar farm rather than the use of the solar farm and, thus, are not considered in this assessment.

- (b) Customer has the right to direct the use of the solar farm because the conditions in paragraph AG25(b)(ii) exist. Neither Customer, nor Supplier, decides how and for what purpose the solar farm is used during the period of use because those decisions are predetermined by the design of the asset (i.e. the design of the solar farm has, in effect, programmed into the asset any relevant decision-making rights about how and for what purpose the solar farm is used throughout the period of use). Customer does not operate the solar farm; Supplier makes the decisions about the operation of the solar farm. However, Customer's design of the solar farm has given it the right to direct the use of the farm. Because the design of the solar farm has predetermined how and for what purpose the asset will be used throughout the period of use, Customer's control over that design is substantively no different from Customer controlling those decisions.

Example 9B: Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for three years. The power plant is owned and operated by Supplier.

Supplier is unable to provide power to Customer from another plant. The contract sets out the quantity and timing of power that the power plant will produce throughout the period of use, which cannot be changed in the absence of extraordinary circumstances (for example, emergency situations). Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices. Supplier designed the power plant when it was constructed some years before entering into the contract with Customer—Customer had no involvement in that design.

The contract does not contain a lease.

There is an identified asset because the power plant is explicitly specified in the contract, and Supplier does not have the right to substitute the specified plant.

Customer has the right to obtain substantially all of the economic benefits or service potential from use of the identified power plant over the three-year period of use. Customer will take all of the power produced by the power plant over the three-year period of use.

However, Customer does not have the right to control the use of the power plant because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the plant is used. How and for what purpose the plant is used (i.e. whether, when and how much power the plant will produce) is predetermined in the contract. Customer has no right to change how and for what purpose the plant is used during the period of use. Customer has no other decision-making rights about the use of the power plant during the period of use (for example, it does not operate the power plant) and did not design the plant. Supplier is the only party that can make decisions about the plant during the period of use by making the decisions about how the plant is operated and maintained. Customer has the same rights regarding the use of the plant as if it were one of many customers obtaining power from the plant.

Example 9C: Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for 10 years. The contract states that Customer has rights to all of the power produced by the plant (i.e. Supplier cannot use the plant to fulfil other contracts).

Customer issues instructions to Supplier about the quantity and timing of the delivery of power. If the plant is not producing power for Customer, it does not operate.

Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices.

The contract contains a lease. Customer has the right to use the power plant for 10 years.

There is an identified asset. The power plant is explicitly specified in the contract and Supplier does not have the right to substitute the specified plant.

Customer has the right to control the use of the power plant throughout the 10-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the power plant over the 10-year period of use. Customer has exclusive use of the power plant; it has rights to all of the power produced by the power plant throughout the 10-year period of use.
- (b) Customer has the right to direct the use of the power plant because the conditions in paragraph AG25(a) exist. Customer makes the relevant decisions about how and for what purpose the power plant is used because it has the right to determine whether, when and how much power the plant will produce (i.e. the timing and quantity, if any, of power produced) throughout the period of use. Because Supplier is prevented from using the power plant for another purpose, Customer's decision-making about the timing and quantity of power produced, in effect, determines when, and whether, the plant produces output.

Although the operation and maintenance of the power plant are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the power plant is used. Consequently, Supplier does not control the use of the power plant during the period of use. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the power plant is used.

Example 10—Contract for Network Services

Example 10A: Customer enters into a contract with a telecommunications company (Supplier) for network services for two years. The contract requires Supplier to supply network services that meet a specified quality level. In order to provide the services, Supplier installs and configures servers at Customer's premises—Supplier determines the speed and quality of data transportation in the network using the servers. Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract. Customer does not operate the servers or make any significant decisions about their use.

The contract does not contain a lease. Instead, the contract is a service contract in which Supplier uses the equipment to meet the level of network services determined by Customer.

There is no need to assess whether the servers installed at Customer's premises are identified assets. This assessment would not change the analysis of whether the contract contains a lease because Customer does not have the right to control the use of the servers.

Customer does not control the use of the servers because Customer's only decision-making rights relate to deciding upon the level of network services (the output of the servers) before the period of use—the level of network services cannot be changed during the period of use without modifying the contract. For example, even though Customer produces the data to be transported, that activity does not directly affect the configuration of the network services and, thus, it does not affect how and for what purpose the servers are used.

Supplier is the only party that can make relevant decisions about the use of the servers during the period of use. Supplier has the right to decide how data is transported using the servers, whether to reconfigure the servers and whether to use the servers for another purpose. Accordingly, Supplier controls the use of the servers in providing network services to Customer.

Example 10B: Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years. Supplier delivers and installs the server at Customer's premises in accordance with Customer's instructions, and provides repair and maintenance services for the server, as needed, throughout the period of use. Supplier substitutes the server only in the case of malfunction. Customer decides which data to store on the server and how to integrate the server within its operations. Customer can change its decisions in this regard throughout the period of use.

The contract contains a lease. Customer has the right to use the server for three years.

There is an identified asset. The server is explicitly specified in the contract. Supplier can substitute the server only if it is malfunctioning (see paragraph AG19).

Customer has the right to control the use of the server throughout the three-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the server over the three-year period of use. Customer has exclusive use of the server throughout the period of use.
- (b) Customer has the right to direct the use of the server (because the conditions in paragraph AG25(a) exist). Customer makes the relevant decisions about how and for what purpose the server is used because it has the right to decide which aspect of its operations the server is used to support and which data it stores on the server. Customer is the only party that can make decisions about the use of the server during the period of use.

Leases of Low-Value Assets and Portfolio Application (see paragraphs 6–7, AG1 and AG4–AG9)

IE3. The following example illustrates how a lessee might (a) apply paragraphs AG4–AG9 of PBE IPSAS 43 to leases of low-value assets; and (b) determine portfolios of leases to which it would apply the requirements in PBE IPSAS 43.

Example 11— Leases of Low-Value Assets and Portfolio Application

A public sector entity (Lessee) with offices in each province/state of the country has the following leases:

- (a) *Leases of real estate (both office buildings and warehouses).*
- (b) *Leases of hospital equipment.*
- (c) *Leases of cars, both for services personnel and senior management and of varying quality, specification and value.*
- (d) *Leases of trucks and vans used for service delivery purposes, of varying size and value.*
- (e) *Leases of IT equipment for use by individual employees (such as laptop computers, desktop computers, hand held computer devices, desktop printers and mobile phones).*
- (f) *Leases of servers, including many individual modules that increase the storage capacity of those servers. The modules have been added to the mainframe servers over time as Lessee has needed to increase the storage capacity of the servers.*
- (g) *Leases of office equipment:*
 - (i) *Office furniture (such as chairs, desks and office partitions);*
 - (ii) *Water dispensers; and*
 - (iii) *High-capacity multifunction photocopier devices.*

Leases of low-value assets

Lessee determines that the following leases qualify as leases of low-value assets on the basis that the underlying assets, when new, are individually of low value:

- (a) Leases of IT equipment for use by individual employees; and
- (b) Leases of office furniture and water dispensers.

Lessee elects to apply the requirements in paragraph 7 of PBE IPSAS 43 in accounting for all of those leases.

Although each module within the servers, if considered individually, might be an asset of low value, the leases of modules within the servers do not qualify as leases of low-value assets. This is because each module is highly interrelated with other parts of the servers. Lessee would not lease the modules without also leasing the servers.

Portfolio application

As a result, Lessee applies the recognition and measurement requirements in PBE IPSAS 43 to its leases of real estate, hospital equipment, cars, trucks and vans, servers and high-capacity multifunction photocopier devices. In doing so, Lessee groups its cars, trucks and vans into portfolios.

Lessee's cars are leased under a series of master lease agreements. Lessee uses eight different types of car, which vary by price and are assigned to staff on the basis of seniority and territory. Lessee has a master lease agreement for each different type of car. The individual leases within each master lease agreement are all similar (including similar start and end dates), but the terms and conditions generally vary from one master lease agreement to another. Because the individual leases within each master lease agreement are similar to each other, Lessee reasonably expects that applying the requirements of PBE IPSAS 43 to each master lease agreement would not result in a materially different effect than applying the requirements of PBE IPSAS 43 to each individual lease within the master lease agreement. Consequently, Lessee concludes that it can apply the requirements of PBE IPSAS 43 to each master lease agreement as a portfolio. In addition, Lessee concludes that two of the eight master lease agreements are similar and cover substantially similar types of cars in similar territories. Lessee reasonably expects that the effect of applying PBE IPSAS 43 to the combined portfolio of leases within the two master lease agreements would not differ materially from applying PBE IPSAS 43 to each lease within that combined portfolio. Lessee, therefore, concludes that it can further combine those two master lease agreements into a single lease portfolio.

Lessee's trucks and vans are leased under individual lease agreements. There are 6,500 leases in total. All of the truck leases have similar terms, as do all of the van leases. The truck leases are generally for four years and involve similar models of truck. The van leases are generally for five years and involve similar models of van. Lessee reasonably expects that applying the requirements of PBE IPSAS 43 to portfolios of truck leases and van leases, grouped by type of underlying asset, territory and the quarter of the year within which the lease was entered into, would not result in a materially different effect from applying those requirements to each individual truck or van lease. Consequently, Lessee applies the requirements of PBE IPSAS 43 to different portfolios of truck and van leases, rather than to 6,500 individual leases.

Allocating Consideration to Components of a Contract (see paragraphs 13–17 and AG33–AG34)

- IE4. The following example illustrates the allocation of consideration in a contract to lease and non-lease components by a lessee.

Example 12—Lessee allocation of consideration to lease and non-lease components of a contract

Lessor leases a server, a medical ventilator and a computed tomography machine to Lessee to be used in Lessee's hospital operations for four years. Lessor also agrees to maintain each item of equipment throughout the lease term. The total consideration in the contract is CU600,000^(a), payable in annual instalments of CU150,000, and a variable amount that depends on the hours of work performed in maintaining the computed tomography machine. The variable payment is capped at 2 per cent of the replacement cost of the computed tomography machine. The consideration includes the cost of maintenance services for each item of equipment.

Lessee accounts for the non-lease components (maintenance services) separately from each lease of equipment applying paragraph 13 of PBE IPSAS 43. Lessee does not elect the practical expedient in paragraph 16 of PBE IPSAS 43. Lessee considers the requirements in paragraph AG33 of PBE IPSAS 43 and concludes that the lease of the server, the lease of the *medical ventilator* and the lease of the *computed tomography machine* are each separate lease components. This is because:

- (a) Lessee can benefit from use of each of the three items of equipment on its own or together with other readily available resources (for example, Lessee could readily lease or purchase an alternative medical ventilator or computed tomography machine to use in its operations); and
- (b) Although Lessee is leasing all three items of equipment for one purpose (i.e. to engage in hospital operations), the machines are neither highly dependent on, nor highly interrelated with, each other. Lessee's ability to derive benefit from the lease of each item of equipment is not significantly affected by its decision to lease, or not lease, the other equipment from Lessor.

Consequently, Lessee concludes that there are three lease components and three non-lease components (maintenance services) in the contract. Lessee applies the guidance in paragraphs 14–15 of PBE IPSAS 43 to allocate the consideration in the contract to the three lease components and the non-lease components.

Several suppliers provide maintenance services for a similar server and a similar medical ventilator. Accordingly, there are observable standalone prices for the maintenance services for those two items of leased equipment. Lessee is able to establish observable stand-alone prices for the maintenance of the server and the medical ventilator of CU32,000 and CU16,000, respectively, assuming similar payment terms to those in the contract with Lessor. The computed tomography machine is highly specialised and, accordingly, other suppliers do not lease or provide maintenance services for similar computed tomography machines. Nonetheless, Lessor provides four-year maintenance service contracts to customers that purchase similar computed tomography machine from Lessor. The observable consideration for those four-year maintenance service contracts is a fixed amount of CU56,000, payable over four years, and a variable amount that depends on the hours of work performed in maintaining the computed tomography machine. That variable payment is capped at 2 per cent of the replacement cost of the computed tomography machine. Consequently, Lessee estimates the stand-alone price of the maintenance services for the computed tomography machine to be CU56,000 plus any variable amounts. Lessee is able to establish observable stand-alone prices for the leases of the server, the desktop computer and the computed tomography machine of CU170,000, CU102,000 and CU224,000, respectively.

Lessee allocates the fixed consideration in the contract (CU600,000) to the lease and non-lease components as follows:

CU	Server	Medical ventilator	Computed tomography machine	Total
Lease	170.000	102.000	224.000	496.000
Non-lease				104.000
Total fixed consideration				600.000

Lessee allocates all of the variable consideration to the maintenance of the *computed tomography machine*, and, thus, to the non-lease components of the contract. Lessee then accounts for each lease component applying the guidance in PBE IPSAS 43, treating the allocated consideration as the lease payments for each lease component.

(a) In these Illustrative Examples, currency amounts are denominated in 'currency units' (CU).

Lessee Measurement (see paragraphs 19–42 and AG35–AG42)

IE5. The following example illustrates how a lessee measures right-of-use assets and lease liabilities. It also illustrates how a lessee accounts for a change in the lease term.

Example 13—Measurement by a Lessee and Accounting for a Change in the Lease Term

Part 1—Initial Measurement of the Right-of-Use Asset and the Lease Liability

Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000.

At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines that the lease term is 10 years.

The interest rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, receives the lease incentive from Lessor and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognises assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000
Right-of-use asset	CU20,000	
Cash (initial direct costs)		CU20,000
Cash (lease incentive)	CU5,000	

Right-of-use asset

CU5,000

Part 2—Subsequent Measurement and Accounting for a Change in the Lease Term

In the sixth year of the lease, Lessee acquires Entity A. Entity A has been leasing a floor in another building. The lease entered into by Entity A contains a termination option that is exercisable by Entity A. Following the acquisition of Entity A, Lessee needs two floors in a building suitable for the increased workforce. To minimise costs, Lessee (a) enters into a separate eight-year lease of another floor in the building leased that will be available for use at the end of Year 7 and (b) terminates early the lease entered into by Entity A with effect from the beginning of Year 8.

Moving Entity A's staff to the same building occupied by Lessee creates an economic incentive for Lessee to extend its original lease at the end of the non-cancellable period of 10 years. The acquisition of Entity A and the relocation of Entity A's staff is a significant event that is within the control of Lessee and affects whether Lessee is reasonably certain to exercise the extension option not previously included in its determination of the lease term. This is because the original floor has greater utility (and thus provides greater benefits) to Lessee than alternative assets that could be leased for a similar amount to the lease payments for the optional period—Lessee would incur additional costs if it were to lease a similar floor in a different building because the workforce would be located in different buildings. Consequently, at the end of Year 6, Lessee concludes that it is now reasonably certain to exercise the option to extend its original lease as a result of its acquisition and planned relocation of Entity A.

Lessee's incremental borrowing rate at the end of Year 6 is 6 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a nine-year term, and with similar collateral. Lessee expects to consume the right-of-use asset's future economic benefits or service potential evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

The right-of-use asset and the lease liability from Year 1 to Year 6 are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance CU	Lease payment CU	5% interest expense CU	Ending balance CU	Beginning balance CU	Depreciated on charge CU	Ending balance CU
1	355,391	-	17,770	373,161	420,391	(42,039)	378,352
2	373,161	(50,000)	16,158	339,319	378,352	(42,039)	336,313
3	339,319	(50,000)	14,466	303,785	336,313	(42,039)	294,274
4	303,785	(50,000)	12,689	266,474	294,274	(42,039)	252,235
5	266,474	(50,000)	10,823	227,297	252,235	(42,039)	210,196
6	227,297	(50,000)	8,865	186,162	210,196	(42,039)	168,157

At the end of the sixth year, before accounting for the change in the lease term, the lease liability is CU186,162 (the present value of four remaining payments of CU50,000, discounted at the original interest

rate of 5 per cent per annum). Interest expense of CU8,865 is recognised in Year 6. Lessee's right-of-use asset is CU168,157.

Lessee remeasures the lease liability at the present value of four payments of CU50,000 followed by five payments of CU55,000, all discounted at the revised discount rate of 6 per cent per annum, which is CU378,174. Lessee increases the lease liability by CU192,012, which represents the difference between the remeasured liability of CU378,174 and its previous carrying amount of CU186,162. The corresponding adjustment is made to the right-of-use asset to reflect the cost of the additional right of use, recognised as follows.

Right-of-use asset	CU192,012
Lease liability	CU192,012

Following the remeasurement, the carrying amount of Lessee's right-of-use asset is CU360,169 (i.e. CU168,157 + CU192,012). From the beginning of Year 7 Lessee calculates the interest expense on the lease liability at the revised discount rate of 6 per cent per annum.

The right-of-use asset and the lease liability from Year 7 to Year 15 are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance CU	Lease payment CU	6% interest expense CU	Ending balance CU	Beginning balance CU	Depreciation charge CU	Ending balance CU
7	378,174	(50,000)	19,690	347,864	360,169	(40,019)	320,150
8	347,864	(50,000)	17,872	315,736	320,150	(40,019)	280,131
9	315,736	(50,000)	15,944	281,680	280,131	(40,019)	240,112
10	281,680	(50,000)	13,901	245,581	240,112	(40,019)	200,093
11	245,581	(55,000)	11,435	202,016	200,093	(40,019)	160,074
12	202,016	(55,000)	8,821	155,837	160,074	(40,019)	120,055
13	155,837	(55,000)	6,050	106,887	120,055	(40,019)	80,036
14	106,887	(55,000)	3,113	55,000	80,036	(40,018)	40,018
15	55,000	(55,000)	-	-	40,018	(40,018)	-

Variable Lease Payments (see paragraphs 28, 40, 43(b) and 44)

IE6. The following example illustrates how a lessee accounts for variable lease payments that depend on an index and variable lease payments not included in the measurement of the lease liability.

Example 14—Variable Lease Payments Dependent on an Index and Variable Lease Payments Linked to Sales

Example 14A—Lessee enters into a 10-year lease of property with annual lease payments of CU50,000, payable at the beginning of each year. The contract specifies that lease payments will increase every two years on the basis of the increase in the Consumer Price Index for the preceding 24 months. The Consumer

Price Index at the commencement date is 125. This example ignores any initial direct costs. The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognises assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000

Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

During the first two years of the lease, Lessee recognises in aggregate the following related to the lease.

Interest expense	CU33,928	
Lease liability		CU33,928
Depreciation charge	CU81,078 (CU405,391 ÷ 10 × 2 years)	
Right-of-use asset		CU81,078

At the beginning of the second year, Lessee makes the lease payment for the second year and recognises the following.

Lease liability	CU50,000	
Cash		CU50,000

At the beginning of the third year, before accounting for the change in future lease payments resulting from a change in the Consumer Price Index and making the lease payment for the third year, the lease liability is CU339,319 (the present value of eight payments of CU50,000 discounted at the interest rate of 5 per cent per annum = CU355,391 + CU33,928 – CU50,000).

At the beginning of the third year of the lease the Consumer Price Index is 135.

The payment for the third year, adjusted for the Consumer Price Index, is CU54,000 (CU50,000 × 135 ÷ 125). Because there is a change in the future lease payments resulting from a change in the Consumer Price Index used to determine those payments, Lessee remeasures the lease liability to reflect those revised lease payments, i.e. the lease liability now reflects eight annual lease payments of CU54,000.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of CU54,000 discounted at an unchanged discount rate of 5 per cent per annum, which is CU366,464. Lessee increases the lease liability by CU27,145, which represents the difference between the remeasured liability of CU366,464 and its previous carrying amount of CU339,319. The corresponding adjustment is made to the right-of-use asset, recognised as follows.

Right-of-use asset	CU27,145	
Lease liability		CU27,145

At the beginning of the third year, Lessee makes the lease payment for the third year and recognises the following.

Lease liability	CU54,000	
Cash		CU54,000

Example 14B—Assume the same facts as Example 14A except that Lessee is also required to make variable lease payments for each year of the lease, which are determined as 1 per cent of Lessee’s sales generated from the leased property.

At the commencement date, Lessee measures the right-of-use asset and the lease liability recognised at the same amounts as in Example 14A. This is because the additional variable lease payments are linked to future sales and, thus, do not meet the definition of lease payments. Consequently, those payments are not included in the measurement of the asset and liability.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000

Lessee prepares financial statements on an annual basis. During the first year of the lease, Lessee generates sales of CU800,000 from the leased property.

Lessee incurs an additional expense related to the lease of CU8,000 ($CU800,000 \times 1$ per cent), which Lessee recognises in surplus or deficit in the first year of the lease.

Lease Modifications (see paragraphs 45–47)

IE7. Examples 15–19 illustrate the requirements of IPSAS 43 regarding lease modifications for a lessee.

Example 15—Modification that is a Separate Lease

Lessee enters into a 10-year lease for 2,000 square meters of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square meters of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square meters of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).

Lessee accounts for the modification as a separate lease, separate from the original 10-year lease. This is because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract. In this example, the additional underlying asset is the new 3,000 square meters of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognises a right-of-use asset and a lease liability relating to the lease of the additional 3,000 square meters of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square meters of office space as a result of this modification.

Example 16—Modification that Increases the Scope of the Lease by Extending the Contractual Lease Term

Lessee enters into a 10-year lease for 5,000 square meters of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily

determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e. CU100,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7 per cent per annum.

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on: (a) an eight-year remaining lease term, (b) annual payments of CU100,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified lease liability equals CU597,130. The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is CU346,511. Lessee recognises the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (CU250,619) as an adjustment to the right-of-use asset.

Example 17—Modification that Decreases the Scope of the Lease

Lessee enters into a 10-year lease for 5,000 square meters of office space. The annual lease payments are CU50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square meters of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are CU30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5 per cent per annum.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU30,000 and (c) Lessee's incremental borrowing rate of 5 per cent per annum. This equals CU129,884.

Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset on the basis of the remaining right-of-use asset (i.e., 2,500 square meters corresponding to 50 per cent of the original right-of-use asset).

50 per cent of the pre-modification right-of-use asset (CU184,002) is CU92,001. Fifty per cent of the pre-modification lease liability (CU210,618) is CU105,309. Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU92,001 and the carrying amount of the lease liability by CU105,309. Lessee recognises the difference between the decrease in the lease liability and the decrease in the right-of-use asset ($CU105,309 - CU92,001 = CU13,308$) as a gain in surplus or deficit at the effective date of the modification (at the beginning of Year 6).

Lessee recognises the difference between the remaining lease liability of CU105,309 and the modified lease liability of CU129,884 (which equals CU24,575) as an adjustment to the right-of-use asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Example 18—Modification that Both Increases and Decreases the Scope of the Lease

Lessee enters into a 10-year lease for 2,000 square meters of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to (a) include an additional 1,500 square meters of space in the same building starting from the beginning of Year 6 and (b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square meters is CU150,000

payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum.

The consideration for the increase in scope of 1,500 square meters of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square meters of space as a separate lease.

The pre-modification right-of-use asset and the pre-modification lease liability in relation to the lease are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance	6% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
1	736,009	44,160	(100,000)	680,169	736,009	(73,601)	662,408
2	680,169	40,810	(100,000)	620,979	662,408	(73,601)	588,807
3	620,979	37,259	(100,000)	558,238	588,807	(73,601)	515,206
4	558,238	33,494	(100,000)	491,732	515,206	(73,601)	441,605
5	491,732	29,504	(100,000)	421,236	441,605	(73,601)	368,004
6	421,236				368,004		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of: (a) a three-year remaining lease term, (b) annual payments of CU150,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified liability equals CU393,647, of which (a) CU131,216 relates to the increase of CU50,000 in the annual lease payments from Year 6 to Year 8 and (b) CU262,431 relates to the remaining three annual lease payments of CU100,000 from Year 6 to Year 8.

Decrease in the lease term

At the effective date of the modification (at the beginning of Year 6), the pre-modification right-of-use asset is CU368,004. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset for the original 2,000 square meters of office space (i.e. a remaining three-year lease term rather than the original five-year lease term). The remaining right-of-use asset for the original 2,000 square meters of office space is CU220,802 (i.e. $CU368,004 \div 5 \times 3$ years).

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is CU421,236. The remaining lease liability for the original 2,000 square meters of office space is CU267,301 (i.e. present value of three annual lease payments of CU100,000, discounted at the original discount rate of 6 per cent per annum).

Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU147,202 ($CU368,004 - CU220,802$), and the carrying amount of the lease liability by CU153,935 ($CU421,236 - CU267,301$). Lessee recognises the difference between the decrease in the lease liability and the decrease in the right-of-use asset ($CU153,935 - CU147,202 = CU6,733$) as a gain in surplus or deficit at the effective date of the modification (at the beginning of Year 6).

ED PBE IPSAS 43 LEASES

Lease liability	CU153,935	
Right-of-use asset		CU147,202
Gain		CU6,733

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7 per cent per annum, which is CU4,870 (CU267,301 – CU262,431), as an adjustment to the right-of-use asset.

Lease liability	CU4,870	
Right-of-use asset		CU4,870

Increase in the leased space

At the commencement date of the lease for the additional 1,500 square meters of space (at the beginning of Year 6), Lessee recognises the increase in the lease liability related to the increase in scope of CU131,216 (i.e. present value of three annual lease payments of CU50,000, discounted at the revised interest rate of 7 per cent per annum) as an adjustment to the right-of-use asset.

Right-of-use asset	CU131,216	
Lease liability		CU131,216

The modified right-of-use asset and the modified lease liability in relation to the modified lease are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance	7% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
6	393,647	27,556	(150,000)	271,203	347,148	(115,716)	231,432
7	271,203	18,984	(150,000)	140,187	231,432	(115,716)	115,716
8	140,187	9,813	(150,000)	-	115,716	(115,716)	-

Example 19—Modification that is a Change in Consideration Only

Lessee enters into a 10-year lease for 5,000 square meters of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from CU100,000 per year to CU95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum. The annual lease payments are payable at the end of each year.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU95,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. Lessee recognises the difference between the carrying amount of the modified liability (CU389,519) and the lease liability immediately before the modification (CU421,236) of CU31,717 as an adjustment to the right-of-use asset.

Subleases (see paragraph AG59)

IE8. Examples 20–21 illustrate the application of the requirements in PBE IPSAS 43 for an intermediate lessor that enters into a head lease and a sublease of the same underlying asset.

Example 20—Sublease Classified as a Finance Lease

Head lease—An intermediate lessor enters into a five-year lease for 5,000 square meters of office space (the head lease) with Entity A (the head lessor).

Sublease—At the beginning of Year 3, the intermediate lessor subleases the 5,000 square meters of office space for the remaining three years of the head lease to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as a finance lease, having considered the requirements in paragraphs 65–70 of PBE IPSAS 43.

When the intermediate lessor enters into the sublease, the intermediate lessor:

- (a) Derecognises the right-of-use asset relating to the head lease that it transfers to the sublessee and recognises the net investment in the sublease;
- (b) Recognises any difference between the right-of-use asset and the net investment in the sublease in surplus or deficit; and
- (c) Retains the lease liability relating to the head lease in its statement of financial position, which represents the lease payments owed to the head lessor.

During the term of the sublease, the intermediate lessor recognises both finance revenue on the sublease and interest expense on the head lease (Entity A).

Example 21—Sublease Classified as Operating Lease

Head lease—An intermediate lessor enters into a five-year lease for 5,000 square meters of office space (the head lease) with Entity A (the head lessor).

Sublease—At commencement of the head lease, the intermediate lessor subleases the 5,000 square meters of office space for two years to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as an operating lease, having considered the requirements in paragraphs 65–70 of PBE IPSAS 43.

When the intermediate lessor enters into the sublease, the intermediate lessor retains the lease liability and the right-of-use asset relating to the head lease in its statement of financial position.

During the term of the sublease, the intermediate lessor:

- (a) Recognises a depreciation charge for the right-of-use asset and interest on the lease liability; and
- (b) Recognises lease revenue from the sublease.

Lessee Disclosure (see paragraphs 62 and AG50–AG51)

IE9. Example 22 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 62 and AG50 of PBE IPSAS 43 about variable lease payments. This

example shows only current period information. PBE IPSAS 1 *Presentation of Financial Reports* requires an entity to present comparative information.

Example 22—Variable Payment Terms

Lessee with a High Volume of Leases with Some Consistent Payment Terms

Example 22A: Crown Entity XYZ (Lessee) operates four tourism outlets selling touristic merchandise about the city—A, B, C and D. Lessee has a high volume of property leases. Lessee’s policy is to negotiate variable payment terms for newly established tourism outlets. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the proportion of total lease payments that arise from variable payments, and the sensitivity of those variable lease payments to changes in sales, is the information that is relevant to users of its financial statements. This information is similar to that reported to Lessee’s senior management about variable lease payments.

Some of the property leases within the city contain variable payment terms that are linked to sales generated from the tourism outlet. Variable payment terms are used, when possible, in newly established tourism outlets in order to link rental payments to tourism outlet cash flows and minimise fixed costs. Fixed and variable rental payments by tourism outlet for the period ended 31 December 20X0 are summarised below.

	Tourism outlet	Fixed payments	Variable payments	Total payments	Estimated annual impact on total tourism outlet rent of a 1% increase in sales
		No.	CU	CU	CU
A	4,522	3,854	120	3,974	0.03%
B	965	865	105	970	0.11%
C	124	26	163	189	0.86%
D	652	152	444	596	0.74%
	6,263	4,897	832	5,729	0.15%

Example 22B: Crown Entity XYZ (Lessee) has a high volume of property leases of tourism outlets selling touristic merchandise about the city. Many of these leases contain variable payment terms linked to sales from the store. Lessee’s group policy sets out the circumstances in which variable payment terms are used and all lease negotiations must be approved centrally. Lease payments are monitored centrally. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the different types of contractual terms it uses with respect to variable lease payments, the effect of those terms on its financial performance and the sensitivity of variable lease payments to changes in sales is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee’s senior management about variable lease payments.

Many of Crown Entity XYZ’s property leases contain variable payment terms that are linked to the volume of sales made from leased tourism outlets. These terms are used, when possible, in order to match lease payments with tourism outlets generating higher cash flows. For individual tourism outlets, up to 100 per

cent of lease payments are on the basis of variable payment terms and there is a wide range of sales percentages applied. In some cases, variable payment terms also contain minimum annual payments and caps.

Lease payments and terms for the period ended 31 December 20X0 are summarised below.

	Tourism outlets	Fixed payments	Variable payments	Total payments
	No.	CU	CU	CU
Fixed rent only	1,490	1,153	-	1,153
Variable rent with no minimum	986	-	562	562
Variable rent with minimum	3,089	1,091	1,435	2,526
	5,565	2,244	1,997	4,241

A 1 per cent increase in sales across all tourism outlets in the public sector entity would be expected to increase total lease payments by approximately 0.6–0.7 per cent. A 5 per cent increase in sales across all tourism outlets in the public sector entity would be expected to increase total lease payments by approximately 2.6–2.8 per cent.

Lessee with a High Volume of Leases with a Wide Range of Different Payment Terms

Example 22C: Crown Entity XYZ (Lessee) has a high volume of property leases of tourism outlets selling touristic merchandise about the city. These leases contain a wide range of different variable payment terms. Lease terms are negotiated and monitored by local management. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee concludes that information about how its property lease portfolio is managed is the information that is relevant to users of its financial statements. Lessee also concludes that information about the expected level of variable lease payments in the coming year (similar to that reported internally to senior management) is also relevant to users of its financial statements.

Many of the property leases within the city contain variable payment terms. Local management are responsible for store margins. Accordingly, lease terms are negotiated by local management and contain a wide range of payment terms. Variable payment terms are used for a variety of reasons, including minimising the fixed cost base for newly established tourism outlets or for reasons of margin control and operational flexibility. Variable lease payment terms vary widely across the city:

- (a) The majority of variable payment terms are based on a range of percentages of tourism outlet sales;
- (b) Lease payments based on variable terms range from 0–20 per cent of total lease payments on an individual property; and
- (c) Some variable payment terms include minimum or cap clauses.

The overall financial effect of using variable payment terms is that higher rental costs are incurred by tourism outlet with higher sales. This facilitates the management of margins across the city's tourism outlets.

Variable rent expenses are expected to continue to represent a similar proportion of store sales in future years.

- IE10. Example 23 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 62 and AG51 of PBE IPSAS 43 about extension options and termination options. This example shows only current period information. PBE IPSAS 1 requires an entity to present comparative information.

Example 23—Extension Options and Termination Options

Lessee with a High Volume of Leases, that Have a Wide Range of Different Terms and Conditions, which are not Managed Centrally

Example 23A: Lessee has a high volume of equipment leases with a wide range of different terms and conditions. Lease terms are negotiated and monitored by local management. Lessee concludes that information about how it manages the use of termination and extension options is the information that is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee also concludes that information about (a) the financial effect of reassessing options and (b) the proportion of its short-term lease portfolio resulting from leases with annual break clauses is also relevant to users of its financial statements.

Extension and termination options are included in a number of equipment leases across the economic entity. Local teams are responsible for managing their leases and, accordingly, lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Extension and termination options are included, when possible, to provide local management with greater flexibility to align its need for access to equipment with the fulfilment of customer contracts. The individual terms and conditions used vary across the economic entity.

The majority of extension and termination options held are exercisable only by Lessee and not by the respective lessors. In cases in which Lessee is not reasonably certain to use an optional extended lease term, payments associated with the optional period are not included within lease liabilities.

During 20X0, the financial effect of revising lease terms to reflect the effect of exercising extension and termination options was an increase in recognised lease liabilities of CU489.

In addition, Lessee has a number of lease arrangements containing annual break clauses at no penalty. These leases are classified as short-term leases and are not included within lease liabilities. The short-term lease expense of CU30 recognised during 20X0 included CU27 relating to leases with an annual break clause.

Lessee with a High Volume of Leases with Some Consistent Terms and Options

Example 23B: City Council XYZ (Lessee) has a high volume of property leases containing penalty free termination options that are exercisable at the option of Lessee. Lessee's policy is to have termination options in leases of more than five years, whenever possible. Lessee has a central property team that negotiates leases. Lessee concludes that information about termination options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about (a) the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) the proportion of termination options that have been exercised historically is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about termination options.

Many of the property leases across the city contain termination options. These options are used to limit the period to which the city is committed to individual lease contracts and to maximise operational flexibility in terms of opening and closing individual offices. For most leases of offices, recognised lease liabilities do not include potential future rental payments after the exercise date of termination options because Lessee is not reasonably certain to extend the lease beyond that date. This is the case for most leases for which a longer lease period can be enforced only by Lessee and not by the landlord, and for which there is no penalty associated with the option.

Potential future rental payments relating to periods following the exercise date of termination options are summarised below.

Segment	Lease liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (undiscounted)		
		Payable during 20X1–20X5	Payable during 20X6–20Y0	Total
	CU	CU	CU	CU
Operation A	569	71	94	165
Operation B	2,455	968	594	1,562
Operation C	269	99	55	154
Operation D	1,002	230	180	410
Operation E	914	181	321	502
	5,209	1,549	1,244	2,793

The table below summarises the rate of exercise of termination options during 20X0.

Segment	Termination option exercisable during 20X0	Termination option not exercised	Termination option exercised
	No. of leases	No. of leases	No. of leases
Operation A	33	30	3
Operation B	86	69	17
Operation C	19	18	1
Operation D	30	5	25
Operation E	66	40	26
	234	162	72

Example 23C: Lessee has a high volume of large equipment leases containing extension options that are exercisable by Lessee during the lease. Lessee's policy is to use extension options to align, when possible, committed lease terms for large equipment with the initial contractual term of associated customer contracts, whilst retaining flexibility to manage its large equipment and reallocate assets across contracts. Lessee concludes that information about extension options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that (a) information about the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) information about the historical rate of exercise of extension options is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about extension options.

Many of the large equipment leases across the city contain extension options. These terms are used to maximise operational flexibility in terms of managing contracts. These terms are not reflected in measuring lease liabilities in many cases because the options are not reasonably certain to be exercised. This is generally the case when the underlying large equipment has not been allocated for use on a particular customer contract after the exercise date of an extension option. The table below summarises potential future rental payments relating to periods following the exercise dates of extension options.

Segment	Lease liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (discounted)	Historical rate of exercise of extension options
	CU	CU	%
Operation A	569	799	52%
Operation B	2,455	269	69%
Operation C	269	99	75%
Operation D	1,002	111	41%
Operation E	914	312	76%
	5,209	1,590	67%

Sale and Leaseback Transactions (see paragraphs 97–102)

IE11. Example 24 illustrates the application of the requirements in paragraphs 97–102 of PBE IPSAS 43 for a seller-lessee and a buyer-lessor.

Example 24—Sale and Leaseback Transaction

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. 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 NZ IFRS 15 Revenue from Contracts with Customers. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback. This example ignores any initial direct costs.

The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. The amount of the excess sale price of CU200,000 (CU2,000,000 – CU1,800,000) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) amounts to CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease—corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.

Seller-lessee

At the commencement date, Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. This is calculated as: CU1,000,000 (the carrying amount of the building) ÷ CU1,800,000 (the fair value of the building) × CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset).

ED PBE IPSAS 43 *LEASES*

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

- (a) CU559,645 ($CU800,000 \div CU1,800,000 \times CU1,259,200$) relates to the right to use the building retained by Seller-lessee; and
- (b) CU240,355 ($CU800,000 \div CU1,800,000 \times (CU1,800,000 - CU1,259,200)$) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU2,000,000	
Right-of-use asset	CU699,555	
Building		CU1,000,000
Financial liability		CU1,459,200
Gain on rights transferred		CU240,355

Buyer-lessor

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Financial asset	CU200,000 (18 payments of CU16,447, discounted at 4.5 per cent per annum)	
Cash		CU2,000,000

After the commencement date, Buyer-lessor accounts for the lease by treating CU103,553 of the annual payments of CU120,000 as lease payments. The remaining CU16,447 of annual payments received from Seller-lessee are accounted for as (a) payments received to settle the financial asset of CU200,000 and (b) interest revenue.

Comparison with IPSAS 43

PBE IPSAS 43 *Leases* is drawn from IPSAS 43 *Leases*.

The significant differences between PBE IPSAS 43 and IPSAS 43 are:

- (a) PBE IPSAS 43 includes scope clarification paragraphs 4.1 and 4.2. These paragraphs clarify that concessionary leases that meet the definition of a lease are within the scope of the Standard – but an entity applies the measurement requirements of this Standard based on the lease payments as per the lease agreement, and not based on what the lease payments would have been had the lease been at market terms. The scope clarification paragraphs also clarify that an arrangement that confers the right to use an asset for a specified period of time for no consideration does not meet the definition of a lease. These paragraphs will be reconsidered when the IPSASB finalises its project on *Other Lease-type Arrangements*.
- (b) PBE IPSAS 43 includes additional consequential amendments to PBE IPSAS 23 *Revenue from Non-exchange Transactions*. These amendments clarify that leases within the scope of PBE IPSAS 43, as well as arrangements that confer the right to use an asset for a specified period of time for no consideration, are outside the scope of PBE IPSAS 23. This scope exclusion will be reconsidered when the IPSASB finalises its project on *Other Lease-type Arrangements*.
- (c) IPSAS 43 provides an optional practical expedient for the accounting for COVID-19-related rent concessions. This practical expedient is limited to lease payments that would have been due on or before 1 July 2022. Given the timing of the issuance of PBE IPSAS 43, the practical expedient is not included in PBE IPSAS 43.
- (d) PBE IPSAS 43 includes amendments equivalent to those issued by the International Accounting Standards Board to provide relief to entities affected by the phasing out of interest-rate benchmarks, such as interbank offered rates.
- (e) PBE IPSAS 43 includes additional consequential amendments to certain PBE Standards that are based on NZ IFRS – such as PBE FRS 47 (based on NZ IFRS 1), PBE IFRS 4 (based on NZ IFRS 4) and PBE IAS 12 *Income Taxes*. The amendments are based on equivalent amendments to the relevant NZ IFRS.
- (f) PBE IPSAS 43 includes RDR concessions for public benefit entities in Tier 2. These concessions are aligned with those provided in NZ IFRS 16 *Leases*.

Proposed new lease accounting standard

Tier 1 & 2 Public Benefit Entities

PBE IPSAS 43 *Leases*

Consultation document



August 2022

Comment period closes 25 November 2022



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PART ONE: Introduction





1. What is this consultation about?

Many public benefit entities (PBEs) in both the public and the not-for-profit sector enter into different forms of leasing arrangements.

This consultation proposes to introduce a new lease accounting standard based on the recently-issued IPSASB standard IPSAS 43 *Leases*. The proposals require lessees to recognise almost all leases on the statement of financial position and removes the distinction between operating leases and finance leases. For lessors, the accounting requirements remain largely unchanged.

The proposals are aligned with international accounting standards issued by the IPSASB and IASB – allowing New Zealand PBEs to benefit from the latest international thinking on leases. The proposals would also enhance transparency around PBEs' leases and increase comparability between the financial statements of PBEs that lease assets and those that purchase assets. As the proposals are aligned with the lease accounting requirements for for-profit entities, the proposals will make it easier for 'mixed groups' that contain both PBEs and for-profit entities to prepare group financial statements.

Background

In January 2022, the IPSASB issued IPSAS 43 *Leases*, which is aligned with NZ IFRS 16 *Leases*.

IPSAS 43 superseded the IPSASB's old leasing standard, IPSAS 13 *Leases*. Under IPSAS 13, lessees classified leases as 'operating leases' or 'finance leases' – finance leases were recognised as assets and liabilities on the balance sheet, whereas 'operating leases' were not. Instead, operating lease payments were treated as expenses in surplus/deficit over the lease term. In New Zealand, PBEs currently apply PBE IPSAS 13 *Leases*, which is based on the requirements of IPSAS 13.

When proposing to issue a new PBE Standard based on an IPSAS, we consider and seek feedback on the need for New Zealand-specific amendments and/or guidance.

The accompanying Exposure Draft (ED) PBE IPSAS 43 *Leases* is a draft of the proposed New Zealand accounting standard which would be applicable to Tier 1 and Tier 2 PBEs.

Note on concessionary leases

Our proposals, consistent with IPSAS 43, do not include specific requirements for the accounting for the 'concessionary portion' of concessionary leases and similar arrangements.

The IPSASB has a separate ongoing project on the accounting for concessionary leases (i.e. leases with below-market terms) and other lease-like arrangements, such as arrangements where an entity has a right to use an asset over a specified period of time for *no* consideration. The IPSASB expects to issue an ED on *Other Lease-type Arrangements* in December 2022.

ED PBE IPSAS 43 proposals clarify that while concessionary leases that involve the lessee paying consideration are within the scope of the standard (as they meet the definition of a lease), such leases are accounted for by taking into account the agreed lease payments as per the lease agreement, rather than what the lease payments would have been had the lease been on market terms.

We have previously consulted in New Zealand on the IPSASB's exposure drafts (EDs) on leases, which contained the proposals that are now finalised in IPSAS 43. The feedback we received indicated **broad support** for the proposals to align lease accounting with IFRS 16, except for concerns with respect to accounting for concessionary leases.

We note that the proposed PBE IPSAS 43 does not require PBEs to account for the concessionary portion of a concessionary lease at fair value, and does not contain specific requirements for concessionary leases.



Benefits of the proposals

The proposed PBE IPSAS 43 is expected to result in the following benefits, which are consistent with those that led to the introduction of NZ IFRS 16 *Leases* in the for-profit sector.



Increased transparency: The proposals require lessees to recognise a ‘right of use’ asset and a lease liability with respect to all leases, with limited exemptions. Recognition of these assets and liabilities on the balance sheet would increase transparency in relation to the resources available to the public benefit entity as a result of lease agreements, and the public benefit entity’s obligations to make lease payments. This also means that for users of financial statements, the statement of financial position will provide a ‘fuller picture’ of the resources that a public benefit entity uses in its operations – and which generate service potential and/or economic benefit for the public benefit entity – and the public benefit entity’s obligations for future payments.



Eliminate information asymmetry: Under the current requirements, if a user of financial statements wants to know how the public benefit entity’s financial position is impacted by its operating lease obligations, the user would need to make adjustments to the amounts shown in the statement of financial position, based on the lease commitments disclosures in the notes. However, different users would use different techniques to make such adjustments, and the level of detail provided in lease commitments disclosure notes may vary. The recognition of (almost all) leases on the statement of financial position would mean that users no longer need to make such adjustments using different techniques. Therefore, from a user perspective, there would be less ‘information asymmetry’ under the proposals.



Increased comparability: By requiring lessees to recognise a right-of-use asset and a lease liability for (almost all) leases, the proposals would increase comparability between the financial statements of public benefit entities that lease assets and those that purchase assets. At the same time, the proposals still reflect the economic differences between the two types of transactions (for example, the lessee recognises the right to use the leased asset, rather than the underlying asset itself).



Alignment with the latest international thinking: The proposals are based on the IPSASB’s latest standard on leases, IPSAS 43 – which is in turn substantially aligned with the IASB’s IFRS 16 *Leases*. Thus, the proposals reflect the latest international thinking on lease accounting.



Easier reporting for ‘mixed groups’: The proposed PBE IPSAS 43 is substantially aligned with NZ IFRS 16 *Leases*. For public benefit entities with for-profit subsidiaries – sometimes called ‘mixed groups’ – this means that fewer accounting adjustments are needed when preparing the consolidated group financial statements.

Purpose of this Consultation Document

The purpose of this Consultation Document is to seek comments on the proposals set out in the ED.

Timeline and next steps

Submissions on the ED are due by 25 November 2022. Information on how to make submissions is provided on page 6 of this Consultation Document.

After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue the amendments.



2. How to provide feedback

Responding to consultation questions

The New Zealand Accounting Standards Board (NZASB) is seeking comments on the specific matters raised in this Consultation Document. We will consider all comments before finalising the proposals for PBE IPSAS 43 *Leases*.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to comment on only those questions, or issues that are relevant to you.

Making a submission

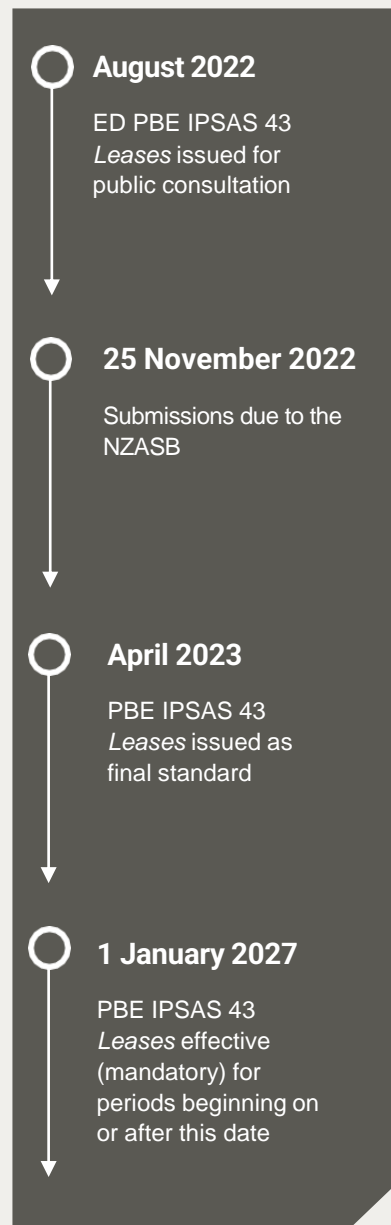
Comments should be submitted electronically using our 'Accounting Standards open for consultation' page (under 'New Zealand consultations') at:

<https://xrb.govt.nz/consultations/accounting-standards-open-for-consultation/>

Please include PBE IPSAS 43 *Leases* in the subject line and indicate whether the comments are made on your own behalf, or on behalf of a group of people, or an entity.

The closing date for submissions is 25 November 2022.

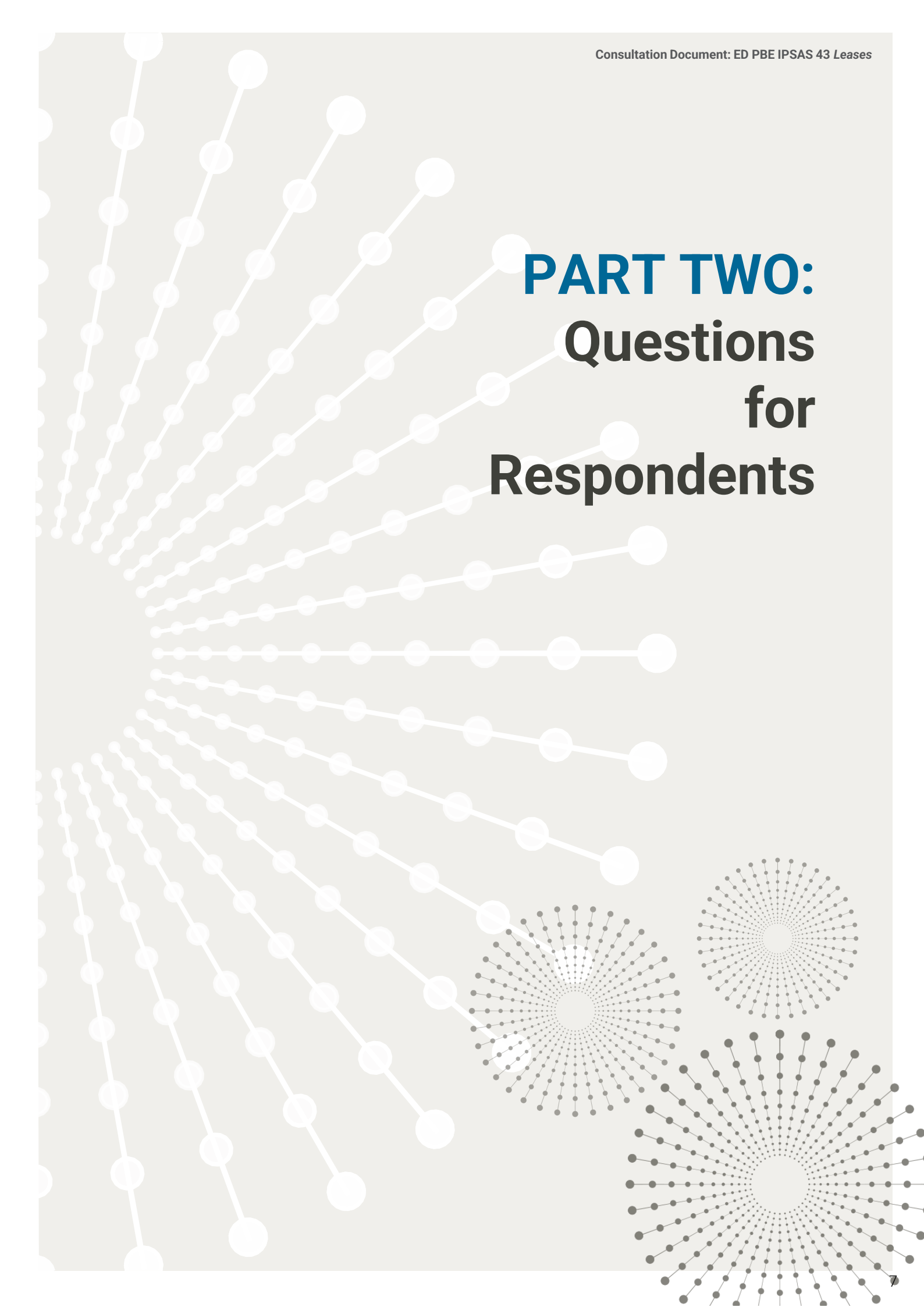
Project Timeline



Publication of submissions, the Official Information Act and the Privacy Act

We intend on publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the XRB website. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).



PART TWO: **Questions** **for** **Respondents**



3. Questions for respondents

The questions for respondents focus on the proposed New Zealand specific amendments to IPSAS 43, as discussed in Section 4 of this Consultation Document.

Clarification of the scope of PBE IPSAS 43 with respect to concessionary leases (Section 4.4)

1. Do you agree with the proposed scope clarification with respect to concessionary leases? That is, do you agree with the clarification that:
 - Concessionary leases that meet the definition of a lease are in the scope of the proposed PBE IPSAS 43;
 - Arrangements that confer the right to use an asset for a specified period of time for no consideration do not meet the definition of a lease in the proposed PBE IPSAS 43; and
 - In applying the measurement requirements in PBE IPSAS 43, an entity takes into account the lease payments as per the lease agreement, and not the lease payments that would have been charged had the lease been on market terms?*
- * Except that an entity would measure its right of use asset at fair value after initial recognition if it is required or elects to do under paragraphs 35 or 36 of PBE IPSAS 43, or if it is a first-time adopter of PBE Standards and elects to use fair value as 'deemed cost' for a right-of-use asset.

Leases of low-value assets (Section 4.5)

2. Do you agree that the assessment of whether a leased asset is of 'low value' should be performed on an absolute value basis for each individual leased asset, as proposed in the ED? If not, on what basis should this assessment be performed?

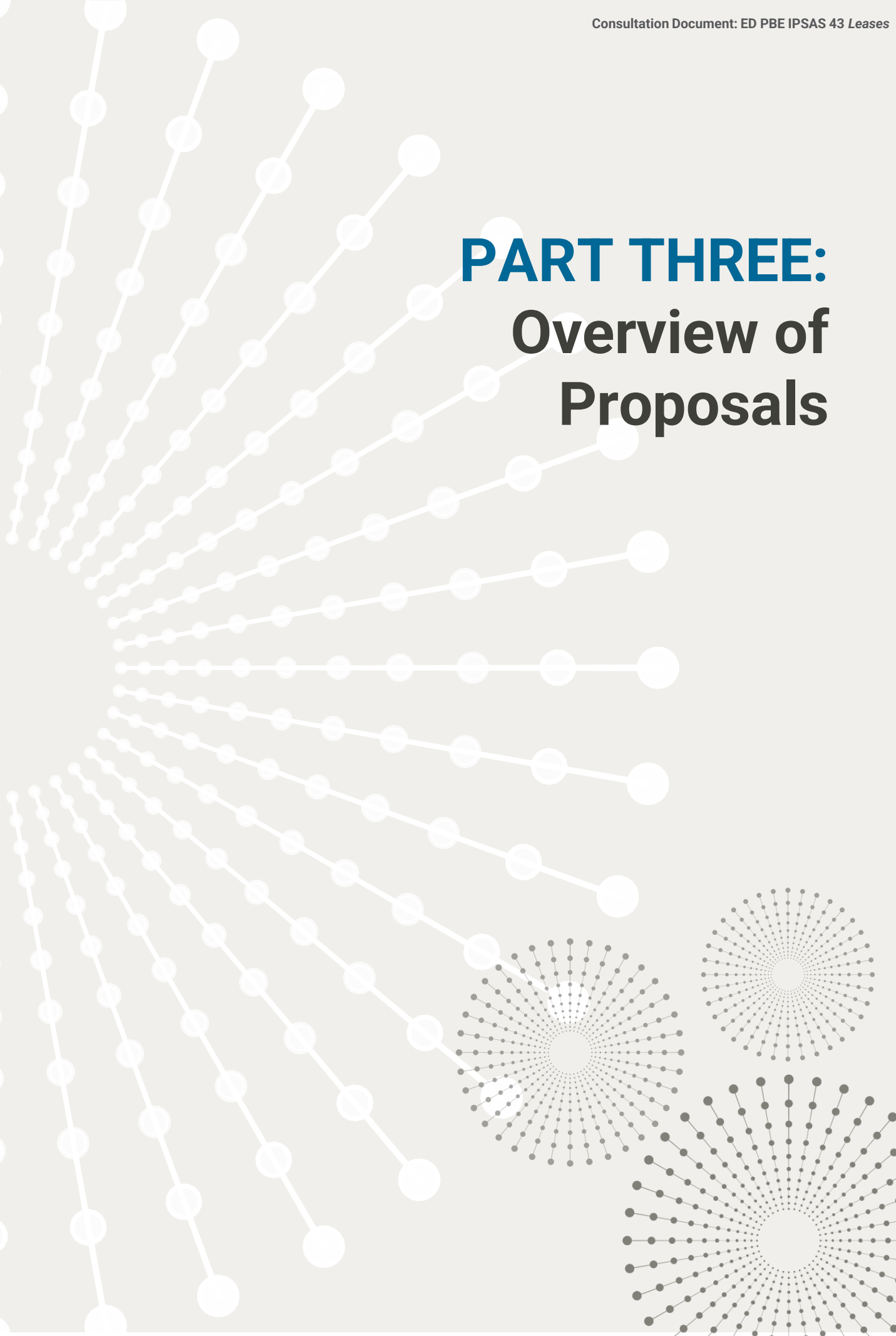
RDR concessions (Section 4.6)

3. Do you agree with the proposed RDR concessions for Tier 2 PBEs?

Effective date and other comments (Section 4.7)

4. Do you agree with the proposed effective date of 1 January 2027?
5. Do you have any other comments on the ED?

PART THREE: **Overview of Proposals**





4. Overview of proposals

4.1 Summary

In this section, we highlight the key aspects of the proposals and those areas where we are particularly interested in your feedback. This section is organised as follows.

- 4.2 Approach to developing PBE IPSAS 43
- 4.3 Main changes from existing lease accounting requirements;
- 4.4 Scope clarification for concessionary leases;
- 4.5 Low-value leases: whether we should modify the requirements in IPSAS 43;
- 4.6 RDR concessions; and
- 4.7 Effective date and other comments.

4.2 Approach to developing PBE IPSAS 43

The proposed PBE IPSAS 43 is closely based on IPSAS 43 which, in turn, is closely based on IFRS 16. In accordance with its usual approach to developing a PBE Standard based on an IPSAS the NZASB has:

- aligned terminology with that used in PBE Standards (for example, PBE Standards include the concept of other comprehensive revenue and expense);
- considered need for any enhancements to make the standard more appropriate for public benefit entities in New Zealand. There are no specific not-for-profit enhancements in the proposed standard; and
- ensured coherence within PBE Standards by considering the existence of New Zealand specific standards or requirements;
- identified reduced disclosure requirements (RDR) for Tier 2 PBEs, with respect to disclosure requirements (aligned with the RDR concessions in NZ IFRS 16 *Leases*).

4.3 Main changes from existing lease accounting requirements

Current

PBE IPSAS 13 *Leases* currently requires **lessees** to distinguish between the following two types of leases, based on what is described as the 'risks and rewards' model:

- (a) **Finance leases:** A lease that is economically similar to purchasing the leased asset; it is recognised on the lessee's statement of financial position as a liability and an asset; and
- (b) **Operating leases:** All other leases not classified as finance leases; not recognised on the statement of financial position. They are recognised as an annual operating expense through surplus or deficit over the lease term – with the total amount of future lease payments disclosed in the notes only. For this reason, operating leases are sometimes referred to as 'off-balance sheet' leases.

Proposed

The proposed PBE IPSAS 43 introduces the 'right of use' model for lessees. Under these proposals, lessees are required to recognise almost all leases on the statement of financial position. This means that lessees would need to bring on to their balance sheet nearly all of those leases that are currently classified as 'operating' leases.



4.3 Main changes from existing lease accounting requirements (continued)

PBE IPSAS 43: proposed lessee accounting requirements for (almost) all leases ¹	Impact on financial statements of lessees with 'operating' leases
<p>Initial recognition of lease on the balance sheet:</p> <ul style="list-style-type: none"> a lease liability, for the obligation to make future lease payments as per the lease agreement, discounted to present value; and a right-of-use (ROU) asset, for the right to use the underlying asset over the lease term, in exchange for the lease payments. <p>Accounting after initial recognition:</p> <ul style="list-style-type: none"> The lease liability decreases as the lessee makes payments. Interest (unwinding of lease liability discount) is recognised as an expense, and is included in finance costs. Generally, the ROU asset is depreciated with an expense recognised, usually on a straight-line basis. 	<p>Statement of financial position</p> <p>Liabilities ↑</p> <p>Assets ↑</p> <p>Statement of comprehensive revenue and expense</p> <p>Operating expenses (excluding depreciation and amortisation) ↓</p> <p>Depreciation and amortisation ↑</p> <p>Finance costs ↑</p> <p>Plus: <u>Change in the pattern of expense recognition:</u></p> <p>The ROU asset is usually depreciated on a straight-line basis. For the lease liability, the interest expense is higher at the start of the lease term and lower at the end of it, because the 'principal' of the lease liability decreases as the lessee makes payments (similar to a table mortgage). In contrast, under the current requirements the operating lease expense is generally recognised evenly throughout the lease term.</p> <p><u>Discount rates:</u> The lease liability and right-of-use asset amounts are calculated based on the agreed future lease payments, <i>discounted</i> to present value. The proposed PBE IPSAS 43 contains requirements for determining the discount rate. We expect that under the proposed PBE IPSAS 43, in most cases a PBE lessee would determine the discount rate under PBE IPSAS 43 as the lessee's incremental borrowing rate² – i.e. "the interest rate that the lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment".</p>

¹Exemptions from the right-of-use model under proposed PBE IPSAS 43

- Short-term leases (where the lease term is shorter than 12 months); and
- Leases of low-value assets (where the underlying leased asset is of low value).

A lessee may choose to account for these leases by recognising the associated payments as an expense over the lease term.

²The IPSASB's Basis for Conclusions for IPSAS 43 notes that the incremental borrowing rate can be determined by:

- (a) Taking into account the leases' terms and conditions;
- (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 IPSAS 43.



4.3 Main changes from existing lease accounting requirements (continued)

What changes for lessors?

Under the proposed PBE IPSAS 43, the requirements for lessors are generally similar to the current requirements under PBE IPSAS 13. That is, lessors would still apply the ‘risks and rewards’ model, meaning that they would still distinguish between operating leases and finance leases.

However, the proposed PBE IPSAS 43 includes the following specific changes for lessors:

- ➔ Lease modifications: The proposals require modification to a finance lease to be treated as a separate lease if certain conditions are met, and modifications to an operating lease to be treated as a new lease from the effective date of the modifications. PBE IPSAS 13 does not contain specific requirements relating to lease modifications.
- ➔ Sub-leases: The proposals require an intermediate lessor to classify subleases by reference to the right-of-use asset (i.e. the head lease) – rather than by reference to the underlying asset, as per the current requirements in PBE IPSAS 13.
- ➔ Disclosures: The proposals include enhanced disclosure for lessors about the timing and uncertainty of cash flows relating to leases.

The ED proposes that when a contract contains more than one lease component, or a lease component and a non-lease component, a lessor applies the requirements in the for-profit standard NZ IFRS 15 *Revenue from Contracts with Customers* to allocate the consideration in the contract to the lease and/or non-lease components. The IPSASB has taken the same approach in IPSAS 43. The reference to NZ IFRS 15 is a temporary measure. We plan to update these references when the IPSASB finalises and issues its new standard on Revenue – which we expect to happen before PBE IPSAS 43 becomes effective.

Other ED proposals to note

- Requirements for identifying a lease
- Requirements on combining contracts
- Requirements for lessees on how to treat variable lease payments when determining the lease liability
- Transitional provisions for moving from PBE IPSAS 13 to PBE IPSAS 43



Sale and leaseback transactions

Under the current requirements of PBE IPSAS 13, an entity is able to report fewer assets and less debt by selling an asset and leasing it back as through an ‘operating lease’. However, in substance, the entity continues to have a right to use the sold asset.

The proposed PBE IPSAS 43 requires a seller-lessee to assess whether the transfer of an asset is accounted for as a sale of that asset, which then impacts the accounting for the transaction. If the transfer of the asset is determined to be a sale, then PBE IPSAS 43 requires a seller-lessee to recognise the right to use the sold asset (and the related lease liability), and restricts the amount of gain that can be recognised in a sale and leaseback transaction. If the transfer of the asset is not a sale then PBE IPSAS 43 requires a seller-lessee to continue to recognise the transferred asset and to recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying PBE IPSAS 41.

The ED proposes that when a seller-lessee transfers an asset to a buyer-lessor, both entities determine whether the transfer is accounted for as a sale by applying the requirements in the for-profit standard NZ IFRS 15 for determining when a performance obligation is satisfied. The IPSASB has taken the same approach in IPSAS 43. The reference to NZ IFRS 15 is a temporary measure. We plan to update these references when the IPSASB finalises and issues its new standard on Revenue – which we expect to happen before PBE IPSAS 43 becomes effective.



4.4 Scope clarification for concessionary leases

Concessionary leases are leases with below-market terms. For the purpose of this section (4.4), when we refer to concessionary leases we are also referring to 'leases' for nil consideration, unless otherwise stated. In issuing IPSAS 43, the IPSASB did not explicitly provide a scope exclusion from the standard with respect to concessionary leases. We understand that concessionary leases in which the lessee pays consideration meet the definition of a lease, and are in the scope of IPSAS 43.

The IPSASB has a separate project on developing accounting requirements for concessionary leases. It is not yet clear whether the IPSASB will require fair value measurement for the 'concessionary component' of concessionary leases.

The proposed PBE IPSAS 43 does not include any requirements on the accounting for the 'concessionary component' of concessionary leases. We understand that some New Zealand constituents have concerns about the possibility of having to measure concessionary leases at fair value. We have therefore included in the ED paragraphs 4.1 – 4.2, which clarify the following:

- Concessionary leases where the lessee pays consideration meet the definition of a lease and are within the scope of the proposed standard; but
- PBEs are *not* required to measure the 'concessionary portion' of their concessionary leases at fair value. That is, when accounting for leases under the proposed standard, a PBE is required to take into account the amounts of lease payments as per the lease agreement, and not what the payments would have been had the lease been on market terms.

We have considered whether PBEs that adopt PBE IPSAS 43 should be *permitted* to recognise and measure at fair value the 'concessionary portion' of their concessionary leases (e.g. by applying PBE IPSAS 23). We have decided *not to permit* such fair value measurement at this stage, for the following reasons.

- There is currently no guidance in PBE Standards on how to measure concessionary leases at fair value. We do not intend to consider developing such guidance until the IPSASB's position on this topic becomes clear as part of their separate ongoing project.
- We propose that PBE IPSAS 43 have a mandatory effective date beginning on or after 1 January 2027. PBEs will not be required to adopt PBE IPSAS 43 before this effective date. Therefore, if some PBEs are currently accounting for their concessionary leases at fair value, or at any value that does not reflect the actual lease payments per the lease agreement, such PBEs will be able to continue with this practice until 1 January 2027 (unless they choose to early adopt PBE IPSAS 43). By the time PBE IPSAS 43 becomes effective, we expect to have developed accounting requirements for concessionary leases and to have these requirements available for early adoption.



4.4 Scope clarification for concessionary leases

Questions

1. Do you agree with the proposed scope clarification with respect to concessionary leases? That is, do you agree with the clarification that:

- Concessionary leases that meet the definition of a lease are in the scope of the proposed PBE IPSAS 43;
- Arrangements that confer the right to use an asset for a specified period of time for no consideration do not meet the definition of a lease in the proposed PBE IPSAS 43; and
- In applying the measurement requirements in PBE IPSAS 43, an entity takes into account the lease payments as per the lease agreement, and not the lease payments that would have been charged had the lease been on market terms?*

* Except that an entity would measure its right of use asset at fair value after initial recognition if it is required or elects to do under paragraphs 35 or 36 of PBE IPSAS 43, or if it is a first-time adopter of PBE Standards and elects to use fair value as 'deemed cost' for a right-of-use asset.



4.5 Leases of low-value assets

We did not modify the requirements of IPSAS 43 for leases of low value assets.

The following requirements from IPSAS 43 have been replicated in the proposed PBE IPSAS 43.

- A recognition exemption is provided for 'leases for which the underlying asset is of low value'. An entity need not recognise a ROU asset and a lease liability for leases of low-value assets. Instead, the lease payments relating to such leases may be accounted for as expenses over the lease term.
- IPSAS 43 requires entities to determine whether a leased asset is of 'low value' on an *absolute basis* – and *not based on whether the asset is material* to the entity. 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 leased asset is of 'low value'*.
- Examples of 'low value' underlying assets can include tablet and personal computers, small items of office furniture and telephones (but not cars).
- The assessment of whether a leased asset is of low value is performed on an individual asset basis.

The proposals for 'leases of low value assets' are illustrated in the following example:

If a PBE leases 100 laptops for the use of its employees, the PBE considers whether each individual laptop is considered to be an asset of low value, when applying paragraph AG4–AG9 in the proposed PBE IPSAS 43.

In performing this assessment, the PBE need not determine whether the 100 laptops taken together are considered to be of low value. The PBE also need not determine whether each laptop, or the 100 laptops taken together, are material to the PBE. If the PBE determines that each individual laptop is an asset of low value, then the PBE may choose not to recognise a ROU asset and a lease liability with respect to the lease of the laptops, but instead to recognise the lease payments as an expense over the lease term.

The exemption for low value assets is consistent with the IASB's requirements in IFRS 16 *Leases*. However, unlike the IASB, the IPSASB did not provide an indicative figure that would constitute a 'low value' leased asset. The Basis for Conclusion of IFRS 16 states that when developing the recognition exemption for leases of low-value assets, 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' leased assets, noting that the application guidance in AG4–AG9 provides sufficient guidance on how to determine 'low value'.

Question

2. Do you think that the assessment of whether a leased asset is of 'low value' should be performed on an absolute value basis for each individual leased asset, as proposed in the ED?

If not, on what basis should this assessment be performed?



4.6 RDR concessions

The ED includes proposed disclosure concessions for PBEs in Tier 2. These disclosure concessions are aligned with those provided to Tier 2 for-profit entities under NZ IFRS 16 *Leases*. The proposed Tier 2 disclosure concessions are summarised below:

- (a) Tier 2 PBEs will not be required to provide certain disclosures in tabular format [see paragraphs 57, RDR 57.1 and 90];
- (b) Lessees in Tier 2 will not be required to disclose a maturity analysis for lease liabilities separately from the maturity analysis for other financial liabilities [see paragraph 61];
- (c) Lessors in Tier 2 will not be required to disclose operating lease revenue relating to variable lease payments that do not depend on an index or a rate separately from other operating lease revenue [see paragraph 89(b) and RDR 89.1];
- (d) Tier 2 PBEs will not be required to provide certain disclosures relating to lease term extension options, lease termination options, residual value guarantees and sale and leaseback transactions [see paragraphs AG51–AG53].

Question

3. Do you agree with the proposed RDR concessions?

4.7 Effective date and other comments

The ED proposes that PBE IPSAS 43 *Leases* be effective for annual financial statements covering periods beginning on or after 1 January 2027, with early adoption permitted. This date is tentative and would be reviewed prior to issuing the finalised Standard.

We believe that an effective date of 1 January 2027 would allow PBEs sufficient time to prepare for the application of the Standard. Furthermore, we proposed this effective date with a view to ensuring that the requirements of PBE IPSAS 43 do not become mandatory in New Zealand before the requirements for concessionary leases (to be developed after the IPSASB finalises its project on the topic) become available.

With early application permitted, those PBEs who wish to adopt PBE IPSAS 43 early will be able to do so.

Questions

- 4. Do you agree with the proposed effective date of 1 January 2027, with early adoption permitted?
- 5. Do you have any other comments on the ED?



Cover Memo

Project:	Insurance Activities in the Public Sector	Meeting:	AASB August 2022 (M189) NZASB August 2022 (M102)
Topic:	Consider stakeholder feedback	Agenda item:	AASB 4.1 NZASB 8.1
Contacts:	Angus Thomson athomson@asb.gov.au Tereza Bublikova tereza.bublikova@xrb.govt.nz Patricia Au pau@asb.gov.au Charis Halliday charis.halliday@xrb.govt.nz	Date:	18 July 2022
		Project priority	Medium
		Decision-making	High
		Project status	Feedback on AASB ED 319 / NZASB ED 2022-3

Objectives of this agenda item

1. The objectives of this agenda item are for the AASB and the NZASB to:
 - (a) CONSIDER comments received from stakeholders on AASB ED 319/NZASB ED 2022-3 *Insurance Contracts in the Public Sector* relating to
 - (i) indicators for determining the public sector arrangements that are within the scope of AASB 17/PBE IFRS 17 *Insurance Contracts*;
 - (ii) risk adjustments for measuring insurance liabilities;
 - (b) DECIDE on the broad direction to take regarding (i) and (ii);
 - (c) CONSIDER two emerging issues on ‘adverse development covers’ and ‘investment components’;
 - (d) NOTE a matter relating to bank depositor compensation schemes; and
 - (e) NOTE that the due process for finalising the project may require the exposure of a revised draft Standard for comment.

Reasons for bringing this agenda item to the Boards

2. The Boards issued AASB ED 319/NZASB ED 2022-3 in March 2022 with a 90-day comment period ending on 8 June 2022.¹
3. Across the two jurisdictions, eleven comment letters have been received (please see the [Appendix](#) to this Cover Memo for a listing of the respondents). In addition, staff met with a number of financial statements preparers and auditors during the comment period to discuss their views, only some of whom subsequently submitted a comment letter. The agenda papers for this meeting refer specifically to matters raised in the eleven comment letters – the issues raised in the stakeholder discussions were generally consistent with the comment letters. The

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



exception was selected feedback on risk adjustments, which is noted in Agenda paper AASB 4.3/NZASB 8.3.

4. The focus for this meeting is on the two issues that drew the most commentary and diversity in views:
 - (a) the indicators for determining the public sector arrangements that are within the scope of AASB 17/PBE IFRS 17; and
 - (b) risk adjustments for measuring insurance liabilities.

The staff are prioritising these topics to maximise the time available for Board deliberation on the most complex issues.

5. In addition, this meeting will discuss two emerging issues:
 - (a) adverse development covers; and
 - (b) investment components;

that the Boards may wish to address in a public sector context.

6. The other proposed modifications in the Exposure Drafts were generally well-supported by stakeholders and will be considered at the next meetings of the Boards. Those proposals related to:

- (a) an exemption from sub-grouping onerous versus non-onerous contracts at initial recognition;
- (b) an exemption from sub-grouping contracts issued no more than a year apart;
- (c) an amendment to the initial recognition requirements so that they do not depend on when contracts become onerous;
- (d) guidance on coverage periods, which has consequences for assessing eligibility for the premium allocation approach in a public sector context; and
- (e) guidance on determining the cash flows within the contract boundary.

7. An emerging issue on ‘captive insurers’ will also be considered at the next meetings of the Boards.

Papers for this agenda item

AASB	NZASB	Document title
Agenda Paper 4.2	Agenda Paper 8.2	Indicators for determining which arrangements are within the scope of the Standard
Agenda Paper 4.3	Agenda Paper 8.3	Risk adjustments in measuring insurance liabilities
Agenda Paper 4.4	Agenda Paper 8.4	Emerging issues: adverse development covers, investment components
Agenda Paper 4.5 [in supplementary folder]	Agenda Paper 8.5 [in supplementary folder]	Comment letters received on AASB ED 319 and NZASB ED 2022-3
Agenda paper 4.6	Agenda paper 8.6	Bank depositor compensation schemes



Overview of staff recommendations

8. The following table provides a high-level summary of the staff recommendations in AASB Agenda Papers 4.2–4.4/NZASB Agenda Papers 8.2–8.4.

Agenda paper	Summary of staff recommendations
AASB 4.2/NZASB 8.2	<p>In respect of the proposed indicators for determining which arrangements are within the scope of AASB 17/PBE IFRS 17, staff recommend:</p> <ul style="list-style-type: none"> (a) retaining all the proposed indicators and not adding alternative indicators, but: <ul style="list-style-type: none"> (i) making the ‘identifiable coverage period’ and ‘enforceable nature of an arrangement’ indicators pre-requisites for applying AASB 17/PBE IFRS 17; and (ii) ranking the other indicators as primary and secondary indicators; (b) adding examples that would help identify when an arrangement is enforceable and when an arrangement has an identifiable coverage period; (c) adding guidance on the definition of ‘insurance contract’ in a public sector context; and (c) enhancing the guidance on features of a scheme that might not meet the indicators.
AASB 4.3/NZASB 8.3	<p>In respect of risk adjustments in measuring insurance liabilities, staff recommend:</p> <ul style="list-style-type: none"> (a) not to modify the requirements in AASB 17/PBE IFRS 17 to determine risk adjustments, but to require disclosure of the sensitivity of insurance liabilities to changes to the confidence level, such as plus or minus 10%; and (b) providing guidance to the effect that: <ul style="list-style-type: none"> (i) public sector entities that do not seek to be compensated for bearing risk in their pricing/funding would be expected to have zero risk adjustments in their liabilities for remaining coverage; (ii) some public sector entities may seek to be compensated for bearing risk, which would be determined based on identifiable facts and circumstances [such as pricing above break even] and, therefore, have risk adjustments above zero in their liabilities for remaining coverage; (iii) public sector entities that are not indifferent between fulfilling a liability that has a range of possible outcomes arising from non-financial risk and fulfilling a liability that would generate fixed cash flows with the same expected present value, would be expected to have risk adjustments above zero [that is, use a confidence level above 50%] in measuring their liabilities for incurred claims; and



Agenda paper	Summary of staff recommendations
	(iv) public sector entities that are indifferent between fulfilling a liability that has a range of possible outcomes arising from non-financial risk and fulfilling a liability that would generate fixed cash flows with the same expected present value, would be expected to have zero risk adjustments [that is, use a 50% confidence level] in measuring their liabilities for incurred claims.
AASB 4.4/NZASB 8.4	In respect of the adverse development covers and the investment component issues, staff recommend to take no action, but to monitor the issues in respect of public sector entities.

The AASB’s due process

9. In accordance with paragraph 6.5(g) of the [AASB Due Process Framework for Setting Standards](#) (the Due Process Framework), the AASB is required to consider whether its proposals in an ED should be re-exposed for public comment prior to finalisation. Paragraph 7.7.1 of that framework outlines the criteria the AASB would use in making this determination, as follows:
 - (a) extent of new substantive issues not considered during the initial consultation (e.g. new requirements, terminology and/or examples);
 - (b) extent of change to original proposals (structural changes excluded);
 - (c) extent of input from interested parties and whether any key stakeholders have not provided input; and
 - (d) any new evidence on the extent and nature of the issue being addressed.
10. In addition, paragraph 7.6.7 of the Due Process Framework states that “Where there is some change from the ED but not enough to warrant re-exposure, a ‘fatal-flaw review’ version of a pronouncement may also be issued for a short period for public comment as a final opportunity to identify any further unintended consequences of the proposals, prior to voting by the Board.”
11. Based on the staff analysis included in the agenda papers for this meeting, staff consider that a re-exposure in the form of an ED is unlikely to be needed because staff regard the likely changes to the ED 319 proposals to be largely in line with the feedback received.
12. However, staff consider it is likely that the AASB would need to expose a fatal-flaw review draft version of the Standard to identify any further unintended consequences of the revisions made to the proposed indicators, and to the proposed guidance and disclosure requirements on risk adjustments.

The NZASB’s due process

13. The NZASB is required to consider whether its proposals in an ED should be re-exposed for public comment prior to finalisation. In making this determination the NZASB considers:
 - (a) extent of new substantive issues not considered during the initial consultation (e.g. new requirements, terminology and/or examples);
 - (b) extent of change to original proposals (structural changes excluded);
 - (c) extent of input from interested parties and whether any key stakeholders have not provided input; and



- (d) any new evidence on the extent and nature of the issue being addressed.
14. Based on the staff analysis included in the agenda papers for this meeting, staff consider that a re-exposure in the form of an ED is unlikely to be needed because staff regard the likely changes to the ED proposals to be largely in line with the feedback received and that key stakeholders have provided their input.
15. Rather than exposing a fatal-flaw review draft version of the Standard, staff consider that the NZASB could circulate a draft Standard for review with the affected stakeholders directly (given the limited number of stakeholders).

Proposed next steps and timeline

16. The following table outlines the proposed timeline needed to progress the project, assuming the Boards issue a draft version of the Standard for public comment prior to finalisation.
17. Each Board issued the existing version of AASB 17/PBE IFRS 17 on the assumption that the public sector project would be completed by the end of 2022. Meeting this timeline is important because:
- otherwise, there will be potentially significant additional administrative processes for the Boards to complete in issuing and reissuing Standards; and
 - a number of ED respondents supported a 2025 effective date for public sector entities, only subject to the Boards having the Standard issued by the end of 2022. If the standard is issued later, some respondents suggested deferring the application date.

Activity / Topic	AASB	NZASB
Decide the Broad direction on the proposed indicators and risk adjustments	3 August 2022 meeting	11 August 2022 meeting
Consider feedback, analysis and recommendations on the remaining ED proposals outlined in paragraph 6 above Consider an emerging issue on captive insurers Consider staff's proposed changes to the draft Standard	21-22 September 2022 meeting	18 October 2022 meeting
Consider feedback on the Fatal-Flaw Review Draft Standard <i>AASB 2022-X Amendments to Australian Accounting Standards – Insurance Contracts: Consequential Amendments for Public Sector Entities [AASB only]</i>	21-22 September 2022 meeting	N/A
The AASB and NZASB (or their subcommittee) to approve issuing revised draft Standards for comment out of session. Propose issuing the draft Standards by 26 October 2022, with a 14-day comment period until 9 November 2022.	26 October 2022	26 October 2022
The AASB and NZASB to: (a) consider stakeholder comments on the draft Standards; (b) vote on the ballot-draft Standards at their December 2022 meetings; and (c) publish the final Standards by 31 December 2022.	Planned 14-15 December 2022 meeting	Planned 14 December 2022 meeting

Question for Board members

Q1: Do Board members have any comments on the proposed next steps and timeline?



Appendix: List of respondents

Across the two jurisdictions, eleven comment letters have been received [shown in date order]:

Respondent	
OAGNZ	Office of the Auditor-General New Zealand
PwC	PwC (Australia)
TSY NZ	Treasury New Zealand
iCare	iCare NSW
HoTARAC	The Heads of Treasuries Accounting and Reporting Advisory Committee
EQC	The Earthquake Commission (NZ)
ACAG	The Australasian Council of Auditors-General
ACC	Accident Compensation Commission (NZ)
ICWA	Insurance Commission of Western Australia
RBNZ	Reserve Bank of New Zealand
KPMG	KPMG (Australia)



Staff paper

Project:	Insurance Activities in the Public Sector	Meeting:	AASB August 2022 (M189) NZASB August 2022 (M102)
Topic:	Indicators for determining which arrangements are in the scope of the Standard	Agenda item:	AASB 4.2 NZASB 8.2
Contacts:	Angus Thomson athomson@asb.gov.au Tereza Bublikova tereza.bublikova@xrb.govt.nz Patricia Au pau@asb.gov.au Charis Halliday charis.halliday@xrb.govt.nz	Date:	18 July 2022
		Project priority	Medium
		Decision-making	High
		Project status	Consider feedback on Exposure Draft

Objectives of this agenda paper

1. The objectives of this agenda paper are for the AASB and the NZASB to:
 - (a) CONSIDER key stakeholder feedback received on the proposed indicators for determining whether public sector arrangements fall within the scope of AASB 17/PBE IFRS 17 *Insurance Contracts* (questions 7 to 9 of AASB ED 319/NZASB ED 2022-3 *Insurance Contracts in the Public Sector*); and
 - (b) DECIDE on any changes required to be made to the indicators for the purposes of finalising the Standard.

Structure of this paper

2. This paper is structured as follows:
 - (a) Indicators proposed in AASB ED 319/NZASB ED 2022-3
 - (i) General comments on all indicators
 - (ii) Comments on specific indicators
 - (b) Ranking indicators
 - (c) [Appendix](#): Collation of comments on questions 7 to 9 of AASB ED 319/NZASB ED 2022-3 regarding the proposed indicators
3. The status of ‘captive insurers’ within the scope of AASB 17/PBE IFRS 17 [probably most relevant for the AASB] has been raised as an issue by a number of respondents and will be discussed at the September 2022 AASB meeting and October 2022 NZASB meeting.
4. There are questions for the Board members in respect of (a) and (b).
5. The following table provides an overview of the respondent comments, staff comments, and staff recommendations in respect of (a) and (b).



Overview

Indicator	Respondent comments	Staff comments	Staff recommendations
General comments (all indicators)	While some respondents do not support each proposed indicator, most consider it relevant to retain them all.	Indicators are not a perfect solution, but there appear to be no viable alternative solutions other than directly identifying which entities are within scope or allowing an open choice of which Standards to apply.	Retain all the proposed indicators; do not add alternative indicators; add/enhance guidance.
Ranking	Almost all respondents specifically supported some form of ranking of the indicators.	Identifying pre-requisites has some relevant precedents in Australia and New Zealand.	Rank the indicators into categories of pre-requisite, important, and secondary.
Individual indicators:			
Similarity of risks and benefits	Mixed feedback on whether the level of riskiness is a positive or negative factor.	Potential need to clarify which elements the indicator relates to.	Retain the indicator; rank as important; enhance guidance.
Identifiable coverage period	Respondents were supportive.	Further discussion on a person's inherent status in meeting eligibility criteria for participation in a scheme, versus the existence of an identifiable coverage period is needed.	Retain the indicator; rank as pre-requisite.
Enforceable arrangement	Respondents were supportive.	No amendments needed.	Retain the indicator; rank as pre-requisite.
Source and extent of funding	Respondents were supportive, but acknowledged there is no particular tipping point in respect of the extent of funding. One respondent considers it is more relevant to focus on how an amount of funding is calculated, rather than its source.	Staff do not support widening the indicator to encompass how the funding is calculated provided the indicator does not become a pre-requisite.	Retain the indicator; rank as important.
Management practices, assessing performance	Most respondents were supportive; one was not; one sought clarification.	Place more emphasis on underwriting, which is a key feature of insurance, in explaining this indicator.	Retain the indicator; rank as secondary; enhance guidance.
Assets held to pay benefits	Most respondents were supportive; one was not.	No amendments needed.	Retain the indicator; rank as secondary.

Indicators proposed in AASB ED 319/NZASB ED 2022-3

6. AASB ED 319/NZASB ED 2022-3 asked the following questions:

Q7: Public sector arrangements to which AASB 17/PBE IFRS 17 should apply would be identified based on a collective assessment of the following proposed indicators:

- (a) similarity of risks covered and benefits provided;
- (b) identifiable coverage period;
- (c) enforceable nature of arrangement;
- (d) source and extent of funding;
- (e) management practices and assessing financial performance; and
- (f) assets held to pay benefits.

Do you agree with these proposed indicators? If you disagree with the proposed indicators, which of them would you exclude?

Q8: Do you have suggested alternatives or additional indicators? If so, please outline those indicators and provide supporting reasoning.

General comments (all indicators)

Stakeholder feedback and staff comments

7. The following table summarises the general comments on the proposed list of indicators and staff comments.

Stakeholder feedback	Staff comment
Most respondents support using indicators to determine whether public sector arrangements fall within the scope of AASB 17/PBE IFRS 17. However, some respondents consider that it remains uncertain how governments will distinguish between insurance activities versus social benefits and compensation schemes.	Staff note that the indicators are not a perfect solution, but that there appear to be no viable alternative solutions other than (a) directly identifying which entities are within scope or (b) allowing an open choice of which Standards to apply. Both these alternative approaches were considered and rejected by the Boards.
While many respondents consider some indicators to be more relevant than others, most are in favour of retaining all the proposed indicators. One respondent (iCare) disagrees with three of the indicators – please refer to the analysis by indicator below.	While some respondents do not support each proposed indicator, most consider it relevant to retain them all.
Three respondents [iCare, HoTARAC and ACAG] mention providing more guidance on what constitutes a ‘social benefit’ scheme that would not be included within the scope of AASB 17/PBE IFRS 17.	Staff are not in favour of providing any detailed explanations of what constitutes a ‘social benefit’ scheme that would be excluded from the Standard on the basis that the Boards are yet to tackle this subject. However, staff note that it could be



Stakeholder feedback	Staff comment
	useful to draw on more of the material in IPSAS 42 <i>Social Benefits</i> in describing features of a scheme that might not meet the indicators.
<p>One respondent [iCare] suggests additional indicators of schemes that are not insurance, including:</p> <ul style="list-style-type: none"> • having a government guarantee; • having the ability to change benefits; and • being an insurer of last resort [that is, providing benefits the private sector is unwilling to cover]. <p>However, two respondents [ACC and TSY NZ] hold the view that filling ‘protection gaps’ that would not otherwise be met by private sector insurers is a reason for including such public sector arrangements within AASB 17/PBE IFRS 17, rather than a reason for exclusion.</p>	<p>Staff are not in favour of adding:</p> <p>(a) an indicator regarding government guarantee on the basis that they are either implicit or explicit for all public sector entities;</p> <p>(b) an indicator regarding ‘having the ability to change benefits’ on the basis that it is already addressed [in the obverse sense] in the proposed indicator ‘enforceable nature of arrangement’; or</p> <p>(c) a separate indicator regarding ‘being an insurer of last resort’ or ‘filling a protection gap’ on the basis that it implies that the level of riskiness is relevant to identifying an insurance risk that falls within AASB 17/PBE IFRS 17. Please also see the comments on riskiness below in respect of the discussion of ‘similarity of risks covered and benefits provided’.</p>
<p>One respondent [TSY NZ] proposes that definition of ‘insurance contract’ be widened to bring public sector insurance schemes appropriately into scope, as follows:</p> <p style="padding-left: 40px;">An insurance contract is a contract <u>or statutory arrangement</u> under which one party (the issuer) accepts significant insurance risk from another party <u>or group</u> (the policyholder <u>or policyholder group</u>) by agreeing to compensate policyholders <u>or other affected parties</u> if a specified uncertain future event (the insured event) adversely affects policyholders <u>or those other affected parties</u>.</p>	<p>Staff are not in favour of amending the definition of ‘insurance contract’ for the public sector on the basis that AASB 17/PBE IFRS 17.2 already requires relevant external regulation to be considered when identifying the terms of insurance contracts. However, staff consider that the wording suggested by TSY NZ could be used as the basis for additional guidance on the definition in a public sector context.</p>
<p>Four respondents [PwC, HoTARAC, ACAG and KPMG] suggested that the Boards should include examples to help guide entities in applying the indicators.</p>	<p>Staff are not in favour of including examples of applying the indicators to schemes on the basis that:</p> <p>(a) they would become the de facto ‘standards’; and</p> <p>(b) in the context of AASB 17/PBE IFRS 17, the few examples included in the</p>



Stakeholder feedback	Staff comment
	<p>Standard itself and the examples set out in IFRS 17 <i>Illustrative Examples</i> are typically not of ‘grey’ areas in the requirements, but demonstrate how the Standard applies. The types of examples that would need to be presented to assist in applying the indicators would inevitably be in grey areas where judgement is required to be applied to very specific sets of circumstances.</p> <p>However, staff note that providing examples relating to the way in which specific indicators are applied could be useful – please refer to the discussion below on ranking indicators.</p>

Staff recommendations – General comments (all indicators)

8. Staff recommend:
- (a) retaining all the proposed indicators [also see discussion on specific indicators below] and not add alternative indicators;
 - (b) adding guidance on the definition of ‘insurance contract’ in a public sector context using the TSY NZ’s suggested changes to the definition as a basis;
 - (c) consider enhancing the guidance on features of a scheme that might not meet the indicators, potentially drawing on material in IPSAS 42 *Social Benefits*; and
 - (d) not to include examples of applying the indicators to schemes in the guidance.

Question for Board members

Q1: Do Board members agree with the staff recommendations noted in paragraph 8? If not, what other alternatives would you suggest?

Specific indicator: Similarity of risks covered and benefits provided

Stakeholder feedback

9. A number of respondents [including TSY NZ and HoTARAC] have effectively identified that there could be two elements to this indicator:
- similarity or comparability between the risks and the benefits themselves;
 - similarity with the level of riskiness when compared with private sector insurance contracts, because public sector entities are often filling a gap in the market relating to left with insuring the more catastrophic risks. [HoTARAC considers this element contributes to this indicator not being effective.]



10. However, there are differences of view among respondents about whether the level of riskiness is a positive or negative factor in determining whether a public sector arrangement should be within scope. Some respondents consider:
- that filling a gap left by the market or providing complementary insurance in addition to private sector insurers [accepting risks and providing compensation that otherwise would not be offered, or would otherwise be considered unaffordable] is indicative of insurance [TSY NZ].
 - the ‘last resort’ nature of an arrangement is not indicative of insurance and, therefore, ‘similarity of risks covered and benefits provided’ should not be retained as an indicator because governments might target areas of private sector market failure [iCare].

Staff comments

11. Staff consider this indicator to be essential because it is intuitive that a public sector arrangement which addresses similar risks and benefits to insurance contracts in the private sector would be a good candidate to fall within the scope of AASB 17/PBE IFRS 17
12. The fact that a public sector arrangement is identified as filling a gap in the market and relates to a very high level of riskiness should not be a factor that indicates a public sector arrangement would be outside the scope of AASB 17/PBE IFRS 17.
13. Staff consider that the nature of the risk is key for identifying whether an arrangement should be in the scope of the Standard, but not the level of riskiness. Some insurance contracts address risks that are inherently more extreme than others.
14. Staff consider that the two aspects of this indicator can be more clearly explained by identifying:
- (a) similarity between the risks and the benefits themselves as being the focus;
 - (b) similarity with the level of riskiness when compared with private sector insurance contracts, as not being relevant in respect of this indicator; and
 - (c) explaining that some ‘last resort’ risks or ‘protection gaps’ might be peculiar to the public sector while others would be along the spectrum of riskiness.

Staff recommendations

15. Staff recommend:
- (a) retaining the proposed indicator; and
 - (b) explaining that similarity between the risks and the benefits themselves is the focus, not the level of riskiness. While some ‘last resort’ risks or ‘protection gaps’ might be peculiar to the public sector in terms of their level of riskiness, this should not preclude them from being in the scope of AASB 17/PBE IFRS 17. The explanation could be briefly included in the body of the Standard with more comprehensive supporting explanation in the Basis for Conclusions.

Question for Board members

Q2: In respect of the “similarity of risks covered and benefits provided” indicator, do Board members agree with the staff recommendations noted in paragraph 15? If not, what other alternatives would you suggest?

Specific indicator: Identifiable coverage period

Stakeholder feedback

16. Respondents supported this proposed indicator.
17. One respondent [HoTARAC] seeks clarification about the reference in ED 319.BC136/NZASB ED 2022-3.BC148 to “someone’s inherent status” in explaining schemes that have eligibility criteria for participation rather than an identifiable coverage period. [For example, whether being a victim of a natural disaster is a matter of inherent status.]
18. One respondent [TSY NZ] also suggested amending the guidance in paragraph AusB16.10/AGB16.10 of the ED on coverage period to specifically refer to statutory arrangements, as follows [mark up in underline]:

An insurance contract or applicable statutory arrangement has an identifiable coverage period – either the period during which insured events occur (losses-occurring coverage) or the period during which claims become known (claims-made coverage). The coverage period might be explicitly stated in the contract or otherwise be determinable from the terms of the contract or statutory arrangement.

Staff comments

19. Staff consider that the Standard can include further discussion on a person’s inherent status in meeting eligibility criteria for participation in a scheme, which contrasts with having an identifiable coverage period for events that might arise and for which a person might be eligible for compensation under an insurance arrangement.
20. Staff support mentioning ‘statutory arrangements’ in discussing coverage periods, but in a less specific context than suggested by TSY NZ on the basis that AASB 17/PBE IFRS 17.2 already implies that statutory arrangements can be among the terms of insurance contracts.

Staff recommendations

21. Staff recommend:
 - (a) retaining the proposed indicator;
 - (b) adding further discussion in the guidance in the Standard on a person’s inherent status in meeting eligibility criteria for participation in a scheme, versus the existence of an identifiable coverage period; and
 - (c) not mentioning ‘statutory arrangements’ directly in discussing coverage periods, but acknowledging their role in the context of AASB 17/PBE IFRS 17.2.

Question for Board members

Q3: In respect of the “identifiable coverage period” indicator, do Board members agree with the staff recommendations noted in paragraph 21? If not, what other alternatives would you suggest?

Specific indicator: Enforceable nature of arrangement

22. All respondents supported this proposed indicator.

Staff comments

23. Staff support mentioning ‘statutory arrangements’ in discussing the enforceable nature of an arrangement, but in a less specific context than suggested by TSY NZ on the basis that AASB 17/PBE IFRS 17.2 already implies that statutory arrangements can be among the terms of insurance contracts.

Staff recommendations

24. Staff recommend:

- (a) retaining the proposed indicator; and
- (b) not mentioning ‘statutory arrangements’ directly in discussing enforceability, but acknowledging their role in the context of AASB 17/PBE IFRS 17.2.

Question for Board members

Q4: Do Board members agree with the staff recommendations noted in paragraph 24? If not, what other alternatives would you suggest?

Specific indicator: Source and extent of funding

Stakeholder feedback

25. Respondents supported this proposed indicator, including that the greater the extent of funding by the insured/beneficiary, the more likely an arrangement is to be insurance. However, there was an acknowledgement that there is no particular tipping point in respect of the extent of funding.
26. One respondent [ACC] considers that it is more relevant to focus on how an amount of funding is calculated, rather than its source being, for example, general taxation. They suggest an actuarially calculated appropriation would be indicative of insurance.

Staff comments

27. Staff do not support widening the indicator to encompass how the funding is calculated. Staff consider that actuarial-style calculations could be associated with a variety of funding arrangements beyond insurance.
28. Staff note that, while this indicator would imply that an arrangement with no funding sourced from insureds/beneficiaries is not an insurance arrangement, unless it was identified as a pre-requisite, the arrangement could still be within the scope of AASB 17/PBE IFRS 17 based on other indicators – see discussion on Q9 below.

Staff recommendation

29. Staff recommend retaining the proposed indicator without any substantive amendment.

Question for Board members

Q5: In respect of the “source and extent of funding” indicator, do Board members agree with the staff recommendation to retain the proposed indicator without any substantive amendment?

Specific indicator: Management practices and assessing financial performance

Stakeholder feedback

30. Most respondents agreed with this indicator.
31. One respondent [iCare] disagrees with the indicator because most schemes operated by government would be expected to possess this attribute to meet relevant governance standards.
32. One respondent [KPMG] considers that merely conducting underwriting and risk management, managing the entity's capital and ensuring fair, and prudent claims management would not, in itself, meet the indicator and seeks clarification of how conducting the specified activities are expected to satisfy whether an entity meets the indicator.

Staff comments

33. Staff acknowledge that it would be expected all government schemes are well managed and treat beneficiaries fairly and in a general sense is not necessarily indicative of insurance contracts. Staff consider that it would be helpful to emphasise the particular key features of management most closely associated with insurance activities, such as underwriting, in explaining this indicator.

Staff recommendations

34. Staff recommend:
 - (a) retaining the proposed indicator; and
 - (b) placing more emphasis on underwriting, which is a key feature of insurance, in explaining this indicator.

Question for Board members

Q6: In respect of the “management practices and assessing financial performance” indicator, do Board members agree with the staff recommendations noted in paragraph 34? If not, what other alternatives would you suggest?

Specific indicator: Assets held to pay benefits

Stakeholder feedback

35. Most respondents agreed with this indicator.
36. One respondent [iCare] disagrees with retaining ‘assets held to pay benefits’ as an indicator because this is a standard arrangement for establishment of most public sector schemes.

Staff comments and recommendations

37. Staff recommend retaining this indicator without any substantive amendment considering there is already sufficient acknowledgement that other [non-insurance] schemes would often also have assets held to pay benefits.

Question for Board members

Q7: In respect of the “assets held to pay benefits” indicator, do Board members agree with the staff recommendation to retain the proposed indicator without any substantive amendment?

Ranking the indicators

38. AASB ED 319/NZASB ED 2022-3 asked the following questions:

Q9: Do you agree with not assigning a relative significance to the indicators or having any other form of ranking approach to indicators? If you disagree:

- (a) which indicators would you identify as being most significant, or how would you otherwise rank the indicators, and why?
- (b) would you identify some indicators as pre-requisites for applying AASB 17 and, if so, which ones, and why?

39. In developing ED 319/ED 2022-3, the Boards:

- concluded that they would not propose assigning a relative significance to each of the indicators on the basis that this is generally inconsistent with principle-based standard setting and with the notion of making a collective assessment and applying judgement based on the relevant circumstances [ED 319.BC210/ED 2022-3.BC222]; and
- decided to include a specific question in the ED on whether the indicators should be ranked in some manner and, if so, how they should be ranked and the reasons for that ranking. [ED 319.BC211/ED 2022-3.BC223]

Stakeholder feedback

40. Two respondents supported a collective assessment and no ranking of the indicators [EQC and ICWA], although one [EQC] noted that it would fall with the scope of AASB 17/PBE IFRS 17 in any case.
41. Nine respondents supported some form of ranking of the indicators, as summarised in the following table. Staff note there was also support for ranking among stakeholders with whom we conducted discussions but who chose not to lodge a comment letter.

	(a)	(b)	(c)	(d)	(e)	(f)
Support this indicator being:	<i>Similarity of risks and benefits</i>	<i>Identifiable coverage period</i>	<i>Enforceable arrangement</i>	<i>Source and extent of funding</i>	<i>Mgt practices, assessing performance</i>	<i>Assets held to pay benefits</i>
Pre-requisite		PwC, TSY NZ, iCare, HoTARAC, ACC, KPMG	PwC, TSY NZ, iCare, HoTARAC, ACAG, ACC, KPMG	HoTARAC ¹		
Primary [or high-rank] indicator	PwC, ACAG, ACC	ACAG		PwC, HoTARAC ² , TSY NZ ³ , ACAG, ACC	TSY NZ ⁴ , ACC	

1 or primary

2 or pre-requisite

3 rebuttable

4 rebuttable



	(a)	(b)	(c)	(d)	(e)	(f)
Support this indicator being:	<i>Similarity of risks and benefits</i>	<i>Identifiable coverage period</i>	<i>Enforceable arrangement</i>	<i>Source and extent of funding</i>	<i>Mgt practices, assessing performance</i>	<i>Assets held to pay benefits</i>
Secondary rank	TSY NZ, KPMG			iCare, KPMG	PwC, HoTARAC, ACAG, KPMG	PwC, TSY NZ, ACAG, ACC, KPMG
Low rank [or delete]	iCare ⁵ , HoTARAC				iCare	iCare, HoTARAC

42. While the summary is an imperfect guide to the nuances in some of the submissions, it suggests the following broad conclusions:
- majority support for (b) *Identifiable coverage period* being a pre-requisite, rather than an indicator
 - majority support for (c) *Enforceable nature of arrangement* being a pre-requisite, rather than an indicator
 - the next most highly-ranked indicator is (d) *Source and extent of funding*
 - feedback on (a) *Similarity of risks covered and benefits provided* was mixed
 - there was only moderate support for (e) *Management practices and assessing financial performance* remaining an indicator
 - there was only moderate support for (f) *Assets held to pay benefits* remaining an indicator.
43. The main reasons provided by respondents in favour of ranking, and identifying pre-requisites in particular, were that:
- an *Identifiable coverage period* is needed to enable AASB 17/PBE IFRS 17 to be implemented, both in principle and in practical terms;
 - the *Enforceable nature of an arrangement* is essential to there being a contract, consistent with other Standards applied in the public sector that relate to contracts [on revenue recognition and leases];
 - an *Identifiable coverage period* and the *Enforceable nature of an arrangement* are key distinguishing factors from government schemes that are subject only to eligibility criteria;
 - identifying some pre-requisites would tend to result in a greater level of consistency in application and, therefore, in more consistent outcomes; and
 - identifying pre-requisites would make the assessment easier compared with the potential burden of making a collective assessment of six indicators.
44. Among those who support identifying pre-requisites, there was explicit support from two respondents [ACC and KPMG] for assessing the other [remaining] indicators collectively.

⁵ but using insurer of last resort as an exclusion



45. One respondent [TSY NZ] specifically suggested guidance along the following lines:
- some of the individual indicators are indicators of conditions that are necessary to apply insurance accounting – if the indicator is not met, insurance accounting is likely to be impossible [pre-requisite];
 - a second group of indicators is focussed on whether insurance accounting should be applied – if these indicators are met, insurance accounting is likely to be appropriate [important indicators]; and
 - the third group of indicators add qualitative considerations to the previous indicators – if these indicators are met, that would support the use of insurance accounting; however, their absence does not preclude insurance accounting being applied [secondary indicators].

Staff comments

46. Staff consider that an *Identifiable coverage period* and the *Enforceable nature of an arrangement* are the most significant indicators for the reasons noted immediately above.
47. Staff note that an *Identifiable coverage period* is needed to apply AASB 17/PBE IFRS 17 and, therefore, recommend that it be a pre-requisite. Accordingly:
- (a) if a **coverage period can be identified**, the relevant arrangements would be eligible to apply AASB 17/PBE IFRS 17 and it would be a strong indication that the Standard should apply – however, the other indicators may not support that conclusion; and
 - (b) if a **coverage period cannot be identified**, the relevant arrangements would be ineligible to apply AASB 17/PBE IFRS 17 regardless of the [other] indicators.
48. Staff consider that the *Enforceable nature of an arrangement* is needed to apply AASB 17/PBE IFRS 17 and, therefore, recommend that it be a pre-requisite. Accordingly:
- (a) if **enforceability can be established**, the relevant arrangements would be eligible to apply AASB 17/PBE IFRS 17 and it would be a strong indication that the Standard should apply – however, the other indicators may not support that conclusion; and
 - (b) if **enforceability cannot be established**, the relevant arrangements would be ineligible to apply AASB 17/PBE IFRS 17 regardless of the [other] indicators.
49. Staff consider that identifying pre-requisites has some precedent in both the AASB's and NZASB's Standards.
- (a) The Australian implementation guidance for not-for-profit entities in Appendix F of AASB 15 *Revenue from Contracts with Customers*, essentially sets out that establishing enforceability and identifying whether a performance obligation exists are pre-requisites for applying AASB 15. We consider the AASB 15 discussion on identifying performance obligations by reference to enforceable agreements that involve sufficiently specific promises between parties could be a useful model for providing examples on identifying an enforceable [insurance] arrangement and identifying coverage periods in the context of AASB 17.
 - (b) Within PBE IPSAS 23 *Revenue from Non-exchange Transactions* entities must work through the requirements in paragraphs 8 – 11 to determine whether the substance of a transaction is that of a non-exchange or an exchange transaction. Additionally, in PBE IPSAS 11 *Construction Contracts*, in the absence of a documented contract, entities need to determine whether there is a binding arrangement in order to apply the Standard. This could also provide a useful model for providing examples on identifying an



enforceable [insurance] arrangement and identifying coverage periods in the context of PBE IFRS 17.

50. Staff consider that *Source and extent of funding* and *Similarity of risks covered and benefits provided* should be identified as important indicators that would usually have relevance on a sliding scale: Accordingly:
- (a) the greater the extent of funding of a scheme that is sourced from the person/entity who stand to benefit from coverage, the stronger would be the indication that AASB 17/PBE IFRS 17 should apply; and
 - (b) the greater the similarity between risks and benefits provided under a scheme and those provided under insurance contracts issued by private sector insurers, the stronger would be the indication that AASB 17/PBE IFRS 17 should apply.
51. Staff consider that *Management practices and assessing financial performance* and *Assets held to pay benefits* should be identified as secondary indicators that may help determine whether AASB 17/PBE IFRS 17 should apply when the other indicators are not definitive.

Staff recommendations

52. Staff recommend:
- (a) making both of the following two features **pre-requisites** for applying AASB 17/PBE IFRS 17:
 - Identifiable coverage period
 - Enforceable nature of an arrangement
 - (b) identifying the following as **important indicators** that would usually have relevance on a sliding scale:
 - Source and extent of funding
 - Similarity of risks covered and benefits provided
 - (c) identifying the following as **secondary indicators** that may help determine whether AASB 17/PBE IFRS 17 applies when the other indicators are not definitive:
 - Management practices and assessing financial performance
 - Assets held to pay benefits
 - (d) including brief commentary in guidance explaining the manner in which ranking is expected to function, along the lines suggested by a number of respondents and explaining the rationale for the Boards' decisions on ranking in the Basis for Conclusions
 - (e) including examples that help identify when an arrangement is enforceable and when an arrangement has an identifiable coverage period, probably in an Appendix.

Question for Board members

Q8: In respect of ranking indicators and identifying features of an arrangement that should be considered pre-requisites, do Board members agree with the staff recommendations noted in paragraph 52? If not, what other alternatives would you suggest?



Appendix: Collation of comments on questions 7 to 9 in AASB ED 319 / NZASB ED 2022-3

This Appendix summarises the key comments received from respondents on questions 7 to 9 in AASB ED 319/NZASB ED 2022-3 regarding the proposed indicators for determining which public sector arrangements are in the scope of AASB 17/PBE IFRS 17

Indicators – scope of standard

Q7: Public sector arrangements to which AASB 17 should apply would be identified based on a collective assessment of the following proposed indicators:

- (a) similarity of risks covered and benefits provided;
- (b) identifiable coverage;
- (c) enforceable nature of arrangement;
- (d) source and extent of funding;
- (e) management practices and assessing financial performance; and
- (f) assets held to pay benefits.

Do you agree with these proposed indicators? If you disagree with the proposed indicators, which of them would you exclude?

	Q7 – general comments
PwC	<p>The indicators need to be grounded in the definition of insurance risk, to enable new types of insurance to be included over time. More guidance/examples would be valuable for consistent application.</p> <p>We have not uncovered better alternative indicators.</p>
TSY NZ	<p>Further work is needed on the definition, on the indicators, and the connection between them.</p> <p>The definition needs to be widened to bring public sector insurance schemes appropriately into scope. Our proposed definition is:</p> <p>An insurance contract is a contract <i>or statutory arrangement</i> under which one party (the issuer) accepts significant insurance risk from another party <i>or group</i> (the policyholder <i>or policyholder group</i>) by agreeing to compensate policyholders <i>or other affected parties</i> if a specified uncertain future event (the insured event) adversely affects policyholders <i>or those other affected parties</i>.</p>



Q7 – general comments	
	<p>To illustrate, currently ACC appropriately accounts for its activities as insurance. This is despite ACC being non-voluntary, and despite compensation not being dependent on a risk transfer payment (levy or premium) being paid. The definition in the standard is not met, and the current application guidance with the proposed indicators does not change that fact.</p> <p>If those adjustments are made to the definition, the application guidance on the proposed indicators, particularly (a) [similar risks and benefits] and (d) [source and extent of funding] could be better connected to the definition.</p>
iCare	<p>Unambiguous guidance on the scope of AASB 17 is critical in ensuring uniform application. The proposed indicators do not provide a clear distinction between an insurance contract and a social benefit scheme.</p> <p>iCare acknowledges the challenges of attempting to achieve uniformity in applying this standard across multiple jurisdictions. However, it is also important to acknowledge the construct of the various schemes and legislative frameworks they operate under when accounting for what on face value appears to be schemes that provide similar benefits and cover similar risks.</p>
HoTARAC	<p>Members agree that all of the above factors are relevant when assessing whether an insurance contract exists in the public sector context. However:</p> <ul style="list-style-type: none"> • some of the proposed indicators should instead be taken as the prerequisite/defining characteristics • some indicators are more relevant than others, and this should be clarified, rather than left to preparers’ judgment • if no relative significance can be assigned, the proposed indicators would be better included as guidance that does not form part of the standard • there is insufficient clarity around social benefits and compensation schemes • there is insufficient guidance on how to make a balanced assessment using the indicators – adding illustrative examples of applying the proposed indicators for a collective assessment would be useful. <p>A collective assessment using the six indicators, as currently expressed, would create a significant burden for many public sector entities that do not have insurance contracts. This would lead to inconsistent outcomes due to an insufficient basis to form a judgment that could be expected to be formed by the majority of the preparers:</p> <ul style="list-style-type: none"> • a large number of social benefits schemes and compensation schemes will need to go through the collective assessment, only because they have some or all of the elements in the “definition of an insurance contract”.



	Q7 – general comments
	<ul style="list-style-type: none"> several BC paras suggest that certain indicators are definitive, while other indicators could also be features of non-insurance contracts. Clarifying the relative importance of each indicator in the main text of the standard will be critical to making a balanced judgment. <p>Examples [Note]</p> <p>Add illustrative examples of collective assessments using the proposed indicators, with different outcomes, to allow for comparison. HoTARAC can provide real-life examples to assist with illustrative examples if needed. Without clarifying the substance of an insurance contract in the public sector amendments, it will be challenging for preparers to apply judgments to arrive at consistent conclusions, which will lead to significant diversity in practice.</p> <p>Social benefits [Note]</p> <p>Clarify whether “social benefits” and “compensation schemes” should be scoped out, including identifying their essential features. This could include providing examples of social benefit or compensation schemes that should be treated as insurance contracts, if appropriate. HoTARAC notes the conclusion to oppose scoping out certain arrangements in paragraph BC200. However, HoTARAC also notes some paragraphs (e.g., AusB16.2, BC136, BC166, BC176, BC178(c)) imply that social benefits and compensation schemes are not intended to be treated as insurance contracts. This appears to be an inherent contradiction. Our consultation indicates applying the proposed indicators may lead to social benefits and compensation schemes being in the scope of AASB 17, including examples scoped out in the BC paragraphs above.</p> <p>Rebuttable presumptions about schemes [Note]</p> <p>Including a rebuttable assumption that certain schemes are, or are not, insurance contracts, could reduce unnecessary work in scoping assessments.</p> <p><i>Note: these three comments were in HoTARAC’s response to Q11 – they have been located here due to their association with ‘Scope’.</i></p>
EQC	Agree with the proposed indicators, noting that it is clear that EQC is captured by the standard.
ACAG	<p>Agree with the proposed indicators.</p> <p>Using an illustrative example that applies the indicators to a common public sector arrangement (such as lifetime care benefits) may help promote greater consistency in judgements across like arrangements.</p> <p>It is not clear whether social benefit schemes should be scoped out of AASB 17. Paragraphs AusB16.2, BC199 and BC200 have not specifically excluded social benefit schemes from the scope and require an assessment of the social benefit arrangement against the proposed</p>



	Q7 – general comments
	indicators. There are also a number of paragraphs which identify that social benefit schemes are different from insurance contracts (paragraphs AusB16.2, BC136, BC146) and that these schemes are not intended to be included (paragraph BC166).
ACC	Agree broadly with the proposed indicators.
ICWA	Agree with all the proposed scope indicators.
KPMG	Agree with the indicators that have been identified.

	Q7(a) – similarity of risks covered and benefits provided
PwC	Ranked 3 rd – see the response to Q9.
TSY NZ	<p>This indicator seems to have two elements:</p> <ul style="list-style-type: none"> • Similarity or comparability between the risks and the benefits • Similarity with comparable private sector insurance contracts. <p>Often a feature of public sector insurance contracts is that they fill a ‘protection gap’ that would otherwise not be met by insurance markets. In our view, this is a rationale for inclusion rather than exclusion from the standard.</p> <p>Agree with this indicator – but, include guidance that public sector entities often fill a gap left by the market or provide complementary insurance in addition to private sector insurers, accepting risks and providing compensation that otherwise would not be offered, or would otherwise be considered unaffordable. The complementarity of such arrangements indicates public sector entity’s arrangements are insurance contracts.</p>
iCare	<p>Disagrees with this indicator.</p> <p>Private insurers cover similar risks and benefits in other jurisdictions not bound by the legislative framework of the NSW.</p>



	Q7(a) – similarity of risks covered and benefits provided
	The requirement to identify arrangements outside of the Australian/New Zealand jurisdiction is not practical or feasible. In addition, there are fundamental differences between the legislation applicable in NSW vs other jurisdictions as highlighted in the comparison to Victoria [provided in the submission].
HoTARAC	Agree with this indicator – but, practical applicability is low because public sector schemes often target areas private sector entities will not insure, including the same services, but for high-risk cohorts. Recommend clarifying this is not a primary indicator for the assessment and removing “have similar characteristics” in paragraph BC127 because it is a very broad term and could cause confusion, or clarify what it means in the context of the proposed indicator.
ACC	Agree with the feedback from TSY NZ and their recommendations on ‘similarity of risks covered and compensation provided’ included in the annex to their feedback – see above.
KPMG	It would be helpful to reduce ambiguity that could potentially arise when applying this indicator. For instance, an entity concluding that its risks and benefits are not similar to those in the private sector may not necessarily indicate that its arrangements are not an insurance contract for the reason outlined in paragraph BC131; i.e., some arrangements that are clearly insurance contracts may be issued exclusively in the private sector. We recommend including such an exception in revised wording.

	Q7(b) – identifiable coverage period
PwC	Ranked 2 nd – should be a pre-requisite – see response to Q9.
TSY NZ	Agree with this indicator – extend to “applicable statutory arrangement” having an identifiable coverage period
iCare	Agrees with this indicator. As noted in BC136/137 social benefit schemes are typically open ended and practical implementation of the standards would not allow for the determination of fulfilment cashflows. Agrees that an annual levy for funding purposes is typically for practicality and not for the purposes of coverage (BC138).



	Q7(b) – identifiable coverage period
HoTARAC	<p>Agrees with this indicator – should be a pre-requisite – see response to Q9.</p> <p>Paragraph AusB16.12 scopes out open-ended arrangements to provide benefits based on eligibility criteria. This is slightly different from paragraph BC136 which specifies that eligibility criteria “relate to someone’s inherent status”. HoTARAC recommends clarifying the apparent inconsistency, i.e., whether paragraph AusB16.12 intends open-ended arrangements for benefits based on eligibility criteria that do not relate to someone’s inherent status, being excluded from AASB 17, for example, accidents or natural disasters.</p>
ACAG	<p>The guidance should explain that the party who pays the levy does not have to be the policyholder.</p> <p>Because of the current uncertainty, there are different views in assessing coverage period because there is no contract or arrangement between the payment of the premium / levy and the risks being covered.</p>
KPMG	<p>Agree – however, see response to Q9.</p>

	Q7(c) – enforceable nature of arrangement
PwC	<p>Ranked 1st – should be a pre-requisite – see response to Q9.</p>
TSY NZ	<p>Agree with this indicator – extend to “applicable statutory arrangement” being enforceable – extend to compensating an “other affected party” [not just an insured]</p>
iCare	<p>Agrees with this indicator – should be a pre-requisite.</p> <p>The standard requires a risk margin to account for volatility in claims. There is no need for a risk margin where claims volatility can be managed by changing benefits payable.</p> <p>The reporting date is not relevant as a mitigant to this argument as noted in BC143 as legislative change can occur in less than 12 months if required.</p>



Q7(c) – enforceable nature of arrangement	
HoTARAC	<p>Agrees with this indicator – should be a pre-requisite.</p> <p>This would immediately rule out government schemes where public sector entities retain the capacity to change the benefits payable to scheme participants/eligible beneficiaries, and avoid the need to complete a costly collective assessment process.</p> <p>All the BC paragraphs under the heading “Enforceable nature of arrangement” would still be valid in their current form, as guidance for public sector entities making judgments on the enforceability of an arrangement.</p>
ACAG	<p>The guidance should explain that the party who pays the levy does not have to be the policyholder.</p> <p>Because of the current uncertainty, there are different views in interpreting enforceability – particularly where the policyholder has an enforceable right to compensation, but there is no enforceability from the payer of the premium / levy.</p>
KPMG	<p>Agree – however, see response to Q9.</p>

Q7(d) – source and extent of funding	
PwC	<p>Ranked 4th – see response to Q9.</p>
TSY NZ	<p>Agree with this indicator – add that it is not necessary for the policyholder(s) paying premiums or statutory levies to be the party making claims for compensation.</p>
iCare	<p>Agrees with this indicator.</p> <p>A good indicator on the applicability of this standard is where the policy holder who stands to benefit from the coverage pays for insurance as noted in BC167.</p> <p>Disagree with BC169 if it refers to arrangements such as the NSW Governments Self Insurance entity.</p> <p>The funding from consolidated revenue is to pay for the claims of the previous year that exceeded our initial estimate of claims. If the initial estimate was higher, the funds are returned to consolidated revenue as this is an administrative mechanism to manage claims as opposed to an insurance arrangement.</p>



	Q7(d) – source and extent of funding
HoTARAC	<p>Agrees with this indicator – should be a pre-requisite or primary indicator:</p> <ul style="list-style-type: none"> • Because it immediately rules out a range of social benefits such as aged pensions, universal healthcare activities and disability support [Paragraph BC166] • to achieve consistency with the GFS manual (please refer to Q12 below). HoTARAC agrees that the extent (above zero) of funding, from premiums or levies should be a primary indicator in assessing whether an arrangement is insurance in nature, as a “beneficiary-pays” model.
ACC	<p>The guidance differentiates between premiums received from policyholders and funding from other sources (e.g., recurring funding from general taxation). ACC’s Non-Earner’s account funding is sourced from an appropriation that is paid from general taxation. However, the appropriation amount is calculated in a consistent way with ACC’s levied accounts in that it is an estimate of the lifetime costs of the new year of claims. There are publicly available reports that set out the process for calculating the appropriation released annually.</p> <p>The fact it is funded by general taxation is less of an indicator of insurance than how the amount has been calculated. We suggest that additional guidance is included that differentiates between funding directly out of general taxation and an actuarially calculated appropriation (which aligns better with insurance).</p> <p>ACC agrees with TSY NZ’s suggested definition of an insurance contract – see TSY NZ response to Q7 – general comments.</p>
KPMG	<p>Agree – could be useful in assessing whether the arrangement in question is insurance-like as this would ordinarily be a common feature of insurance contracts issued in the private sector.</p> <p>However, we envisage inconsistency in how this indicator is applied when funding is provided by both the policyholder and other sources. There is no clear indication of the tipping point of being / not being an insurance contract when the funding is from a source other than a policyholder. We can see how different interpretations could be applied in determining what would be considered substantive funding by each public sector entity.</p>



Q7(e) – management practices and assessing financial performance	
PwC	Ranked 5 th – may lead to unintended consequences – see response to Q9.
TSY NZ	Agree with this indicator – add that it is not necessary for the policyholder(s) paying premiums or statutory levies to be the party making claims for compensation.
iCare	Disagrees with this indicator. A scheme does not have to be insurance related to have appropriate management practices and assessment of financial performance. For example, fair and prudent claims management should occur under an insurance contract or a compensation benefit fund.
HoTARAC	Agree with this as a secondary indicator –because it is also a feature of arrangements other than insurance contracts, as stated in paragraph BC178(c). The last sentence in para BC178(c) implies that “compensation arrangements” should not be in the scope of insurance contracts. HoTARAC seeks further clarification from the AASB on this point and the essential features of compensation arrangements that mean these are not insurance contracts.
KPMG	Agree – however, it is not clear whether presence or absence of the activities described in AusB16.22(a)-(c) would be the sole determinant factor in assessing this indicator. Under paragraph AusB16.22, an entity is required to have objectives, policies and processes in conjunction with a financial performance assessment based on meeting the objectives and how successfully the policies and processes have been applied. In our view, merely conducting the three activities, i.e., underwriting and risk management, managing the entity’s capital and ensuring a fair and prudent claims management would not, in itself, meet this requirement. The boards should clarify how conducting the specified activities are expected to satisfy whether an entity has objectives, policies and processes for managing risks associated with those arrangements and for its financial performance to be assessed based on how the entity meets those objectives and how successfully it applies those policies and processes.

Q7(f) – assets held to pay benefits	
PwC	Ranked 6 th [last] – may lead to unintended consequences – see response to Q9.



	<i>Q7(f) – assets held to pay benefits</i>
TSY NZ	Agree with this indicator, but only to enhance the judgement from applying the other indicators.
iCare	Disagrees with this indicator. A fund that is restricted to paying benefits is a standard arrangement for establishment of any public sector scheme.
HoTARAC	Could be a secondary indicator, or completely removed from the list of indicators. Assets held for a specific purpose is a common feature of many public sector schemes, including but not limited to insurance arrangements. This feature would often arise because premiums or levies collected specifically for the arrangement, which is demonstrated by the other proposed indicator of “source and extent of funding” – hence “assets held to pay benefits” seems redundant, and may lead to an unnecessary compliance burden, due to the cost of assessing many government schemes with assets specifically held that are not insurance in nature. While the indicator may help scope out some non-insurance arrangements, the same outcome could be achieved if the public sector amendments clarify the importance of certain indicators over others.
KPMG	Agree. In paragraphs BC198-BC200, we note the boards considered but rejected the idea of identifying specific entities or activities that should be scoped out of AASB 17. However, AASB 17.B26 and B27 provide examples of contracts which are insurance contracts and those which are not. We encourage the AASB to provide further guidance with regard to whether and how those paragraphs intended for for-profit private sector entities are to be applied by public sector entities. AASB 17.B26 and B27 provide the AASB with an example approach to help drive consistency in interpretation of the scope requirements given current diversity in practice.

Alternative indicators

Q8. Do you agree or disagree with some or all of the indicators, do you have suggested alternatives or additional indicators? If so, please outline those indicators and provide supporting reasoning.

	<i>Q8 – alternative indicators</i>
PwC	<p>Does not disagree with identifying arrangements to which AASB 17 should apply through a set of indicators.</p> <p>The indicators need to be grounded in the definition of insurance risk, to enable new types of insurance to be included over time. More guidance/examples would be valuable for consistent application.</p> <p>We have not uncovered better alternative indicators.</p>
TSY NZ	See response to Q7.
iCare	<p>Highlights the significance of the legislative construct of public schemes in applying the appropriate accounting standard and consider there are fundamental differences in the governance frameworks and enabling legislation across the various jurisdictions in Australia.</p> <p><i>Suggested alternative/additional indicators of schemes that are not insurance.</i></p> <ul style="list-style-type: none"> • <i>Guarantee provided by government:</i> removes the need for a risk margin to account for the volatility and uncertainty of claims payments, hence there is no significant insurance risk. • <i>Ability to change benefits for beneficiaries:</i> makes a scheme more akin to a social benefit scheme • <i>Insurer of last resort</i> – benefits provided by a government that the private sector is unwilling to cover in the same jurisdiction should not be accounted for as insurance.
EQC	Agree with the proposed indicators.



Ranking indicators

- Q9: The proposed paragraph AusB16.2/AG16.2 requires that the indicators outlined in paragraphs AusB16.3 to AusB16.25/AG16.3 to AG16.25 are considered collectively so that a balanced judgement can be made. The Boards considered that the proposed indicators should not be ranked or be assigned a relative significance because their relative significance is expected to depend on the circumstances. Do you agree with not assigning a relative significance to the indicators or having any other form of ranking approach to indicators? If you disagree:
- which indicators would you identify as being most significant, or how would you otherwise rank the indicators, and why?
 - would you identify some indicators as pre-requisites for applying AASB 17/ PBE IFRS 17 and, if so, which ones, and why?

	Q9 – ranking indicators
PwC	<p>Some indicators are more important than others – an enforceable arrangement and identifiable coverage are necessary to make application operational.</p> <p>Notes that the indicators of <i>management practices and assessing financial performance</i>; and <i>assets held to pay benefits</i> may lead to unintended outcomes such as an underfunded entity or one poorly managed not then applying AASB 17.</p> <p>If we were to rank the indicators, it would be in the following descending order of importance:</p> <ol style="list-style-type: none"> (1) enforceable nature – <i>pre-requisite</i> (2) identifiable coverage – <i>pre-requisite</i> (3) similarity of risks and benefits (4) source and extent of funding (5) management practices (6) assets held.



Q9 – ranking indicators	
TSY NZ	<p>The indicators should be clearly set out as being of three distinct types:</p> <ol style="list-style-type: none"> 1. pre-requisites: (b) [identifiable coverage period] and (c) [enforceable nature of arrangement] 2. indicators that require greater judgement or assessment, with a rebuttable presumption that if the judgement is positive insurance accounting should be applied: (d) [(source and extent of funding] and (e) [management practices and assessing financial performance] 3. useful indicators to enhance the judgement from the first two sets of indicators: (a) [similarity of risks and benefits] and (f) [assets held to pay benefits].
iCare	<p>Ranked in order of relevance:</p> <ol style="list-style-type: none"> (1) enforceable nature – pre-requisite (2) identifiable coverage – pre-requisite – while some social benefit schemes issue annual levy notices, this can be for administrative purposes only and is not a proxy for the coverage period. (3) insurer of last resort – exclusion – benefits provided by a government that the private sector is unwilling to cover in the same jurisdiction should not be accounted for as insurance (4) ability to retrospectively change benefits – exclusion – negates the need for a risk margin and provides an additional lever to manage liabilities that should not be accounted for as insurance (5) funding source – if funded by the beneficiary, the arrangement is more likely to be insurance – the arrangement is unlikely to be insurance where funding is through government appropriations (both direct and look through)



	Q9 – ranking indicators
HoTARAC	<p>(a) similarity of risks and benefits – practical applicability is low</p> <p>(b) identifiable coverage – pre-requisite</p> <p>(c) enforceable nature – pre-requisite</p> <p>(d) source and extent of funding – pre-requisite or primary indicator</p> <p>(e) management practices and assessing financial performance – secondary indicator</p> <p>(f) assets held – secondary indicator, or delete.</p> <p>If the balanced approach is retained, it should be made more explicit that:</p> <ul style="list-style-type: none"> • Indicators do not necessarily have equal weighting when assessing specific arrangements; • The presence of one or more indicators, does not necessarily mean an arrangement is insurance in nature. <p>Without explicit clarification, there is a risk preparers and auditors will apply the indicators in way that leads to inconsistent outcomes.</p>
EQC	Agree with the indicators being considered collectively rather than using a ranking approach (noting that EQC is not affected by this decision).



	Q9 – ranking indicators
ACAG	<p>While understanding the AASB’s rationale for not weighting, the absence of guidance on the importance of the individual indicators could result in differing application by public sector entities and their auditors, even when those entities have similar arrangements.</p> <p>While more prescriptive guidance may not be consistent with a principle-based standard or highly desirable by the industry because it allows less flexibility in application, it would improve the consistency and comparability of financial statements across like public sector entities.</p> <p>If the AASB does not rate the individual indicators, some ACAG Offices suggest specifying which indicators are of higher importance by splitting these into primary and secondary indicators. ACAG believes the following indicators would be primary indicators (for which more weight is applied):</p> <ul style="list-style-type: none"> • similarity of risks covered and benefits provided • identifiable coverage period • enforceable nature of the arrangement (and a pre-requisite – see below) • source and extent of funding. <p>ACAG believes the following indicators would be secondary indicators [because they would be present in many other public sector arrangements, such as social benefit and other arrangements]:</p> <ul style="list-style-type: none"> • management practices and assessing financial performance • assets held to pay benefits. <p>If a public sector arrangement does not create enforceable rights and obligations then this would not align with AASB 17.2, but in theory could still result in the insurance arrangement being assessed as being within the scope of AASB 17 based on other indicators. If arrangements that were not enforceable were included in the scope of AASB 17 then this would be contrary to other Standards such as AASB 15 <i>Revenue for Contracts with Customers</i>, AASB 16 <i>Leases</i> and AASB 1058 <i>Income of Not-for-Profit Entities</i>.</p>



<i>Q9 – ranking indicators</i>	
ACC	<p>Some indicators should be given more weight than others:</p> <ul style="list-style-type: none"> (b) identifiable coverage – <i>pre-requisite</i> (c) enforceable nature – <i>pre-requisite</i> (f) assets held – lower weight – having assets held to pay benefits is not a key requirement of defining an insurance contract, particularly in the public sector where solvency is not such an issue. <p>The remaining indicators are of equal importance with flexibility in how many of these indicators would need to be met:</p> <ul style="list-style-type: none"> (a) similarity of risks and benefits (d) source and extent of funding (e) management practices and assessing financial performance.
ICWA	<p>Agree with not assigning a relative significance to the indicators or having any other form of ranking approach to indicators.</p>
KPMG	<p>An insurance contract cannot exist unless the arrangement is enforceable and the coverage period is known. A process should be followed similar to the steps required for a not-for-profit entity in determining whether they have an arrangement in the scope of AASB 15:</p> <ul style="list-style-type: none"> • Identify whether there is an enforceable agreement (AASB 17.AusB16.13 - AusB16.16), which is similar to the requirements in AASB 15.F10 – F18; and then • Identify whether there is a coverage period (AASB 17.AusB16.10 – AusB16.12), which is similar to identifying the period over which the good or services are transferred in identifying sufficiently specific performance obligations in AASB 15.F20(d) and F24. <p>Once these indicators are met, the other indicators should be considered collectively to determine whether an insurance contract exists – we do not think that one is more significant than the other. We see the application of indicators is similar to those in other accounting standards, such as the principal vs agent indicators in AASB 15.</p>

Staff paper

Project:	Insurance Activities in the Public Sector	Meeting:	AASB August 2022 (M189) NZASB August 2022 (M102)
Topic:	Risk adjustments in measuring insurance liabilities	Agenda item:	AASB 4.3 NZASB 8.3
Contacts:	Angus Thomson athomson@asab.gov.au Tereza Bublikova tereza.bublikova@xrb.govt.nz Patricia Au pau@asab.gov.au Charis Halliday charis.halliday@xrb.govt.nz	Date:	18 July 2022
		Project priority	Medium
		Decision-making	High
		Project status	Feedback on AASB ED 319 / NZASB ED 2022-3

Objectives of this agenda paper

1. The objectives of this agenda paper are for the AASB and the NZASB to:
 - (a) CONSIDER key comments received on question 6 of AASB ED 319/NZASB ED 2022-3 *Insurance Contracts in the Public Sector* relating to the AASB proposal not to make modifications to the requirements for a risk adjustment and the NZASB proposal for a risk adjustment measured using a rebuttable 75% level of confidence; and
 - (b) DECIDE on the risk adjustment requirements for the purposes of finalising the Standard.

Structure of this paper

2. This paper is structured as follows:
 - (a) Background to the risk adjustment requirement in AASB 17/PBE IFRS 17
 - (b) No modification versus 75% rebuttable presumption
 - (c) Additional disclosures regarding sensitivity of insurance liabilities
 - (d) Staff recommendations
 - (e) [Appendix A](#): Collation of comments on question 6 of AASB ED 319/NZASB ED 2022-3 regarding the risk adjustment
 - (f) [Appendix B](#): Current practice – risk margins.

Background to the risk adjustment requirement in AASB 17/PBE IFRS 17

3. AASB 17/PBE IFRS 17 defines 'risk adjustment for non-financial risk' as:

The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts.

4. AASB 17.B87/PBE IFRS 17.AG87 explains:

The risk adjustment for non-financial risk for insurance contracts measures the compensation that the entity would require to make the entity indifferent between:

- (a) fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and
- (b) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contracts.

5. The risk adjustment for non-financial risk in AASB 17/PBE IFRS 17 is different from the concept of risk margin in the current Standards, which does not consider the compensation that the entity would require for bearing risks. Under the current Standards, the calculation of the outstanding claims liability includes, in addition to the central estimate of the present value of the expected future payments, a risk margin that relates to the inherent uncertainty in the central estimate of the present value of the expected future payments [AASB 1023.5.1.6/PBE IFRS 4. D5.1.6].

Question for respondents in the Exposure Drafts

6. In respect of risk adjustments, question 6 of AASB ED 319/NZASB ED 2022-3 asked stakeholders whether they:

- (a) support the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement; or
- (b) support the NZASB approach of specifying a rebuttable presumption that a risk adjustment reflecting an amount that is estimated to achieve a 75 per cent confidence level is included when measuring a liability for incurred claims; or
- (c) have a suggested alternative approach.

No modification versus 75% rebuttable presumption

Stakeholder feedback

7. Many respondents acknowledged that the proposed 75% rebuttable presumption would be straightforward to implement and avoid debate. One respondent [EQC] explicitly supported requiring the 75% rebuttable confidence level, while noting that, if this were to be removed, they would work with the New Zealand Treasury to determine a suitable risk adjustment. Staff also note that one of the stakeholders consulted by staff who did not subsequently lodge a comment letter was in favour of achieving consistency across public sector entities with the rebuttable presumption of a 75% confidence level.

8. Most respondents supported not having an explicit modification to AASB 17/PBE IFRS 17 for the following reasons:

- consistency with principle-based standard setting;
- many public sector entities would need to rebut the 75% confidence level because it would not be consistent with their pricing policies; and
- a rebuttable 75% confidence level could be viewed as more onerous than the requirements for the private sector.



9. One respondent [PwC] who supported no modification to the Standard suggested that the Heads of Treasuries Accounting and Reporting Advisory Committee could be involved in setting a benchmark for risk adjustments among Australian public sector entities, rather than the Boards.
10. Staff note that two of the stakeholders consulted by staff who did not subsequently lodge a comment letter were confident that consistency across public sector entities could be achieved without the need for a rebuttable presumption.
11. Some respondents also support the Boards providing some form of application guidance, including:
 - to assist entities to determine when an estimate other than the central estimate would need to be used; that is, when other than a zero risk adjustment would be needed [OAG];
 - on the basis that the risk adjustment requirement in AASB 17/PBE IFRS 17 is simply an expression of compensation required due to the uncertainty in fulfilling the liability – additional application guidance should be provided to assist entities that do not require compensation [TSY NZ]; and
 - to explain whether a public sector entity can have a zero risk adjustment and the circumstances when this may be appropriate [HoTARAC and ACAG]
 - explaining how the risk adjustment requirements differ from the existing risk margin requirements [ACC].
12. Staff note that one of the stakeholders consulted by staff who did not subsequently lodge a comment letter expressed the view that a zero risk adjustment does not seem realistic in respect of insurance liabilities and the uncertainty associated with them.

Staff comments – compensation for risk

13. A strict application of the AASB 17/PBE IFRS 17 definition of ‘risk adjustment for non-financial risk’ to an entity that does not seek to be compensated for bearing risk would seem to result in a zero risk adjustment. Since almost all public sector entities do not seek to be compensated in their pricing of levies/premiums for bearing risk, it could reasonably be expected [based on the definition alone] that they would determine zero risk adjustments [a liability with a confidence level of 50%].
14. However, based on AASB 17.B87/PBE IFRS 17.GA87 (quoted in paragraph 4 above), many of the same public sector entities may be reluctant to say they are indifferent between:
 - (a) fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and
 - (b) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contracts.
15. In a private sector context, in which most entities seek to be compensated for bearing risk, the definition and AASB 17.B87/PBE IFRS 17.AG87 both point to a risk adjustment above zero.
16. Given that most public sector entities do not have a level of compensation in mind to anchor their thinking on the measurement of risk adjustments, there remains a concern about the time and resources that might be expended by public sector entities and their advisers debating how the unmodified requirements of AASB 17/PBE IFRS 17 would apply.

17. Staff note there could be two competing perspectives:

<p><i>Risk adjustment would typically be zero</i> <i>[compensation perspective]</i></p>	<p><i>Risk adjustment would typically be positive</i> <i>[indifference to variable cash flows perspective]</i></p>
<p>Public sector entities typically set levies/premiums at break even.</p> <p>An entity literally not seeking to be compensated for bearing risk and based on the ‘risk adjustment’ definition would measure its liability for remaining coverage and liability for incurred claims using a 50% confidence level.</p>	<p>Many public sector entities have large liabilities for incurred claims [often their largest liability by far].</p> <p>Entity management may not be indifferent between fulfilling the claims liability and fulfilling a liability that will generate fixed cash flows with the same expected present value. Accordingly, that entity would measure its liabilities for incurred claims using a confidence level above 50%.</p>

18. Staff note that, as previously discussed by the Boards in November/December 2021 (see [Agenda Paper 5.3](#) for the November 2021 AASB meeting, which is also Agenda Paper 9.2 for the December 2021 NZASB meeting), it is feasible that the confidence level for measuring a liability for remaining coverage, which is based on premiums [under the premium allocation approach] could be different from the confidence level applied to the liability for incurred claims. It is also feasible that the actual pricing structure does not necessarily reflect the risk appetite of the entity. The [minutes](#) for the November/December 2021 meetings note that the Boards agreed to avoid interpreting AASB 17/PBE IFRS 17 on this issue, including not proposing any public sector guidance or modifications that would be construed as interpretations of the matter.
19. If the Boards are to provide guidance on risk adjustments in a public sector context, staff consider that they would need to address the two potentially competing perspectives [**compensation versus indifference to variable cash flows**] in that guidance. Staff believe this can be done in a manner that would not involve interpreting AASB 17/PBE IFRS 17 – refer to paragraphs 22 and 23 below.
- Staff comments – pricing for ‘capital management’ purposes**
20. Staff note that pricing decisions can be based on a range of factors. Complications can arise, for example, when entities include a margin in levies for capital management purposes. By way of illustration, an entity may need to build up its capital in preparation for enhancing future benefits or to make up for previous under-reserving because claims experience has been worse than expected.
21. Staff consider that it would be reasonable to distinguish cases of ‘capital management’ and ‘capital repair’ from cases when an entity is pricing with a view to being compensated for risk. That is, there may be cases when entities price above break even for reasons other than seeking to be compensated for risk, which should be acknowledged. Staff consider that guidance around these issues could be useful.



Staff comments – proposed additional guidance

22. Staff consider that the risk adjustment definition and related AASB 17/PBE IFRS 17 explanatory material should not be modified, but that additional guidance be provided along the following lines.
- (a) Public sector entities that do not seek to be compensated for bearing risk in their pricing/funding [which may relate to funding from levying insureds or from elsewhere, such as from sponsoring governments] would be expected to have zero risk adjustments in their liabilities for remaining coverage. There would be no implicit risk adjustment, in particular, under the premium allocation approach, which measures liabilities for remaining coverage based on levies/premiums received.
 - (b) An ongoing policy of break-even pricing would be indicative of a public sector entity that is not seeking to be compensated for bearing risk.
 - (c) Some public sector entities may seek to be compensated for bearing risk, which would be determined based on identifiable facts and circumstances [such as pricing above break even] and, therefore, have risk adjustments above zero in their liabilities for remaining coverage.
 - (d) Pricing a margin into levies for ‘capital management’ purposes, including building reserves to enhance future benefits or make up for previous under-reserving for the entity on a stand-alone basis because claims experience has been worse than expected, would not be regarded as seeking compensation for bearing risk.
 - (e) Entities that are not indifferent between:
 - (i) fulfilling the claims liability that has a range of possible outcomes arising from non-financial risk; and
 - (ii) fulfilling a liability that would generate fixed cash flows with the same expected present value;would be expected to have risk adjustments above zero [measure its liabilities for incurred claims using a confidence level above 50%].
 - (f) Break even pricing is not, of itself, inconsistent with having a risk adjustment for liabilities for incurred claims. An entity may not price for bearing risk over the long term, but nonetheless not be indifferent to the risk of uncertainty in the timing and/or amount of claims cash flows.
23. Staff consider the Basis for Conclusions should explain the public sector context for the guidance and recommend including the following points.
- (a) In the private for-profit sector, there would generally be expected to be some, at least broad, connection between the compensation charged for bearing risk included in setting premiums and the extent to which the insurer is indifferent between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87. This broad connection would be expected given that private sector insurers endeavour to remain profitable and are expected to remain solvent from a prudential reporting perspective.
 - (b) In the public sector, due to an entity holding a monopoly position and/or implicit or explicit government guarantees, the broad connection noted in (a) above may not exist. Accordingly, a public sector entity might use a confidence level of 50% in pricing levies/premiums, which are the basis for measuring its liabilities for remaining coverage (including under the premium allocation approach) while measuring its liabilities for



incurred claims applying a confidence level above 50% (and have a risk adjustment above zero).

24. Based on the information stakeholders have provided about how public sector arrangements are currently being managed, staff acknowledge that the likely practical outcome of the above explanatory material would be that:
- (a) in measuring their **liabilities for remaining coverage**:
 - (i) most [possible all] public sector entities would be expected to have **zero risk adjustments** because risk is not priced into their levies/premiums, which is consistent with current practice;
 - (ii) in the event that risk is priced into a public sector entity's levies/premiums, it would have a **risk adjustment above zero**;
 - (b) in measuring their **liabilities for incurred claims**:
 - (i) some public sector entities would have **zero risk adjustments** on the basis that their managements are **indifferent** between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87;
 - (ii) some public sector entities would have **positive risk adjustments** on the basis that their managements are **not indifferent** between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87.

Staff comments – impacts of the proposed guidance

25. The impact of the guidance described in paragraph 24 on the measurement of liabilities for incurred claims by public sector entities would differ depending on their circumstances – the following examples are illustrative. [Appendix B](#) to this paper outlines current practices on risk margins among Australian and New Zealand public sector entities.

<i>Standard currently applied by the entity</i>	<i>Risk margin currently applied by the entity</i>	<i>Risk adjustment under AASB 17/PBE IFRS 17</i>	<i>Likely impact</i>
AASB 1023/PBE IFRS 4	75% confidence level	50% plus confidence level	No change [if 50% plus = 75%] or small change
		50% confidence level	Reduced liability
AASB 137 [Australia only] ¹	50% confidence level	50% plus confidence level	Increased liability
		50% confidence level	No change
	75% confidence level	50% confidence level	Reduced liability

26. Any transitional adjustment would be expected to be a debit/credit to insurance liabilities and a credit/debit to equity [AASB 17/PBE IFRS 17.C4(c)]. The transition adjustment amount could be material because some public sector entities have liabilities for incurred claims that relate to decades of past accident/underwriting years.

1 AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. Staff are not aware of any New Zealand public sector entities that are candidates for applying PBE IFRS 17 which are currently applying PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.



27. Staff note that, in cases in which there is a link between pricing [setting levies/premiums] and the accounting position, there could be, for example:
- (a) temporary downward impacts on pricing for an entity that moves from measuring insurance liabilities based on a 75% confidence level to a 50% confidence level; and
 - (b) temporary upward impacts on pricing for an entity that moves from measuring their liabilities based on a 50% confidence level to a 75% confidence level.

Additional disclosures

Stakeholder feedback

28. Some respondents mention that sensitivity disclosures relating to best estimates would be useful to help explain potential variability in insurance liabilities, particularly when an entity has a zero risk adjustment [TSY NZ and ACC].

Staff comments

29. AASB 17/PBE IFRS 17 already requires the following disclosures:
- in respect of insurance liabilities as a whole, sensitivities around key assumptions and the impacts on profit and equity, which would typically include disclosures of the impact on along the following lines [AASB 17/PBE IFRS 17.128]:
 - 5-10% plus or minus variation in weighted average term to settlement of claims
 - 5-10% plus or minus variation in the level of claims
 - 1-2% plus or minus change of discount rate
 - 1-2% plus or minus change of inflation rate²
 - in respect of the risk adjustment, the confidence level applied [AASB 17/PBE IFRS 17.119].³
30. Staff consider that, because public sector entities do not have the same focus around compensation for bearing risk that exists in the commercial private sector, the reporting of risk adjustments by public sector entities might be less comparable than for the private sector. Accordingly, public sector entities should be required to make additional disclosures to help overcome the potential lack of comparability.
31. Staff consider that, in addition to the requirements noted above, public sector entities should be required to disclose, for example, sensitivity of insurance liabilities to changes to the confidence level, such as plus or minus 10%. The amounts are not difficult to determine and provide an overall snapshot of variability that builds on the existing AASB 17/PBE IFRS 17.128 disclosures. This disclosure would be a particularly useful for an entity that has a zero risk adjustment.

2 Please note, these are typical examples of sensitivity disclosures required. The actual disclosures made in response to the requirements would depend on the entity's circumstances.

3 If the entity uses a technique other than the confidence level technique, the entity must disclose the technique used and the confidence level corresponding to the results of that technique [AASB 17/PBE IFRS 17.119]. Public sector entities would not be expected to use anything other than a confidence level approach.



32. Staff acknowledge that this is akin to an approach that the Boards previously considered and rejected in developing AASB ED 319/NZASB ED 2022-3. In 2021, the Boards considered a range of possible approaches in respect of risk adjustments:
- (a) No modifications
 - (b) No modifications – **with disclosure** required of a risk adjustment at a benchmark confidence level (such as 75%) to provide a point of reference for comparison
 - (c) Specifying a zero risk adjustment – that is a confidence level of 50%
 - (d) Specifying a zero risk adjustment – **with disclosure** required of a risk adjustment that would have been recognised if AASB 17/PBE IFRS 17 applied unmodified
 - (e) Specifying a particular confidence level above 50% (such as 75%)
 - (f) Specifying a particular confidence level above 50% – **with disclosure** required of a risk adjustment that would have been recognised if AASB 17/PBE IFRS 17 applied unmodified.

Staff recommendations

33. Staff recommend:
- (a) not to modify the requirements in AASB 17/PBE IFRS 17 to determine risk adjustments based on the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise from insurance contracts;
 - (b) providing guidance to the effect that:
 - (i) public sector entities that do not seek to be compensated for bearing risk in their pricing/funding [which may relate to funding from levying insureds or from elsewhere, such as from sponsoring governments] would be expected to have zero risk adjustments in their liabilities for remaining coverage. In particular, under the premium allocation approach, which measures liabilities for remaining coverage based on levies/premiums received, there would be no implicit risk adjustment;
 - (ii) some public sector entities may seek to be compensated for bearing risk, which would be determined based on identifiable facts and circumstances [such as pricing above break even] and, therefore, have risk adjustments above zero in their liabilities for remaining coverage. This could include cases in which entities have been tasked with raising revenue for the controlling government. However, it would not include cases in which entities have, for example, been tasked with building reserves to cater for long-term variability of cash flows of the entity on a stand-alone basis, without resorting to working capital from government;
 - (iii) public sector entities that are not indifferent between fulfilling a liability that has a range of possible outcomes arising from non-financial risk and fulfilling a liability that would generate fixed cash flows with the same expected present value, would be expected to have risk adjustments above zero [measure their liabilities for incurred claims using a confidence level above 50%];
 - (iv) some public sector entities may be indifferent between the two sets of cash flows mentioned in (iii) above and would be expected to have no risk adjustments [measure their liabilities for incurred claims using a confidence level of 50%];



- (c) in the Basis for Conclusions, explaining the public sector context for the guidance [see paragraphs 22 and 23 above];⁴ and
- (d) requiring disclosure of the sensitivity of insurance liabilities to changes to the confidence level, such as plus or minus 10%.

Question for Board members

Q1: Do Board members agree with the staff recommendations noted in paragraph 33? If not, what other alternatives would you suggest?

4 Staff note that the Basis for Conclusions to AASB ED 319/NZASB ED/2022-3 currently includes discussion that might be inconsistent with these recommendations and would need to be revised, depending on the Boards' decisions at this meeting.



Appendix A: Collation of comments on question 6 in AASB ED 319 / NZASB ED 2022-3 – risk adjustments

Q6 The AASB is proposing no modifications to the AASB 17 requirement for a risk adjustment that reflects the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

In contrast, the NZASB is proposing a modification to require a risk adjustment that reflects an amount that is estimated to achieve a 75 per cent confidence level for a liability for incurred claims, which can be rebutted.

The proposed paragraph 37.1 in the NZASB’s Exposure Draft states:

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

(a) Do you support:

- (i) the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement; or
- (ii) the NZASB approach of specifying a rebuttable presumption that a risk adjustment reflecting an amount that is estimated to achieve a 75 per cent confidence level is included when measuring a liability for incurred claims?

Please provide your reasons.

(b) Do you have a suggested alternative approach? If so, please outline the approach and provide supporting reasoning.

	Q6 – risk adjustments
OAG NZ	<p>Does not support the NZASB proposed modification.</p> <p>Supports the principles-based approach that makes no modifications to PBE IFRS 17.37.</p> <p>PBE IFRS 17.37 [adjusting the estimated present value of future cash flows to reflect compensation required for bearing the uncertainty about the amount and timing of the cash flows] and PBE IFRS 17.119 [disclosures about the risk adjustment] are appropriate for public sector entities. Supports the AASB’s conclusions and reasons for public sector entities to apply AASB 17/PBE IFRS 17 with no modification (see paragraphs BC126-BC127).</p>



	Q6 – risk adjustments
	<p>Public sector entities set levies to recover expected costs – the central estimate is the most relevant amount for these expected costs. Recognising a liability above the central estimate would mean the entity will recover levies and other funds at an amount over and above what it requires or expects to pay in claims. This would be inconsistent with the principle of inter-generational equity.</p> <p>While acknowledging the cost-benefit reasons for proposing the rebuttable presumption, they are not considered sufficiently compelling to justify a 75 % confidence level, rather than using the central estimate, when measuring a liability for incurred claims.</p> <p>If a rebuttable presumption was required, it would be preferable for the rebuttable presumption to be that no risk margin is included, and if this is rebutted, then the entity uses a 75% confidence level.</p> <p>Recommend that:</p> <ul style="list-style-type: none"> • A public sector entity be required to apply PBE IFRS 17 without the proposed modification; and • Application guidance be included in PBE IFRS 17 to assist entities to determine when an estimate other than the central estimate would need to be used.
PwC	<p>Do not disagree with the AASB proposal for not modifying the AASB 17 requirement for a risk adjustment. There is inherent risk in estimating these future cashflows and a risk adjustment acknowledges this.</p> <p>While pragmatically we can see how a 75% confidence level can be justified, as this is a principle-based standard, a particular per cent should not be legislated. Significant judgement would need to be applied by public sector entities to determine the level of compensation they require for bearing the risk of uncertainty associated with liabilities for incurred claims. In the private sector risk adjustments have trended over time towards consistency, assisted by guidance from APRA.</p> <p>Encourage as part of the implementation process for the Heads of Treasury Accounting and Reporting Advisory Committee (HoTARAC) to do an analysis and adopt something like the NZASB approach as part of their implementation process for all public sector entities to:</p> <ol style="list-style-type: none"> (1) have a consistent approach based on a common confidence level, (2) reduce report preparation costs by removing the need for management and auditors to determine/assess risk adjustments, and (3) better illustrate the impacts of any changes in risk adjustments, which provides useful information about changing levels of uncertainty about the amount and timing of cash flows over time.



Q6 – risk adjustments	
TSY NZ	<p>Preparers, auditors, and users need to be very clear about the purpose of the risk adjustment in the public sector and its usefulness to users of public sector financial statements.</p> <p>Under the current proposed standard, the Treasury does not think that is the case.</p> <p>The proposal suggests two conflicting rationales for the adjustment, which leads to two different interpretations of risk adjustments for public sector insurance arrangements:</p> <ul style="list-style-type: none"> • First Rationale: Risk adjustment as an allowance for uncertainty; and • Second Rationale: Risk adjustment as a compensation for uncertainty <p>Neither would necessarily result in the application of a rebuttable presumption that a risk adjustment reflecting an amount that is estimated to achieve a 75% probability of liability for incurred claims.</p> <p>The AASB proposal is likely to lead to unnecessary and costly debates between preparers and auditors and confusion among users.</p> <p><i>Implication for the proposed standard</i></p> <p>A public sector amendment is appropriate for the proposed standard. The public sector difference arises because public sector entities seeking to improve wellbeing and resilience of policyholder groups do not require compensation for bearing the uncertainty related to insurance contract liabilities.</p> <p>Option 1: If the NZASB considers it appropriate for a risk adjustment for public sector entities to prudently make an allowance to represent the uncertainty in fulfilling the liability (the first rationale), the definition of the risk adjustment should be reworded in such cases to reflect that, and additional guidance provided to assist in its calculation.</p> <p>Option 2: If the risk adjustment is simply an expression of the compensation required due to the uncertainty in fulfilling the liability (the second rationale), additional application guidance should be provided to assist preparers who do not require compensation. The guidance should explicitly allow for a zero-risk adjustment and may include additional sensitivity disclosures, so the effect of the uncompensated uncertainty is made clear.</p> <p>Treasury prefers Option 2 – it provides the cleanest and most understandable position for preparers, auditors and users. However, Treasury would prefer Option 1 to the rebuttable presumption currently proposed in ED 2022-3.</p>



	Q6 – risk adjustments
iCare	Supports not modifying AASB 17. The NZASB proposal would be more onerous than the requirements of the private sector. iCare’s risk management is based on industry best practice and aligned to APRA Guidelines where practicable.
HoTARAC	Members support the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement. However, we seek clarification from the AASB on the possible contradiction between paragraph BC114(b) that states public sector entities might determine a zero risk adjustment, and paragraphs BC109, 111 and 112, which state that requiring a zero risk adjustment would be inappropriate.
EQC	Historically have reserved at a 75% probability of sufficiency, and more recently at 85%, at the decision of the Board to take a more conservative approach. Overall, the application of the rebuttable 75% confidence level is more clear cut in application than the alternatives, as the determination of a risk adjustment could be contentious in the public sector. We note Treasury advice that the determination of the EQC levy must follow guidance in respect of compulsory levies; in particular that it must only reflect the cost of services provided, so no profit margin is allowed. Overall, we are supportive of the NZASB approach with the 75% rebuttable confidence level. If this were to be removed, we would work with our colleagues at The Treasury to determine a suitable risk adjustment.
ACAG	Supports the AASB approach of not modifying the AASB 17 requirement regarding the risk adjustment as this is consistent with a principles-based standard and allows public sector entities to have regard to their individual facts and circumstances. However, the Basis for Conclusions should explain whether a public sector entity can have a zero-risk adjustment and the circumstances when this may be appropriate. Contradictory views are expressed in paragraphs BC93 and BC114 which may result in differing application by public sector entities and their auditors, even when those entities have similar arrangements. Irrespective of whether the scheme is long tail, some ACAG Offices believe some risk adjustment may be necessary because: <ul style="list-style-type: none"> • even where the agency’s liability is guaranteed by its government, own credit risk does not appear to be part of the AASB 17 definition of risk adjustment • public sector entities are subject to the same or similar variability of cash-flows (i.e., uncertainty of the amounts of outstanding claims) as private sector entities.



Q6 – risk adjustments	
ACC	<p>The requirement should principles-based with the goal being to improve information for the users of public sector financial statements.</p> <p>ACC’s funding policy is based on best estimate assumptions with no pricing for additional risk. The Government has an on-going obligation to fund the ACC Scheme and its funding policy is long-term in nature pursuant to the Accident Compensation Act. ACC is able to adjust future levies to make up for higher-than-expected past claims. Our balance sheet should be consistent with our funding policy and no risk adjustment be included.</p> <p>It is important for users to understand the uncertainty in large balance sheet items like insurance liabilities. We suggest a sensitivity is included for the risk adjustment, which would provide better transparency. Sensitivity analysis generally includes individual changes in assumptions. A sensitivity for risk adjustment would provide additional information in that it considers all assumptions at once.</p> <p>If we are required to recognise a risk adjustment on balance sheet, we are comfortable with the NZASB proposed modification above. We note that the proposed wording differs slightly from the current risk margin approach in IFRS 4 in that it explicitly mentions timing and non-financial risk. We would appreciate additional guidance on if/how the methodology proposed differs from the current risk margin approach.</p>
ICWA	<p>Support no modifications to AASB 17 regarding the risk adjustment. The addition of a risk margin on claim liabilities recognises the inherent risk in the valuation of future claim costs and that such liabilities are not risk-free.</p> <p>The ICWA intends to continue to apply a risk margin that will achieve a 75% probability of sufficiency across all its insurance portfolios.</p> <p>The disclosure requirements will enable users to understand the risk margin assumptions of the entity and provide the ability to compare the underlying assumptions of different public sector entities.</p>
KPMG	<p>We support not modifying the risk adjustment requirement as this is consistent with principle-based standard setting. Although NZASB approach of standardising the probability of sufficiency with a rebuttable presumption would make the requirement relatively straightforward to implement, we note the risk adjustment under AASB 17 is entity-specific.</p> <p>The risk adjustment is “revenue-like in nature” and therefore its information value for public sector entities will not be the same as for private sector counterparts, as the approach to pricing risk in their contracts is different.</p> <p>The risk adjustment information would be useful from a claims and claims management perspective, which we understand is where users’ focus lies in the public sector.</p>



Appendix B: Current practices – risk margins

B.1 The table below outlines the practices of a number of Australian and New Zealand entities with respect to risk margins. The table and commentary below is reproduced from the AASB [Agenda Paper 10.3](#) and NZASB Agenda Paper 5.3 for the April 2021 meetings of the Boards.

Entity		Risk margin ¹	Currently applying
Accident Compensation Commission (NZ)		Yes – 75% PoA ²	PBE IFRS 4
Earthquake Commission (NZ)		Yes – 85% PoA	PBE IFRS 4
iCare (NSW):	Dust Diseases Care	None	AASB 137
	Lifetime Care	None	AASB 137
	Insurance for NSW – various Funds	Some at 75% PoA – some have none	Some use AASB 1023 and others AASB 137
	Home Building Compensation	Yes – 75% PoA	AASB 1023
	Workers' Insurance	Yes – 80% PoA	AASB 1023
	Sporting Injuries Scheme	Yes – 75% PoA	AASB 1023
	Building Insurers' Guarantee	None	AASB 137
WorkSafe (QLD)		Yes – 75% PoA	AASB 1023
WorkSafe (VIC)		Yes – 75% PoA	AASB 1023
WorkCover [RiskCover Fund] (WA)		Yes – 75% PoA	AASB 1023
ReturnToWorkSA (SA)		Yes – 75% PoA	AASB 1023
ComCare (Australia)		Yes – 75% PoA	AASB 1023
Victorian Managed Insurance Authority (VIC)		Yes – 75% PoA	AASB 1023
South Australian Finance Authority (SA) [SAicorp Division]		Yes – 75% PoA	AASB 1023
Insurance Commission (WA)	Risk Cover Fund	Yes – 75% PoA	AASB 137
	Third Party Insurance Fund	Yes – 75% PoA	AASB 1023
	Motor Vehicle Catastrophic Injury	Yes – 75% PoA	AASB 1023
Transport Accident Commission (VIC)		Yes – 75% PoA	AASB 1023
Motor Accident Insurance Board (TAS)		Yes – 75% PoA	AASB 1023
Nominal Defendant (QLD)		None	AASB 1023
National Injury Insurance Agency (QLD)		None	AASB 137
Lifetime Support Authority (SA)		Yes – 81% PoA	AASB 137
Australian Reinsurance Pool Corporation		None – currently has no claim liabilities	AASB 1023

1 Some entities refer to a 'prudential reserve'.

2 **PoA = 'Probability of Adequacy' or 'Confidence Level'**. Some entities have a fixed percentage year-on-year; however, the PoA varies from year-to-year for others. In most cases, the PoA for 2020 annual reports is shown here.



- B.2 Based on stakeholder feedback from interviews conducted by staff and through the review of financial statements, most public sector entities consider that:
- (a) AASB 1023/PBE IFRS 4 requires a risk margin to be included in measuring liabilities for outstanding claims ('liability for incurred claims' in AASB 17/PBE IFRS 17 language); and
 - (b) AASB 137/PBE IAS 37 does **not require** a risk margin to be included in measuring provisions, **but permits** a risk/prudential margin to be included.
- B.3 The stakeholder feedback also revealed that some public sector entities:
- (a) chose to apply AASB 137/PBE IAS 37 (rather than AASB 1023/PBE IFRS 4) because they do not regard risk margins as appropriate to their circumstances;
 - (b) had assumed that their risk adjustments under AASB 17/PBE IFRS 17 would be the same as their risk margins under AASB 1023/PBE IFRS 4; and/or
 - (c) have yet to consider whether they would have a risk adjustment under AASB 17/PBE IFRS 17 and, if they did, whether it would be more or less than any risk margin they currently apply.



Staff paper

Project:	Insurance Activities in the Public Sector	Meeting:	AASB August 2022 (M189) NZASB August 2022 (M102)
Topic:	Emerging issues: adverse development covers and investment components	Agenda item:	AASB 4.4 NZASB 8.4
Contacts:	Angus Thomson athomson@asb.gov.au Tereza Bublikova tereza.bublikova@xrb.govt.nz Patricia Au pau@asb.gov.au Charis Halliday charis.halliday@xrb.govt.nz	Date:	18 July 2022
		Project priority	Medium
		Decision-making	High
		Project status	Feedback on AASB ED 319/ NZASB ED 2022-3

Objectives of this agenda paper

1. The objectives of this agenda paper are for the AASB and the NZASB to:
 - (a) CONSIDER two emerging issues in the public sector regarding:
 - (i) adverse development covers; and
 - (ii) investment components; and
 - (b) DECIDE on whether to monitor these emerging issues or address them now.

Adverse development covers

Background

2. Most general insurance is for claims incurred due to events that arise in the coverage period.
3. By way of example, an insurer that issues contracts which cover claims arising from incidents that occur during a one-year coverage period and that subsequently manages the claims to settlement can be considered as having two liabilities:
 - (a) a liability for the risk of [future] incidents occurring over the one-year coverage period; and
 - (b) a liability for [past] incidents which occurred during the one-year coverage period that may take years to settle.
4. Typically, an insurer would treat (a) as a liability for remaining coverage and recognise premium revenue over one year, and treat (b) as a liability for incurred claims.
5. The IASB's Transition Resource Group for IFRS 17 clarified that, under IFRS 17, an insurer could exercise an accounting policy choice to treat (b) as a second form of coverage for



‘consequential risks’.¹ However, few if any entities are expected to treat consequential risks as coverage, since it would be inconsistent with longstanding industry practice.

6. However, under AASB 17.B5/PBE IFRS 17.AG5, if the insurance contracts change hands after the initial coverage period, an insurer acquiring a liability for [past] incidents from another insurer would have only the one coverage period relating to the period of settlement of claims.
7. In these cases, entities are required to treat the consequential risks as coverage under AASB 17.B5/PBE IFRS 17.AG5, which notes [emphasis added]:

B5/AG5 Some insurance contracts cover events that have already occurred but the financial effect of which is still uncertain. An example is an insurance contract that provides insurance coverage against an adverse development of an event that has already occurred. **In such contracts, the insured event is the determination of the ultimate cost of those claims.**

Accordingly, AASB 17/PBE IFRS 17 requires a liability for incurred claims in the hands of the originating insurer to be converted into a liability for remaining coverage in the hands of the acquiring entity.

8. The following examples are intended to illustrate the possible accounting treatments.

Example 1: Insurer A issues insurance contracts and manages the claims to final settlement

	Coverage for incidents occurring in a one-year period	10-year period of claims settlement [and possible adverse development]	Implications
Expected practice	Recognise liability for remaining coverage	Recognise liability for incurred claims	Coverage [and revenue recognition] period is one year
Possible policy choice	Recognise liability for remaining coverage	Recognise liability for remaining coverage for ‘consequential risks’	Coverage [and revenue recognition] period is 11 years [one plus 10]

Example 2: Insurer A issues insurance contracts and Insurer B acquires the contracts from Insurer A after the initial coverage period and manages the claims to final settlement

	Coverage for incidents occurring in a one-year period	10-year period of claims settlement [and possible adverse development]	Implications
Required practice	Insurer A: Recognise liability for remaining coverage	Insurer B: Recognise liability for remaining coverage	Coverage [and revenue recognition] period is one year for Insurer A
			Coverage [and revenue recognition] period is 10 years for Insurer B

¹ In particular, paragraphs 9(b) of the [Summary of the Transition Resource Group for IFRS 17 Insurance Contracts meeting held on 26–27 September 2018](#).



Feedback on AASB ED 319/NZASB ED 2022-3

9. In one comment letter on AASB ED 319/NZASB ED 2022-3, and based on several staff discussions with stakeholders, adverse development coverage has emerged as a possible issue in the public sector.

Implications

10. If an adverse development arrangement, based on an assessment of the indicators, falls within AASB 17/PBE IFRS 17, the adverse development coverage relates to the claims run-off period, which is potentially a long period. This may make it difficult to meet the eligibility criteria for applying the premium allocation approach, in which case the more complex general measurement model would need to be applied.²
11. Adverse development coverage would typically end either at the time claims are actually settled, or close to that time. Accordingly, the insurer may never recognise a liability for incurred claims and there may never be any claims development disclosures to help demonstrate how well the insurer has estimated claims over the long term.

Stakeholder feedback received during outreach

12. There is currently one arrangement staff are aware of being established by a public sector entity in Australia that assumes the claims liabilities of private sector insurers five years after the events that gave rise to the claims. The public sector entity is compensated by a levy on the premiums for the contracts issued by the private sector insurers. There are two potential issues:
- accounting for the arrangement on an ongoing basis for future contracts; and
 - accounting for the backlog of existing contracts under the arrangement.
13. In respect of **future contracts**, this particular arrangement has some of the features of an adverse development cover. However, staff also note the following two significant factors.
- (a) Further analysis might determine this particular arrangement is not an adverse development cover. This is on the basis that the relevant legislation might make the public sector a party to the insurance contracts when they are first issued by the private sector entity, rather than being contracts that are transferred from the private sector entity to the public sector entity at the claims settlement stage.
- (b) It is not yet clear whether further arrangements that have some of the features of an adverse development cover might arise in future, including across other jurisdictions.
14. In respect of the **backlog of contracts**, on transition to AASB 17/PBE IFRS 17, an accounting policy choice is available that permits the 'acquired contracts' to be treated as resulting in a liability for incurred claims [AASB 17/PBE IFRS 17.C9A]. However, other than at transition, there is no relief available in AASB 17/PBE IFRS 17 to cater for the introduction of new arrangements or the transfer of insurance contracts between entities under common control, such as from one public sector entity to another.
15. One option the Boards could consider is to provide the same policy choice as the transitional provision for a public sector entity to account for the insurance contracts acquired in their settlement period as an adverse development cover or as a liability for incurred claims.

² One of the eligibility criteria for an entity to apply the simpler premium allocation approach to measure liabilities for remaining coverage is when the coverage period of the contract is one year or less [AASB 17/PBE IFRS 17.53(b)].



Private versus public sector context

- 16. There is no explicit basis for regarding the issue of adverse development covers in the public sector as being different from the private sector.
- 17. Even though there may ordinarily be an expectation among users that a public sector entity would report claims and claims development during a claims settlement period, consistent with all the other claims that it might manage, the same could probably be said for private sector entities.

Staff recommendation³

- 18. Based on the feedback received to date, staff have not identified a public-sector-specific reason to modify AASB 17/PBE IFRS 17 regarding this matter. Staff recommend not taking any action now, except to monitor the issue of adverse development covers among public sector entities.

Question for Board members

Q1: In respect of adverse development covers, do Board members agree with the staff recommendation to take no action now, but to monitor the issue in respect of public sector entities?

Investment components

Background

- 19. IFRS 17 has been designed to apply to all types of insurance contracts, many of which have conventionally been hybrid contracts that include both an insurance component and an investment component.
- 20. Under AASB 17/PBE IFRS 17, an ‘investment component’ is defined as follows:

The amounts that an insurance contract requires the entity to repay to a policyholder in all circumstances, regardless of whether an insured event occurs.
- 21. This definition could potentially be applicable to a range of general insurance contracts that have not been conventionally considered to have investment components, as demonstrated in the following simplistic example for a workers’ compensation contract with a coverage period from 1 July 20X1 to 30 June 20X2.

Premium from employer to insurer	Paid on 15 July 20X1	\$1,000
Expected claims	Coverage for 1 July 20X1 to 30 June 20X2	\$900
Rebate if actual claims are below \$800	Coverage for 1 July 20X1 to 30 June 20X2	\$50

- 22. The insurer will repay the employer \$50 in all circumstances, either as claims or a premium rebate, as shown in the following table. Accordingly, the \$50 is an investment component.

³ Please note that staff do not presume the Boards would wish to modify AASB 17/PBE IFRS 17 in the event that adverse development covers became a material issue in the public sector, since the information resulting from applying AASB 17/PBE IFRS 17 [unmodified] may be considered useful.



Level of claims	Repaid to employer	Nature of repayment
\$1,100	\$1,100	All claims
\$900	\$900	All claims
\$800	\$800	All claims
\$700	\$750	Part claims, part rebate
\$0	\$50	All rebate

Accounting treatment of investment components

23. AASB 17/PBE IFRS 17 paragraphs 10–13 and AG31 require insurers to identify **distinct** ‘investment components’ and account for them separately under AASB 9/PBE IPSAS 41, which would involve:
- presenting investment components in the balance sheet as a financial liability, rather than as part of the insurance liabilities; and
 - accounting for the revenue and expense impacts of the investment component under AASB 9/PBE IPSAS 41.
24. When ‘investment components’ relate to cash flows that are highly interrelated with the relevant insurance contracts, they are **non-distinct** based on AASB 17.B32/PBE IFRS 17.AG32, and are accounted for under AASB 17/PBE IFRS 17, which would involve:
- presenting investment components in the balance sheet as part of the insurance liabilities; and
 - not recognising any revenue or expense impacts of receiving or repaying the investment component in the income statement under AASB 17 [or AASB 9].

The workers’ compensation example above is for a **non-distinct** investment component and would be accounted for within AASB 17/PBE IFRS 17.

Stakeholder feedback received during outreach

25. Staff have been conducting outreach among workers’ compensation insurers in the public sector to help determine whether investment components are likely to arise. Based on the feedback received so far from entities that have considered the issue:
- most claims-related premium adjustments [including rebates] are made to the following year’s premiums, which does not give rise to an investment component because it relates to a different coverage period and claims-related premium adjustments are a valid form of risk-rating for the subsequent premium; and
 - there is only an immaterial level of claims-related premium adjustments that are made to current year premiums, which could give rise to an investment component.
26. However, some public sector entities have not yet given sufficient consideration to the issue to determine whether they would have material investment components.

Public versus private sector context

27. The notion that a public sector entity would exclude a portion of its levy/premium income from its income statement on the basis that it represents investment components may seem counter-intuitive to users of the financial statements. That is, there may ordinarily be an



expectation among users that a public sector entity would report as income all the levies/premiums it collects for accountability purposes.

28. However, there is no explicit basis for regarding the issue of non-distinct investment components in the public sector as being different from the private sector.

Staff recommendation⁴

29. Based on the feedback received to date, staff have not identified a public-sector-specific reason to modify AASB 17/PBE IFRS 17 regarding this matter. Staff recommend monitoring the issue of investment components among public sector entities.

Question for Board members

Q2: In respect of the investment component issue, do Board members agree with the staff recommendation to take no action now, but to monitor the issue in respect of public sector entities?

4 Please note that staff do not presume that the Boards would wish to modify AASB 17/PBE IFRS 17 in the event that investment components became a material issue in the public sector, since the information resulting from applying AASB 17/PBE IFRS 17 [unmodified] may be considered useful.



Staff Paper

Project:	Insurance Activities in the Public Sector	Meeting:	AASB August 2022 (M189) NZASB August 2022 (M102)
Topic:	Bank depositor compensation schemes	Agenda item:	AASB 4.6 NZASB 8.6
Contacts:	Angus Thomson athomson@asb.gov.au Tereza Bublikova tereza.bublikova@xrb.govt.nz Patricia Au pau@asb.gov.au Charis Halliday charis.halliday@xrb.govt.nz	Date:	18 July 2022
		Project priority	Medium
		Decision-making	Low
		Project status	Feedback on AASB ED 319/ NZASB ED 2022-3

Objectives of this paper

1. The objectives of this paper are for the AASB and the NZASB to:
 - (a) NOTE the submission letter from the Reserve Bank of New Zealand on ED 2022-3 *Insurance Contracts in the Public Sector* regarding bank depositor compensation schemes; and
 - (b) DECIDE whether any action is needed.

Background

2. In its response to ED 2022-3, the Reserve Bank of New Zealand commented that it is preparing to establish a Depositor Compensation Scheme for New Zealand, subject to the passage of draft legislation.¹ This raises the issue of accounting for bank deposit guarantees and similar arrangements.
3. This paper explains why staff propose that the Boards do not address the issue of bank depositor compensation schemes provided by public sector entities in this project.

Structure of this paper

4. This paper outlines:
 - (a) the scope of:
 - (i) AASB 9/NZ IFRS 9 *Financial Instruments*, AASB 7/NZ IFRS 7 *Financial Instruments: Disclosures* and AASB 132/NZ IAS 32 *Financial Instruments: Presentation*
 - (i) AASB 17/PBE IFRS 17 *Insurance Contracts*
 in the context of ‘financial guarantees’;
 - (b) the nature of contingent liabilities; and
 - (c) the nature of provisions.

¹ [Deposit Takers Bill – Exposure Draft: Explanatory Notes \(rbnz.govt.nz\)](#) – see chapter 2.2 and Appendix A



Financial guarantees

5. A bank depositor compensation scheme could be regarded as a type of ‘financial guarantee contract’ as defined in AASB 9/PBE IPSAS 41:

A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

6. If accounted for under AASB 9/PBE IPSAS 41, financial guarantee contracts are recognised as liabilities:

- (a) initially measured at fair value [AASB 9/PBE IPSAS 41.5.1.1]; and
- (b) subsequently measured at the higher of [AASB 9/PBE IPSAS 41.4.2.1(e)]:
 - (i) the amount of the loss allowance determined in accordance with AASB 9/PBE IPSAS 41.5.5 (expected credit losses); and
 - (ii) the amount initially recognised under AASB 9/PBE IPSAS 41.5.1.1 less, when appropriate, any income recognised in accordance with the principles of AASB 15/PBE IFRS 15.

7. AASB 17/PBE IFRS 17.7(e) says:

An entity shall not apply PBE IFRS 17 to: ...²

- (e) financial guarantee contracts, unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts. The issuer shall choose to apply either PBE IFRS 17 or PBE IPSAS 28 *Financial Instruments: Presentation*, PBE IPSAS 30 *Financial Instruments: Disclosures* and PBE IPSAS 41 *Financial Instruments* to such financial guarantee contracts. The issuer may make that choice contract by contract, but the choice for each contract is irrevocable.

8. In the event that an entity had previously accounted for a financial guarantee as an insurance contract, it can choose to continue to do so under AASB 17/PBE IFRS 17.7(e). Staff note that:

- we are not aware of any public sector entities with financial guarantees accounted for as insurance contracts; and
- any new financial guarantees are not eligible for the accounting policy choice in AASB 17/PBE IFRS 17.7(e).

Contingent liabilities

9. ‘Contingent liability’ is defined in AASB 137.10/PBE IPSAS 19.18 *Provisions, Contingent Liabilities and Contingent Assets* as:

A contingent liability is:

- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) a present obligation that arises from past events but is not recognised because:

² This quote uses the New Zealand references for convenience.



- (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
- (ii) the amount of the obligation cannot be measured with sufficient reliability.

10. Contingent liabilities are the subject of disclosure – they are not recognised on balance sheet [AASB 137.27/PBE IPSAS 19.35].

Provisions

11. ‘Provision’ is defined in paragraph 10 of AASB 137.10/PBE IPSAS 19.18 as:
a liability of uncertain timing or amount.

12. A provision is recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation [AASB 137.14/PBE IPSAS 19.22].

13. The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period [AASB 137.36/PBE IPSAS 19.44].

Staff analysis and discussion

14. A bank depositor compensation scheme such as that proposed for New Zealand:

- (a) would not qualify for recognition under AASB 17/PBE IFRS 17 in the event that it is regarded as being a financial guarantee because there is no track record of applying insurance accounting;
- (b) seems unlikely to be a provision, at least until a relevant credit event occurs that would lead to a probable outflow of resources; and
- (c) might be regarded as a contingent liability, and the subject of disclosure.

15. The Australian government has a similar scheme to that proposed for New Zealand – the *Financial Claims Scheme – Deposits*, authorised under the *Banking Act 1959* that guarantees deposits up to AUD250,000 at eligible authorised deposit-taking institutions. In the Consolidated Financial Statements of the Australian Government, disclosures are presented about the scheme among the Government’s ‘significant but remote indemnities, guarantees and warranties’, including disclosure of the latest estimate of deposits eligible for coverage [AUD1.1 trillion as at 31 December 2020]. [page 135, [2021](#)]

16. The New Zealand and Australian governments each have a range of schemes that could fall into a broadly similar category as a depositor guarantee, including the following.

New Zealand	Australia
Business Finance Guarantee Scheme: Established in March 2020 to support small and medium businesses to access credit related to, responding to, or recovering from, COVID-19. Loans are indemnified for 80% of their value . The indemnities are initially reported at fair value as a financial guarantee	Small and Medium Enterprise Guarantee Scheme: Government guarantees to eligible lenders to enhance lenders’ willingness and ability to provide credit, to support small and medium enterprises (SMEs) to access additional funding to continue operating through the COVID-19 outbreak.



New Zealand	Australia
<p>contract and included as part of other provisions (note 22), representing the indemnity fee foregone by providing the indemnity without charge. The scheme closed on 30 June 2021 with lending facilities totalling \$2.86 billion. [page 63 & 113, 2021 – Note 22 Provisions]</p>	<p>Guaranteed loans up to \$250,000. The Scheme is capped at \$20 billion. Disclosed as an ‘unquantifiable indemnity, guarantee or warranty’. [page 135, 2021]</p>
<p>National Provident Fund guarantee: A provision has been recognised for the guarantee of superannuation schemes managed by the National Provident Fund (NPF). Included in the provision is the NPF's defined benefit plan annuitants scheme unfunded liability position of \$762 million (2021), represented by a gross estimated pension obligation of \$801 million (2021) with net investment assets valued at \$39 million (2021). [page 113, 2021– Note 22 Provisions]</p>	<p>Terrorism reinsurance scheme: The Australian Reinsurance Pool Corporation administers a terrorism reinsurance scheme for commercial property and associated business interruption losses arising from a Declared Terrorism Incident. The Australian Government guarantees payment above the private sector retrocession balance up to a maximum of \$10 billion. The Australian Government also operates the Australian Victims of Terrorism Overseas Payment Scheme to provide financial assistance to Australians who are victims of a declared overseas terrorist act. Disclosed as an ‘unquantifiable indemnity, guarantee or warranty’. [page 134, 2021]</p>
<p>New Zealand Export Credit Office guarantees: The Office provides a range of guarantee products to assist exporters to manage risk and capitalise on trade opportunities. The obligations to third parties are guaranteed by the Crown and are intended to extend the capacity of facilities in the private sector. [page 121, 2021 – Note 26 Contingent Liabilities]</p>	<p>Medical indemnities: The Australian Government indemnifies potential liabilities under the <i>Medical Indemnity Act 2002</i> and the <i>Midwife Professional Indemnity (Commonwealth Contribution) Scheme Act 2010</i>. The Australian Government also indemnifies certain health-care organisations for adverse events arising from the provision of agreed services or health-care products (including blood products and vaccines). Disclosed as an ‘unquantifiable indemnity, guarantee or warranty’. [page 134, 2021]</p>
	<p>Financial Claims Scheme – Insurance: A Policyholder Compensation Facility established under the <i>Insurance Act 1973</i> provides a mechanism for making payments to eligible beneficiaries with a valid claim against a failed general insurer. Disclosed as a ‘significant but remote indemnity, guarantee or warranty’. [page 135, 2021]</p>

Staff comments

17. Staff note that addressing financial guarantees and any similar arrangements in the public sector are outside the scope of the current insurance project on the basis that:
- depositor compensation schemes such as that proposed for New Zealand would not be eligible to apply AASB 17/PBE IFRS 17;
 - the similar scheme in Australia is currently treated among the Commonwealth’s ‘significant but remote indemnities, guarantees and warranties’, subject to disclosure and not recognition and measurement; and



- there is a potentially wide range of issues associated with accounting for government guarantees that are well beyond the current project.

Question for Board members

Q1: Do Board members agree with staff that the issue of bank depositor compensation schemes is outside the scope of the current project on insurance activities in the public sector?

Date: 28 July 2022
To: NZASB Members
From: Tereza Bublikova
Subject: Public Sector Specific Financial Instruments

Expected Board deliberations

Project priority	Low – Guidance is non-authoritative and is consistent with current accounting practice in New Zealand
Complexity of Board decision-making	Low – Key stakeholders confirmed general support for proposals and key issues have already been considered and resolved by the Board.

Overview of agenda item

Project status	Seeking Board approval to issue final pronouncement.
Purpose	The proposed amendments (i.e., introduction of the IPSASB non-authoritative guidance) will ensure that PBE IPSAS 41 <i>Financial Instruments</i> continues to be aligned with IPSAS.
Board action required	APPROVE for issue <i>Public Sector Specific Financial Instruments (Non-Authoritative Amendments to PBE IPSAS 41)</i> – Agenda Item 9.3. REVIEW cover memo (Agenda item 9.1) and Signing Memo (Agenda Item 9.4) to confirm required due process has been completed.

Recommendation¹

1. We recommend that the Board:
 - (a) NOTES the Treasury submission received on NZASB ED 2022-4 *Public Sector Specific Financial Instruments* (Proposed Non-Authoritative Amendments to PBE IPSAS 41) (agenda item 9.2);
 - (b) APPROVES for issue *Public Sector Specific Financial Instruments* (Non-Authoritative Amendments to PBE IPSAS 41) (agenda item 9.3); and
 - (c) APPROVES the signing memo (agenda item 9.4).

Background

2. At its November 2020 meeting the Board, in accordance with the *Policy Approach to the Development of PBE Standards* (PBE Policy Approach), approved a domestic project to develop an ED and the accompanying Consultation Document on *Public Sector Specific Financial Instruments*, to be based on the IPSASB's *Non-Authoritative Amendments to IPSAS 41 Financial Instruments*.
3. At its April 2022 meeting the Board approved for issue the ED *Public Sector Specific Financial Instruments* (Proposed Non-Authoritative Amendments to PBE IPSAS 41 *Financial Instruments*) and the accompanying Consultation Document with a 90-day comment period (ending on 11 July 2022).
4. The Board agreed the following parameters for this project:
 - (a) the amendments would be applicable for Tier 1 and Tier 2 public benefit entities (PBEs); and
 - (b) the effective date of 1 January 2023, with early application permitted.
5. The proposed amendments (i.e. introduction of the IPSASB non-authoritative guidance) will ensure that PBE IPSAS 41 *Financial Instruments* continues to be aligned with IPSAS 41 *Financial Instruments*.

Summary of the proposed amendments

6. The proposed pronouncements relate to IPSAS 41 amendments to introduce non-authoritative guidance material to clarify the accounting treatment for public sector specific financial instruments, being specifically:
 - (a) Monetary gold;
 - (b) Currency in circulation;
 - (c) International Monetary Fund (IMF) special drawing rights (SDRs); and
 - (d) IMF quota subscriptions.

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).

7. **Table 1** summarises the proposed non-authoritative amendments to PBE IPSAS 41.

Instrument	Guidance type	Proposed amendment to PBE IPSAS 41
Monetary gold	Implementation guidance	IG Section B Definitions B.1.1 Monetary gold
Currency in circulation	Implementation guidance	IG Section B Definitions B1.2.1 Currency issued as legal tender
IMF quota subscription	Illustrative example	IE 32 – Capital Subscriptions held with redemption features
Special drawing rights (SDR)	Implementation guidance	IG Section B Definitions B1.2.2 SDR Holdings B1.2.3 SDR Allocations

8. The proposals would amend the implementation guidance and illustrative examples that accompany PBE IPSAS 41, but which are not an integral part of PBE IPSAS 41. Non-authoritative guidance and examples are intended to assist entities in applying the requirements of standards. They do not establish mandatory requirements.

9. Following a discussion with the New Zealand Treasury (Treasury) about IMF quota subscription, we amended in ED the PBE IPSAS 41 Basis for Conclusion as follow:

BC19. The IPSASB had concluded as part of these non-authoritative amendments to IPSAS 41 (BC3E of IPSAS 41) that “*IMF quota subscriptions share a number of features with those in Illustrative Example 32 in IPSAS 41*”. The NZASB considered Illustrative Example 32 and concluded it was not useful when determining how to account for IMF quota subscriptions because it does not include all the features that are specific to this arrangement. The NZASB noted that each jurisdiction will need to apply the principles and requirements of IPSAS 41 when determining how to account for IMF quota subscriptions, which will be based on their individual facts, circumstances and how they manage IMF transactions and arrangements.

10. Feedback received during the ED consultation period confirmed support for the approach taken by the Board in BC19.

Due process

10. Following the application of the PBE Policy Approach we issued an ED and the accompanying Consultation Document in April 2022, which closed for comment 11 July 2022.
11. Due to the specific nature of the amendments, the amending standard is expected to be largely only relevant for the Reserve Bank of New Zealand (Reserve Bank) and the Treasury.
12. In response to the ED we received one formal comment letter from the Treasury (Agenda item 9.2). The comment letter confirmed general support for the proposals with no concerns highlighted.
13. Staff met with the representatives of the Reserve Bank during the comment period to discuss their views. The Reserve Bank confirmed their general support for the proposed amendments

and decided not to submit a formal comment letter. Before issuing the ED, we also consulted directly with Treasury which resulted in amendments to the basis for conclusions

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

Draft amending standard and signing memorandum

16. Attached is a copy of:
 - (a) Draft *Public Sector Specific Financial Instruments* (Non-Authoritative Amendments to PBE IPSAS 41); and
 - (b) Draft signing memorandum from the Chair of the Board to the Chair of the XRB Board.

Questions for the Board

- Q1. Does the Board APPROVE for issue *Public Sector Specific Financial Instruments* (Non-Authoritative Amendments to PBE IPSAS 41)?
- Q2. Does the Board APPROVE the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board, requesting approval to issue the amending standard?

Attachments

- Agenda item 9.2: Treasury comment letter on NZASB ED 2022-4 *Public Sector Specific Financial Instruments*;
- Agenda item 9.3: Draft *Public Sector Specific Financial Instruments* (Non-Authoritative Amendments to PBE IPSAS 41);
- Agenda item 9.4 Draft signing memorandum

AC-2-7

11 July 2022

Ms April MacKenzie
Chief Executive
External Reporting Board
PO Box 11 250
Manners Street Central
Wellington 6142

Dear April

**ED NZASB 2022-4 –PUBLIC SECTOR SPECIFIC FINANCIAL INSTRUMENTS
(Proposed non-authoritative amendments to PBE IPSAS 41)**

Thank you for the opportunity to comment on ED NZASB 2022-4 –Public Sector Specific Financial Instruments. Our responses to your questions are as follows:

1. Do you agree with the proposal to incorporate amendments equivalent to Non-Authoritative Amendments to IPSAS 41, Financial Instruments as issued by the IPSAB into PBE IPSAS 41 Financial Instruments?

If you disagree, please explain why.

The Treasury agrees with proposals to incorporate the amendments.

We note the amendments relate to non-authoritative guidance, which accompanies but does not form part of a PBE standard, does not establish mandatory requirements and does not change the underlying principles and requirements of PBE IPSAS 41.

Despite the non-authoritative status, and despite some of the guidance not being relevant in New Zealand (for example, monetary gold is not held by the Reserve Bank of New Zealand as a reserve asset), maintaining alignment with the international non-authoritative guidance, particularly regarding currency in circulation and IMF transactions, as part of PBE IPSAS 41 is still helpful. The alignment in the PBE suite of standards makes it easier for New Zealand constituents to access any relevant guidance locally and in one place when applying PBE IPSAS 41 to public sector specific financial instruments.

2. Do you agree with the proposed effective date of the amendments of 1 January 2023 with early adoption permitted?

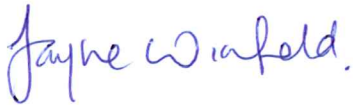
If you disagree, please explain why.

The Treasury agrees with the proposed effective date and the ability to early adopt. This helpfully links to the required adoption date of PBE IPSAS 41 in the Financial Statements of the Government of 1 July 2022.

3. Do you have any other comments on the proposals in this ED?

No.

Yours sincerely



Jayne Winfield
Chief Government Accountant



Public Sector Specific Financial Instruments

(Non-Authoritative Amendments to PBE IPSAS 41)

Issued **August 2022**

This Standard was issued on **XX August** 2022 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is secondary legislation for the purposes of the Legislation Act 2019, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect **XX September** 2022.

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

This Tier 1 and Tier 2 PBE Standard is based on amendments issued by the International Public Sector Accounting Standards Board to clarify the accounting treatment of public sector specific financial instruments, including some instruments with characteristics similar to financial instruments.

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PUBLIC SECTOR SPECIFIC FINANCIAL INSTRUMENTS

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

AMENDMENTS TO THE BASIS FOR CONCLUSIONS ON IPSAS 41 *FINANCIAL INSTRUMENTS*

Part A – Introduction

This Standard sets out amendments to PBE IPSAS 41 *Financial Instruments*.

The amendments clarify the accounting treatment of public sector specific financial instruments, including some instruments with characteristics similar to financial instruments.

Tier 1 and Tier 2 public benefit entities are required to comply with all the requirements in this Standard.

Part B – Scope

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

Part C – Amendments

Amendments to PBE IPSAS 41 *Financial Instruments*

In the NZASB Basis for Conclusions, paragraphs BC17-BC19 and the related heading are added. New text is underlined.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, PBE IPSAS 41.

...

Public Sector Specific Financial Instruments

BC17. In December 2020, the IPSASB issued *Non-Authoritative Amendments to IPSAS 41, Financial Instruments* which amended the non-authoritative Illustrative Examples and Illustrative Guidance accompanying IPSAS 41, *Financial Instruments*. The aim of those amendments was to clarify the accounting treatment of the following items that may be held by public sector entities:

- (a) Monetary gold;
- (b) Currency in circulation;
- (c) International Monetary Fund special drawing rights; and
- (d) IMF quota subscriptions.

BC18. The NZASB considered that some public sector PBEs in New Zealand could also find these clarifications helpful and proposed equivalent amendments to PBE Standards. In April 2022 the NZASB issued for comment NZASB ED 2022-8 *Public Sector Specific Financial Instruments* (Proposed non-authoritative amendments to PBE IPSAS 41). The NZASB noted that the clarifications would ensure that PBE IPSAS 41 continues to be aligned with IPSAS 41.

BC19. The IPSASB had concluded as part of these non-authoritative amendments to IPSAS 41 (BC3E of IPSAS 41) that “*IMF quota subscriptions share a number of features with those in Illustrative Example 32 in IPSAS 41*”. The NZASB considered Illustrative Example 32 and concluded it was not useful when determining how to account for IMF quota subscriptions because it does not include all the features that are specific to this arrangement. The NZASB noted that each jurisdiction will need to apply the principles and requirements of IPSAS 41 when determining how to account for IMF quota subscriptions, which will be based on their individual facts, circumstances and how they manage IMF transactions and arrangements.

BC20. In August 2022 the NZASB finalised the amendments and issued Public Sector Specific Financial Instruments (Amendments to PBE IPSAS 41).

In the Illustrative Examples, paragraph IE211 is amended. Deleted text is struck through and new text is underlined.

Illustrative Examples

These examples accompany, but are not part of, PBE IPSAS 41.

...

Example 32—Capital Subscriptions Held with Redemption Features

IE211. In order to participate in and support the activities of International Development Bank A, or similar international organisation, Federal Government B ~~invests~~invested and ~~acquires~~acquired a fixed number of subscription rights in International Development Bank A, based on Federal Government B's proportional share of global Gross Domestic Product. Each subscription right costs CU1,000, which provides Federal Government B with the right to put the subscription rights back to International Development Bank A in exchange for the initial amount invested (i.e., CU1,000 per subscription right). International Development Bank A has no obligation to deliver dividends on the subscription rights.

...

In the Implementation Guidance, sections B.1.1 to B.1.2.3 and the related headings are added. New text is underlined.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 41.

...

Section B Definitions

Section B provides non-authoritative guidance on whether certain items meet the definitions in PBE IPSAS 41.

B.1 Definition of a Financial Instrument: Gold Bullion

Is gold bullion a financial instrument (like cash) or is it a commodity?

It is a commodity. Although bullion is a highly liquid asset, there is no contractual right to receive cash or another financial asset inherent in bullion.

B.1.1 Definition of a Financial Instrument: Monetary Gold

Is monetary gold a financial instrument (like cash)?

No. Similar to gold bullion, monetary gold is not a financial instrument as there is no contractual right to receive cash or another financial asset inherent in the item. However, given that monetary gold shares several characteristics with a financial asset, applying the principles set out in PBE IPSAS 41 is generally appropriate under the hierarchy set out in paragraphs 9–15 of PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*. It may however be appropriate for an entity to consider other PBE Standards depending on the facts and circumstances related to its holding of monetary gold.

B.1.2 Public Sector Specific Financial Instruments

B.1.2.1 Definition of a Financial Instrument: Currency Issued as Legal Tender

Does issuing currency as legal tender create a financial liability for the issuer?

It depends. Currency derives its value, in part, through the statutory arrangement established between the issuer and the holder of the currency whereby currency is accepted as a medium of exchange and is recognised legally as a valid form of payment. In some jurisdictions, this statutory arrangement further obligates the issuer to

PUBLIC SECTOR SPECIFIC FINANCIAL INSTRUMENTS

exchange currency when it is presented by holders and may explicitly indicate that currency is a charge on government assets.

For the purposes of this Standard, an entity considers the substance rather than the legal form of an arrangement in determining whether there is a contractual obligation to deliver cash. Contracts are evidenced by the following:

- Willing parties entering into an arrangement;
- The terms of the contract create rights and obligations for the parties to the contract; and
- The remedy for non-performance is enforceable by law.

When laws and regulations or similar requirements enforceable by law, such as a Banking Act, set out the requirements and responsibilities of an entity to exchange outstanding currency, a “contract” exists for the purposes of this Standard. A financial liability is created when an entity issues currency to the counterparty as, at this point, two willing parties have agreed to the terms of the arrangement. Where no financial liability exists, an entity should consider whether an obligation is created in accordance with paragraphs 22–43 of PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. Prior to currency being issued, there is no transaction between willing parties. Unissued currency does not meet the definition of a financial instrument. An entity applies paragraph 13 of PBE IPSAS 12 *Inventories* in accounting for any unissued currency.

B.1.2.2 Definition of a Financial Instrument: Special Drawing Rights (SDR) Holdings

Do Special Drawing Rights (SDR) Holdings meet the definition of a financial asset?

Yes. SDR holdings represent a claim on the currencies of members of the International Monetary Fund (IMF). SDRs can be used in transactions with the IMF or can be exchanged between participants of the IMF’s SDR Department. Liquidity is guaranteed by a mechanism requiring participants to deliver cash in exchange for SDRs. Accordingly, SDR holdings are regarded as a financial asset.

B.1.2.3 Definition of a Financial Instrument: Special Drawing Rights (SDR) Allocations

Do Special Drawing Rights (SDR) Allocations meet the definition of a financial liability?

Yes. SDR allocations represent the obligation assumed when SDR holdings are distributed to members. IMF members must stand ready to provide currency holdings up to the amount of their SDR allocation. This represents a contractual obligation to deliver cash. Accordingly, SDR allocations are regarded as a financial liability.

...

Part D – Effective Date

This Standard shall be applied for annual periods ending on or after 1 January 2023. Earlier application is permitted.

Date: 27 July 2022

To: Michele Embling, Chair External Reporting Board

From: Carolyn Cordery, Chair NZASB

Subject: *Public Sector Specific Financial Instruments*

Introduction¹

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue *Public Sector Specific Financial Instruments (Non-Authoritative Amendments to PBE IPSAS 41)*.
2. The amending standard is aligned with the *Non-Authoritative Amendments to IPSAS 41, Financial Instruments* issued by IPSASB in November 2020. The PBE standard is identical to the IPSASB amending standard except for the New Zealand-specific introduction and a scope paragraph limiting the application of the amending standard to Tier 1 and Tier 2 public benefit entities. In addition, in the PBE standard the Board has added its own basis for conclusions.
3. The proposed amendments (i.e. introduction of the IPSASB non-authoritative guidance) will ensure that *PBE IPSAS 41 Financial Instruments* continues to be aligned with *IPSAS 41 Financial Instruments*.

Benefits to New Zealand constituents

4. The amendments to the Implementation Guidance and the Illustrative Examples clarify the accounting treatment of monetary gold, currency in circulation, IMF special drawing rights (SDRs), and IMF quota subscriptions.
5. We expect the amendments to have a limited impact on PBEs for following reasons:
 - (a) The objective of the amendments is to provide additional non-authoritative guidance in IPSAS 41 to clarify the requirements for classifying, recognising, and measuring above mentioned public sector specific financial instruments. Non-authoritative guidance and examples are intended to assist entities in applying the existing requirements of the standards. They do not establish mandatory requirements.
 - (b) Due to the specific nature of the amendments the amending standard is expected to be only relevant to the Reserve Bank of New Zealand (Reserve Bank) and the New Zealand Treasury (Treasury).

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

Due process

6. Following the application of the *Policy Approach to the Development of PBE Standards to Public Sector Specific Financial Instruments (Non-Authoritative Amendments to PBE IPSAS 41)*, the NZASB issued Exposure Draft ED 2022-4 *Public Sector Specific Financial Instruments* in April 2022, with the comment period closing 11 July 2022.
7. In response to the ED, the NZASB received one supportive comment letter from the New Zealand Treasury.
8. In addition, staff met with the representatives of the Reserve Bank during the comment period to discuss their views. The Reserve Bank was generally comfortable with the proposed amendments and decided not to submit a formal comment letter.
9. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in the NZASB's view, meets the requirements of section 22 of the Financial Reporting Act 2013.
10. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the amending standard is likely to require the disclosure of personal information. In the NZASB's view the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Consistency with XRB Financial Reporting Strategy

11. This amending standard will be applicable for Tier 1 and Tier 2 public benefit entities.
12. The amendments provide additional non-authoritative guidance and do not establish any new disclosure requirement. Therefore, Reduced Disclosure Regime (RDR) concession are not applicable.
13. The issue of this amending standard is consistent with the current Financial Reporting Strategy: it aligns with the international standard (i.e. the IPSASB amendments) and is consistent with the Accounting Standards Framework.

Effective date

14. *Public Sector Specific Financial Instruments (Non-Authoritative Amendments to PBE IPSAS 41)* will be mandatory for Tier 1 and Tier 2 public benefit entities from 1 January 2023, with early adoption permitted. This maintains alignment with the effective date of the IPSASB's amendments.

Other matters

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

Recommendation

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

Attachments

Public Sector Specific Financial Instruments (Non-Authoritative Amendments to PBE IPSAS 41).

Certificate of Determination Public Sector Specific Financial Instruments

Carolyn Cordery
Chair NZASB



Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

APPROVAL NZASB 136

Approval to Issue *Initial Application of PBE IFRS 17 and PBE IPSAS 41— Comparative Information*

In accordance with the protocols established between the New Zealand Accounting Standards Board (NZASB) and the External Reporting Board (XRB Board), the NZASB has:

- approved for issue *Initial Application of PBE IFRS 17 and PBE IPSAS 41—Comparative Information*; and
- provided a signing memorandum outlining the due process followed before reaching that decision, and other related information.

I have reviewed the signing memorandum and am satisfied with the information provided. Accordingly, the NZASB is hereby authorised to issue *Initial Application of PBE IFRS 17 and PBE IPSAS 41—Comparative Information* pursuant to section 12(a) of the Financial Reporting Act 2013.

Dated this 21st day of June 2022

A handwritten signature in black ink, appearing to read 'Michele J Embling', written over a horizontal dotted line.

Michele J Embling
Chair
External Reporting Board



Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

APPROVAL NZASB 137

Approval to Issue *2022 Omnibus Amendments to PBE Standards*

In accordance with the protocols established between the New Zealand Accounting Standards Board (NZASB) and the External Reporting Board (XRB Board), the NZASB has:

- approved for issue *2022 Omnibus Amendments to PBE Standards*; and
- provided a signing memorandum outlining the due process followed before reaching that decision, and other related information.

I have reviewed the signing memorandum and am satisfied with the information provided. Accordingly, the NZASB is hereby authorised to issue *2022 Omnibus Amendments to PBE Standards* pursuant to section 12(a) of the Financial Reporting Act 2013.

Dated this 21st day of June 2022

A handwritten signature in black ink, appearing to read 'Michele J Embling', written over a horizontal dotted line.

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Michele J Embling
Chair
External Reporting Board