Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Board Meeting Agenda

In-person meeting, Wellington — Thursday, 15 February 2024

Est Time	Item	Topic	Objective		Page
PUBLIC SESSION					
12.40 pm	**3**	**PBE Conceptual Framework Update**	(GS)		
50 min	3.1	Board memo	Consider	Paper	2
	3.2	Draft ED	Approve	Paper	20
	3.3	Draft Consultation Document	Approve	Paper	44
1.30 pm	**4**	**XRB A1 and XRB A2 updates**	(JC and AS)		
30 min	4.1	Board memo	Consider	Paper	56
	4.2	Draft amending standard: *Updated PBE Tier Size Criteria*	Consider	Paper	81
	4.3	Update to XRB A2	Consider	Paper	88

Next NZASB meeting: 28 March 2024, virtual

TE KĀWAI ĀRAHI PŪRONGO MŌWAHO
EXTERNAL REPORTING BOARD

Memorandum

Date:	2 February 2024
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	**PBE Conceptual Framework Update – Proposed amendments to Chapters 3 and 5**

COVER SHEET

Project priority and complexity

Project priority	**Medium** • While the PBE Conceptual Framework is not a standard, it plays an important role in the development of PBE Standards, and preparers of financial statements refer to the Conceptual Framework when a matter is not specifically addressed by standards. • There are areas of interrelation between the updated definitions of assets and liabilities and the PBE Revenue and Transfer Expenses projects. • The IPSASB's updates to its Conceptual Framework are limited in scope, but they relate to key concepts underpinning financial statements.
Complexity of Board decision-making at this meeting	**Medium** The Board is being asked to APPROVE an Exposure Draft (ED) proposing the incorporation of the IPSASB's updates to Chapters 3 and 5 of its Conceptual Framework into the PBE Conceptual Framework – which includes New Zealand modifications to the Basis for Conclusions as per the Board discussion in December 2023.

Overview of agenda item

Project status	Approval of ED
Project purpose	Consistent with our PBE Policy Approach, to align the PBE Conceptual Framework with the updated IPSASB Conceptual Framework.
Board action required at this meeting	APPROVE an ED proposing to incorporate the IPSASB's updates to Chapters 3 and 5 into the PBE Conceptual Framework. We will ask for Board feedback on the questions raised in this memo. We encourage any editorial comments to be sent directly to staff - gali.slyuzberg@xrb.govt.nz

Purpose and introduction[1]

1. In 2023, the IPSASB updated Chapters 3 and 5 of its Conceptual Framework. The amendments clarify the role of prudence and expand the guidance on materiality, as well as update the definitions of assets and liabilities and related guidance.

2. The purpose of this memo is to seek the Board's approval of an Exposure Draft (ED) proposing to incorporate the IPSASB's updates to Chapters 3 and 5 into the PBE Conceptual Framework – and the accompanying Consultation Document.

3. Please note: This memo does not cover the IPSASB's Conceptual Framework amendments to Chapter 7 on Measurement. The Board agreed to defer the application of the PBE Policy Approach to the IPSASB's recent pronouncements arising from its Measurement project – including the updates to Chapter 7 of the Conceptual Framework – until once the IPSASB finalises 'Phase 2' of its Measurement project, which is currently ongoing.

Recommendations

4. We recommend that the Board:
   (a) Provides FEEDBACK on the draft ED *PBE Conceptual Framework Update* (Proposed Amendments to Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in General Purpose Financial Reports*) and the accompanying Consultation Document;
   (b) APPROVES the ED and Consultation Document to be issued for public consultation.

Structure of this memo

5. This memo includes the following sections.

Background

6. The IPSASB's amendments to Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in Financial Statements* arose from the following developments since the IPSASB Framework was approved in 2014:
   (a) the IPSASB's experience in applying the Framework to the development and maintenance of IPSAS; and
   (b) developments in international thinking about conceptual issues – specifically, the IASB's updates to its Conceptual Framework in 2018.

7. At the NZASB December 2023 meeting, having applied the PBE Policy Approach to the IPSASB's amendments, the Board agreed to develop proposed amendments to the PBE Conceptual Framework as a result of the IPSASB's amendments.

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

8. The Board also discussed potential concerns regarding new paragraphs that the IPSASB added into Chapter 5, which emphasise that the definition of a liability can be met even when the probability of a transfer of resources is low. While those paragraphs are aligned with the updates that the IASB made to its Conceptual Framework in 2018, the IASB also enhanced the recognition guidance in its Conceptual Framework at the same time – whereas the IPSASB did not. There was a concern that if these paragraphs were to be incorporated into the PBE Conceptual Framework, without enhancing the guidance on recognition of liabilities (and assets), this could lead to lack of clarity as to whether liabilities with low probability of resource transfer should be recognised in the financial statements. There was also a concern that not enhancing the recognition guidance in the PBE Conceptual Framework to align with the IASB's enhanced guidance could imply that recognition should work differently for PBEs as compared to for-profit entities, which is not the intended outcome.

9. In considering whether to incorporate the IASB's enhanced guidance into the PBE Conceptual Framework to address the abovementioned concerns, some Board Members noted the following:
   (a) The PBE Conceptual Framework plays a fundamental role in underpinning the requirements in PBE Standards and in the development and maintenance of the entire suite of PBE Standards. Consequently, it is important to safeguard the coherence of the PBE Conceptual Framework. The PBE Conceptual Framework is closely based on the IPSASB Conceptual Framework, and there is a risk that incorporating guidance from a different Conceptual Framework, i.e. the IASB Conceptual Framework – and adapting this guidance to cover public benefit entity-specific concepts, such as service potential – could negatively affect coherence and lead to unintended consequences.
   (b) While some preparers use the PBE Conceptual Framework when preparing financial statements, it appears that not many entities do so – which may affect the cost/benefit considerations of incorporating the IASB's enhanced guidance on recognition into the IPSASB-based PBE Conceptual Framework.

10. Considering the above, in December the Board agreed to incorporate the enhanced guidance on recognition in the IASB's Conceptual Framework into the New Zealand PBE Exposure Draft that would include the IPSASB's amendments to Chapters 3 and 5 – with staff to consider whether to include this recognition guidance:
    (a) in the Basis for Conclusions of the PBE Conceptual Framework; or
    (b) in the core text of the PBE Conceptual Framework, with an explanation in the Basis for Conclusions.

11. On balance, we are recommending to incorporate the IASB's guidance on recognition into the <u>New Zealand Basis for Conclusions</u> of the PBE Conceptual Framework, in the following manner:
    (a) Referring to the enhanced guidance on recognition from the IASB Conceptual Framework in the Basis for Conclusions;
    (b) Explaining the rationale for referring to those paragraphs in the Basis for Conclusions; and

(c) Explaining in the Basis for Conclusions how and in what circumstances this IASB guidance may be referred to by preparers of PBE financial reports in conjunction with the core text of the PBE Conceptual Framework.

12. In determining which paragraphs from the IASB Conceptual Framework to refer to in the Basis for Conclusions of the PBE Conceptual Framework, we have selected those paragraphs that we considered most relevant to mitigating our concern regarding the potential lack of clarity around determining whether to recognise liabilities with low probability of a transfer of resources in financial reports. Appendix 1 of this memo includes Chapter 5 of the IASB Conceptual Framework in full, and shows which paragraphs we have included in the Basis for Conclusions of the draft ED and which paragraphs we have excluded.

13. We consider that including the IASB's enhanced guidance on recognition in the Basis for Conclusions of the PBE Conceptual Framework sufficiently addresses the abovementioned concerns relating to 'low probability', while at the same time retaining the coherence of the largely IPSASB-based core text of the PBE Conceptual Framework.

14. We understand that referring to the IASB Conceptual Framework in conjunction with the PBE Conceptual Framework, in situations where a PBE Standard does not specifically address a transaction, is consistent with the requirements of PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*. Paragraphs 14 and 15 of PBE IPSAS 3 note that when developing accounting policies in the absence of a PBE Standard that specifically applies to a transaction or event, in addition to considering other PBE Standards and the PBE Conceptual Framework, management may also consider the most recent pronouncements of other standard-setting bodies, including the IASB. We note that the enhanced guidance on recognition in the PBE Conceptual Framework does not conflict with the guidance on recognition in the PBE Conceptual Framework – but it is more detailed than the recognition guidance in the PBE Conceptual Framework, and as such it would be helpful in determining whether a liability is to be recognised in situations where a transaction is not specifically covered by individual Standards.

15. We have also explained in the Basis for Conclusions that in considering the recognition guidance from the IASB Conceptual Framework:

(a) where the IASB paragraphs refer to inflows or outflows of economic benefits, a PBE would need to also consider service potential; and

(b) PBEs also need to take into account the fact that the IASB paragraphs use for-profit terminology, e.g. the IASB paragraphs use the term 'income' where PBE literature uses the term 'revenue', etc.

16. Consequently, the draft ED that we are asking the Board to approve at this meeting proposes to incorporate the IPSASB's 2023 amendment to Chapters 3 and 5 into the PBE Conceptual Framework – but also to refer to the enhanced guidance on recognition from the IASB's Conceptual Framework in the Basis for Conclusions of the PBE Conceptual Framework. This is also reflected in the Consultation Document accompanying the draft ED, which we are also asking the Board to approve at this meeting.

Draft ED and Consultation Document

Draft ED

17. The draft ED *PBE Conceptual Framework Update – Proposed amendments to Chapter 3 Qualitative Characteristics and Chapter 5 Elements in General Purpose Financial Reports* is attached as Agenda Item 3.2.

18. The proposed amendments to Chapters 3 and 5 of the PBE Conceptual Framework, and the related Basis for Conclusions, are summarised in the tables below. In reading the tables below, the Board is asked to note the following.

    (a) The PBE Conceptual Framework is an Authoritative Notice, rather than a Standard. Therefore, amendments to the PBE Conceptual Framework would also be issued as an Authoritative Notice.

    (b) In the 'core text' of the PBE ED, the only New Zealand modifications that we made to the IPSASB text were changes for New Zealand spelling, and reflecting the fact that Chapter 5 of the PBE Conceptual Framework is called *Elements in General Purpose Financial Reports* (rather than *Elements in Financial Statements* as per the IPSASB Conceptual Framework).[2] We have not made other modifications to the IPSASB text.

    (c) Staff drafted Appendix A – Commencement and Application (wording aligned with legislative requirements, which apply to Authoritative Notices as well as Standards), as well as the Basis for Conclusions (which includes certain paragraphs from the IASB Conceptual Framework in relation to recognition – see the Background section of this memo and Table 4 for more explanation).

    (d) The tables below do not specifically mention the front page of the ED, *Part A* – Introduction and *Part B – Scope*. As always, these parts were drafted by staff – and will not be compiled into the full PBE Conceptual Framework if and when the amendments are issued as final.

    (e) Please note that in *Part B – Scope*, we provided an explanation on how the PBE Conceptual Framework applies to Tier 1, Tier 2 and Tier 3 PBEs, and therefore how the amendments to the PBE Conceptual Framework applies – given that the applicability of the PBE Conceptual Framework is somewhat different to PBE Standards. That is, we explained that the PBE Conceptual Framework does not override the requirements in PBE Standards, but one of its roles is to assist preparers when preparing financial statements under PBE Standards, and entities applying the Tier 3 Standard can also refer to the PBE Conceptual Framework in certain circumstances. We then explained that the *amendments* to the PBE Conceptual Framework apply in the same way. For this reason, Part B is longer than it usually is in amending Standards.

[2] This is because Chapter 5 of the PBE Conceptual Framework also includes a paragraph on service performance reporting, whereas Chapter 5 of the IPSASB's Conceptual Framework does not.

Table 1 Summary of proposed amendments to Chapter 3 – based on IPSASB amendments

Amendments to Chapter 3 – aligned with IPSASB amendments	Ref
Prudence The amendments clarify the role of prudence in supporting neutrality, which is an aspect of faithful representation. The amendments note the following. • Prudence is the exercise of caution when making judgements under conditions of uncertainty. Exercising prudence means that assets, liabilities, revenue, and expenses are not overstated or understated. • The exercise of prudence does not imply a need for asymmetry (e.g. systematically requiring more evidence for recognising assets or revenue as compared to liabilities and expenses). However, some standards may include asymmetric requirements. These IPSASB-based amendments are also aligned with the IASB's Conceptual Framework.	Para 3.14A – 3.14B
Materiality The amendments update the guidance on materiality by adding a reference to the *obscuring* of information. That is, information is material if omitting, misstating *or obscuring* it could be reasonably expected to influence the discharge of accountability by the entity or the decisions made by users of the financial statements. These IPSASB-based amendments are also aligned with the IASB's Conceptual Framework.	Para 3.32, 3.33A

Table 2 Summary of proposed amendments to Chapter 5 – based on IPSASB amendments

Amendments to Chapter 5 – aligned with IPSASB amendments	Ref
Definition of an asset and related guidance: <u>Rights-based approach to description of 'resource'</u> The ED proposes to amend the description of a 'resource' – which is an element of the definition of an asset – and the related guidance, based on the IPSASB's amendments. The amendments reflect the IPSASB taking a rights-based approach to the description of a resource – similarly to the IASB Conceptual Framework. The IPSASB Conceptual Framework previously described a resource as "an *item* with service potential or the ability to generate economic benefits". The related guidance referred to benefits arising *either from the resource itself, or from rights to use it*. However, the IPSASB agreed with the IASB's argument that the guidance on assets *should not distinguish between benefits* that arise from *owning an object* and those that arise from the *right to use an object*. This is because rights conferred by legal ownership of an object and rights to use the object for some of its useful life are *both types of rights* – not separate phenomena. The new description of a resource in Chapter 5 is: "*a right to either service potential or the capability to generate economic benefits, or a right to both*". Most of the added guidance on rights is based on the guidance in the IASB's Conceptual Framework. However, unlike the IASB, the IPSASB has had to refer both to economic benefits and service potential in its description of a resource and the related guidance – which is also necessary in the PBE Conceptual Framework.	Para 5.6–5.13

Amendments to Chapter 5 – aligned with IPSASB amendments	Ref
Minor amendment to the definition of an asset In the definition of a liability, the reference to past event (singular) is replaced with 'past events' (plural) – given that an asset may arise from a single past event or multiple past events. This IPSASB-based amendment is aligned with the IASB's Conceptual Framework.	
Definition of a liability and related guidance Reference to 'transfer of resources' The ED proposes to update the definition of a liability in line with the IPSASB's amendments to the definition, so that it refers to the present obligation to *transfer resources* – rather than a present obligation for an outflow of resources. Specifically, the definition of a liability is updated as follows: *"A present obligation of the entity ~~for an outflow~~ to transfer ~~of~~ resources as a result of ~~that results~~ ~~from~~ ~~a~~ past events."* In 2018, the IASB made a similar amendment to the definition of a liability in its Conceptual Framework. The previously used term 'outflow of [economic] resources' was linked to guidance on *expected* outflow of resources. The IASB considered that this focus on expectation of outflow conflates the requirements for meeting the *definition* of a liability with the requirements for the *recognition* of a liability. Therefore, in the IASB's Conceptual Framework, the IASB replaced the notion of expected outflow of resources with the notion of potential to require transfer of resources. The IPSASB found this argument persuasive. The ED also includes the IPSASB's amendments to the guidance on the definition of a liability, which the IPSASB based on the IASB's guidance in its Conceptual Framework – with modifications to reflect the public sector context. The amendments to the guidance on the definition of a liability include the IPSASB's new guidance on the concept of 'transfer of resources'. The IPSASB considered this guidance to be particularly important in the context of the new IPSASs on *Revenue* and *Transfer Expenses*, which have a focus on liabilities arising from binding arrangements. The amendments also emphasise that the *definition* of a liability can be met *even when the probability of a transfer/outflow of resources is low*. These amendments are consistent with the guidance on the definition of a liability in the IASB's Conceptual Framework as amended in 2018. *However, the IASB had also enhanced the guidance on the recognition of assets and liabilities in its Conceptual Framework, whereas the IPSASB did not. As discussed in the Background section above, we have addressed potential concerns in this regard by incorporating the enhanced IASB guidance in the Basis for Conclusions (see Table 4 below)*. Minor amendment to the definition of a liability As with the definition of an asset, the ED proposes to refer to 'past events' (plural), rather than a 'past event', in the definition of a liability. Reorganisation of the section on liabilities The ED proposes to rearrange the section on liabilities in Chapter 5, so that the order of topics discussed in the guidance are aligned with the proposed new definition of a liability.	Para 5.14 – 5.26

Amendments to Chapter 5 – aligned with IPSASB amendments	Ref
Unit of account The ED proposes to add into Chapter 5 IPSASB's new guidance on the 'unit of account'. The 'unit of account' is the unit to which recognition criteria and measurement concepts are applied. Currently, there is no specific guidance on the 'unit of account' in the PBE Conceptual Framework. The IPSASB added into Chapter 5 a new section on the 'unit of account', largely based on the equivalent guidance in the IASB's Conceptual Framework. The ED proposes to add the IPSASB's new guidance.	Para 5.26A–5.26H
Binding arrangements that are equally unperformed ('executory contracts') The ED proposes to add into Chapter 5 the IPSASB's new guidance on 'binding arrangements that are equally unperformed'. The IPSASB's guidance is based on the IASB's guidance on executory contracts in its Conceptual Framework. However, the IPSASB decided not to use the term 'executory contracts', because in some jurisdictions the term 'contract' is problematic in the public sector.	Para 5.26I–5.26J

Table 3 – Commencement and Application

Appendix A – Commencement and Application	Ref
In New Zealand, both Standards and Authoritative Notices are required to have a date when they are required to be applied – as per the requirements of the Financial Reporting Act 2013 and the Legislation Act 2019. In the current version of the PBE Conceptual Framework, the 'effective date' is set out in 'Part B', located after the Basis for Conclusions. However, we consider that commencement and application provisions are an integral part of Standards and Authoritative Notices, whereas a Basis for Conclusion accompanies, but is not part of, Standards and Authoritative Notices. The ED therefore relocates 'Part B' before the Basis for Conclusions – and renames this section as Appendix A, as Parts A and B of an ED are usually used as the Introduction and Scope section. We have added the standard commencement and application wording (i.e. those that have been in use since mid-2023) into Appendix A, with respect to the [proposed] amendments to the PBE Conceptual Framework. (The rationale for the proposed mandatory date of 1 January 2028 is explained in the Consultation Document section of this memo further below.)	App A, para A2–A5

Table 4 Basis for Conclusions

NZASB Basis for Conclusions (BC)	Ref
BC paragraphs on the amendments to Chapter 3 The BC paragraphs briefly outline the amendments and the IPSASB's rationale for them (without setting out the full details, as those are available in the IPSASB's Basis for Conclusions, to which we would provide a link on our website), and explains the incorporation of the amendments into the PBE Conceptual Framework.	Para BC10A – BC10C

<table>
<tr><th>NZASB Basis for Conclusions (BC)</th><th>Ref</th></tr>
<tr><td>BC paragraphs on the amendments to Chapter 5
The BC paragraphs briefly outline the amendments and the IPSASB's rationale for them (without setting out the full details, as those are available in the IPSASB's Basis for Conclusions, to which we would provide a link on our website), and explains the incorporation of the amendments into the PBE Conceptual Framework.
We draw the Board's attention to BC paragraphs BC17E–BC17M, which provide:
• An explanation of our concern in relation to new paragraphs 5.16A and 5.16B – which emphasise that the definition of a liability can be met even when the probability of a transfer of resources is low – which the IPSASB added as part of the updates to the guidance on the definition of a liability, without also enhancing its guidance on the recognition as the IASB did in 2018;
• A reference to the enhanced guidance from the IASB Conceptual Framework on recognition – specifically, those paragraphs that we consider most relevant in mitigating the abovementioned concern;
• An explanation that on balance, the abovementioned references to the enhanced guidance from the IASB Conceptual Framework in the BC are expected to be sufficient to mitigate our concern and assist those entities that refer to the PBE Conceptual Framework in preparing financial reports – and an explanation of how preparers may refer to those IASB paragraphs in conjunction with the core text of the PBE Conceptual Framework, in those situations where a preparer uses the PBE Conceptual Framework in determining whether to recognise a liability or an asset in the financial report (we expect such situations to be relatively uncommon for most PBEs).
Please refer to the Background section of this memo for more information.</td><td>Para BC17A–BC17M</td></tr>
</table>

Draft Consultation Document

19. The draft Consultation Document, which is to accompany the ED, is attached as Agenda Item 3.3. The Consultation Document explains the rationale for the ED proposals, summarises the ED proposals, and includes the following questions for respondents:

    (a) Whether respondents agree with, and/or have any feedback on, the proposed amendments to Chapter 3;

    (b) Whether respondents agree with, and/or have any feedback on, the proposed amendments to Chapter 5;

    (c) Whether respondents agree with, and/or have any feedback on, the amendments to the Basis for Conclusions of the PBE Conceptual Framework (which includes a reference to guidance on recognition from the IASB Conceptual Framework);

    (d) Whether respondents agree with the mandatory date of 1 January 2028 (with early application permitted to periods that did not end before the Authoritative Notice 'takes effect' for legislative purposes); and

    (e) Whether respondents have any other feedback on the ED.

20. The suggested mandatory date of 1 January 2028 is aligned with the expected mandatory date of the forthcoming PBE Standards on Revenue and Transfer Expenses. Some PBEs may have revenue and expense transactions that are not specifically addressed by current PBE Standards – in which case, the amendments to the PBE Conceptual Framework in relation to the definition of a liability may possibly affect the accounting treatment of these transactions in these PBEs' financial reports. If the mandatory date of the amendments to the PBE Conceptual Framework is earlier than the mandatory date of the PBE Standards on Revenue and Transfer Expenses, the abovementioned PBEs may need to reassess again their treatment of the abovementioned revenue and expense transactions in line with the new Standards. We think it would be beneficial to allow PBEs to consider the effect (if any) of the amendments to the PBE Conceptual Framework on their revenue and expense transactions at the same time as considering the application of the forthcoming PBE Standards on Revenue and Transfer Expenses – in a holistic manner.

21. In terms of the consultation period, we recommend the standard time of (approximately) 90 days.

22. We plan to seek assistance from our Communications Team to further improve the formatting of the Consultation Document before it is published.

Question for the Board

Draft ED (Agenda Item 3.2)

Q1. Regarding the enhanced guidance on recognition in the IASB's Conceptual Framework, which staff propose to refer to in the Basis for Conclusions of the PBE Conceptual Framework:

(a) Does the Board agree to locate this guidance in the Basis for Conclusions (as opposed to the core text of Chapter 6)?

(b) Does the Board agree with staff's selection of IASB paragraphs to include in the Basis for Conclusions, as shown underneath paragraph BC17I in the draft ED?

(c) Does the Board have any feedback on the explanations in paragraphs BC17E–BC17M of the draft ED?

Q2. Does the Board have feedback on any other aspects of the draft ED?

Q3. Does the Board approve the ED to be issued for public consultation (subject to any changes identified by the Board at this meeting to be finalised via review by the Chair)?

Draft Consultation Document (Agenda Item 3.3)

Q4. Does the Board have any feedback on the draft Consultation Document – including the questions to respondents and the proposed mandatory date?

Q5. Does the Board approve the Consultation Document to be issued for public consultation (subject to any changes identified by the Board at this meeting to be finalised via review by the Chair)?

Next steps

23. If the Board approves the PBE ED and Consultation Document, staff will update it for any changes agreed by the Board at this meeting, and finalise these changes via review by the Chair. We then expect to publish the ED and Consultation Document in March 2024.

24. Our recommended timeline for the consultation and finalisation of the project is shown below (subject to the feedback we receive on the ED and the timing of other NZASB projects):

    (a) March 2024–June 2024: ED consultation in progress

    (b) August 2024: Discussion of feedback with the Board

    (c) October 2024 (or December 2024): Approval of the finalised amendments.

25. We recommend finalising the amendments this year (2024), so that they are in place ahead of the forthcoming PBE Standards on Revenue and Transfer Expenses (but not mandatory until 1 January 2028). Having the amendments to the PBE Conceptual Framework finalised and published before we consult on the Revenue and Transfer Expenses PBE Standards would mean that stakeholder would be able to consider those forthcoming proposed Standards in the context of the updated PBE Conceptual Framework.

Attachments

Agenda item 3.2: Draft ED PBE Conceptual Framework Update (Proposed amendments to Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in General Purpose Financial Reports*)

Agenda item 3.3: Consultation Document

Appendix 1: IASB Conceptual Framework Chapter 5 *Recognition and Derecognition*

Chapter 5 of the IASB Conceptual Framework is reproduced in full below. Those paragraphs that we are suggesting to include in the Basis for Conclusions of the PBE Conceptual Framework (see paragraph BC17I of the draft ED) are highlighted in orange. Those paragraphs that we are proposing to exclude are highlighted in grey.

We have selected those paragraphs that we considered most relevant to mitigating our concern regarding the potential lack of clarity around determining whether to recognise liabilities with low probability of a transfer of resources in financial reports. Therefore:

(a) We have included an introductory paragraph from the 'recognition criteria' section (IASB paragraph 5.7) and the sections on relevance (IASB paragraphs 5.12–5.17) and faithful representation (IASB paragraph 5.18, but not the detailed paragraphs on measurement uncertainty) – as these sections focus on how low probability of inflow/outflow of resources, as well as uncertainty regarding the existence of an asset or liability and other sources of uncertainty – affect the recognition of assets and liabilities.

(b) We have excluded the IASB sections on the 'recognition process (which discusses what recognition means and the links between recognised elements), because we did not consider it to be overly helpful for mitigating the risk regarding the lack of clarity as to whether to recognise a liability with low probability of resource transfer. For similar reasons, we have excluded the general guidance in IASB paragraphs 5.8–5.11 and 5.24-5.25, and the IASB's section on 'derecognition'.

(c) We excluded the detailed IASB paragraphs about measurement uncertainty, as we think that it may be more appropriate to consider whether and how to incorporate these paragraphs into the PBE Conceptual Framework when the Board considers that IPSASB's updates to Chapter 7 *Measurement*.

(d) We also excluded IASB paragraph 5.6, which states that only items that meet the definition of an asset or a liability is recognised in the financial statements. We excluded it because Chapter 5 of the PBE Conceptual Framework – consistent with the IPSASB Conceptual Framework – allows PBE Standards to require recognition of 'other resources' and 'other obligations' that do not meet the definition of an asset/liability as per Chapter 5 in certain circumstances (although neither the IPSASB nor the NZASB has used this option to date).

CHAPTER 5—RECOGNITION AND DERECOGNITION

The recognition process

This section was excluded from the ED's BC – see point (b) at the top of this Appendix.

5.1 Recognition is the process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of one of the elements of financial statements—an asset, a liability, equity, income or expenses. Recognition involves depicting the item in one of those statements—either alone or in aggregation with other items—in words and by a monetary amount, and including that amount in one or more totals in that statement. The amount at which an asset, a liability or equity is recognised in the statement of financial position is referred to as its 'carrying amount'.

5.2 The statement of financial position and statement(s) of financial performance depict an entity's recognised assets, liabilities, equity, income and expenses in structured summaries that are designed to make financial information comparable and understandable. An important feature of the structures of those summaries is that the amounts recognised in a statement are included in the totals and, if applicable, subtotals that link the items recognised in the statement.

5.3 Recognition links the elements, the statement of financial position and the statement(s) of financial performance as follows (see Diagram 5.1):

(a) in the statement of financial position at the beginning and end of the reporting period, total assets minus total liabilities equal total equity; and

(b) recognised changes in equity during the reporting period comprise:

(i) income minus expenses recognised in the statement(s) of financial performance; plus

(ii) contributions from holders of equity claims, minus distributions to holders of equity claims.

5.4 The statements are linked because the recognition of one item (or a change in its carrying amount) requires the recognition or derecognition of one or more other items (or changes in the carrying amount of one or more other items). For example:

(a) the recognition of income occurs at the same time as:

(i) the initial recognition of an asset, or an increase in the carrying amount of an asset; or

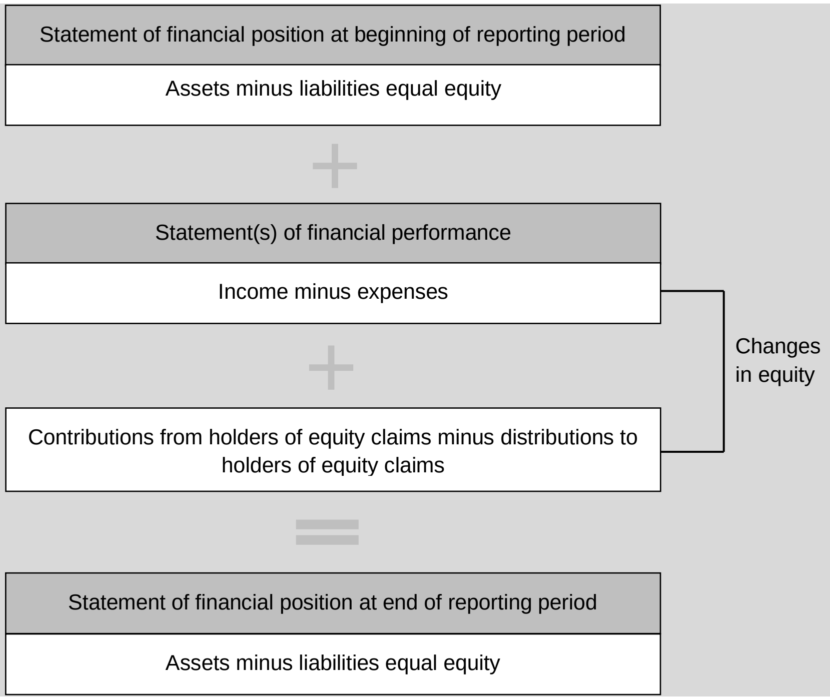
(ii) the derecognition of a liability, or a decrease in the carrying amount of a liability.

(b) the recognition of expenses occurs at the same time as:

(i) the initial recognition of a liability, or an increase in the carrying amount of a liability; or

(ii) the derecognition of an asset, or a decrease in the carrying amount of an asset.

Diagram 5.1: How recognition links the elements of financial statements



5.5 The initial recognition of assets or liabilities arising from transactions or other events may result in the simultaneous recognition of both income and related expenses. For example, the sale of goods for cash results in the recognition of both income (from the recognition of one asset—the cash) and an expense (from the derecognition of another asset—the goods sold). The simultaneous recognition of income and related expenses is sometimes referred to as the matching of costs with income. Application of the concepts in the 2018 *NZ Conceptual Framework* leads to such matching when it arises from the recognition of changes in assets and liabilities. However, matching of costs with income is not an objective of the 2018 *NZ Conceptual Framework*. The 2018 *NZ Conceptual Framework* does not allow the recognition in the statement of financial position of items that do not meet the definition of an asset, a liability or equity.

Recognition criteria

Paragraph 5.7 from this section is included in the BC – see points (a), (b) and (d) at the top of this Appendix for an explanation as to why this paragraph was included and the remaining paragraphs of this section were excluded.

5.6 Only items that meet the definition of an asset, a liability or equity are recognised in the statement of financial position. Similarly, only items that meet the definition of income or expenses are recognised in the statement(s) of financial performance. However, not all items that meet the definition of one of those elements are recognised.

5.7 Not recognising an item that meets the definition of one of the elements makes the statement of financial position and the statement(s) of financial performance less complete and can exclude useful information from financial statements. On the other hand, in some circumstances, recognising some items that meet the definition of one of the elements would not provide useful information. An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with:

(a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity (see paragraphs 5.12–5.17); and

(b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity (see paragraphs 5.18–5.25).

5.8 Just as cost constrains other financial reporting decisions, it also constrains recognition decisions. There is a cost to recognising an asset or liability. Preparers of financial statements incur costs in obtaining a relevant measure of an asset or liability. Users of financial statements also incur costs in analysing and interpreting the information provided. An asset or liability is recognised if the benefits of the information provided to users of financial statements by recognition are likely to justify the costs of providing and using that information. In some cases, the costs of recognition may outweigh its benefits.

5.9 It is not possible to define precisely when recognition of an asset or liability will provide useful information to users of financial statements, at a cost that does not outweigh its benefits. What is useful to users depends on the item and the facts and circumstances. Consequently, judgement is required when deciding whether to recognise an item, and thus recognition requirements may need to vary between and within Standards.

5.10 It is important when making decisions about recognition to consider the information that would be given if an asset or liability were not recognised. For example, if no asset is recognised when expenditure is incurred, an expense is recognised. Over time, recognising the expense may, in some cases, provide useful information, for example, information that enables users of financial statements to identify trends.

5.11 Even if an item meeting the definition of an asset or liability is not recognised, an entity may need to provide information about that item in the notes. It is important to consider how to make such information sufficiently visible to compensate for the item's absence from the structured summary provided by the statement of financial position and, if applicable, the statement(s) of financial performance.

Relevance

This section was included in the ED's BC – see point (a) at the top of this Appendix.

5.12 Information about assets, liabilities, equity, income and expenses is relevant to users of financial statements. However, recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always provide relevant information. That may be the case if, for example:

(a) it is uncertain whether an asset or liability exists (see paragraph 5.14); or

(b) an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low (see paragraphs 5.15–5.17).

5.13 The presence of one or both of the factors described in paragraph 5.12 does not lead automatically to a conclusion that the information provided by recognition lacks relevance. Moreover, factors other than those described in paragraph 5.12 may also affect the conclusion. It may be a combination of factors and not any single factor that determines whether recognition provides relevant information.

Existence uncertainty

5.14 Paragraphs 4.13 and 4.35 discuss cases in which it is uncertain whether an asset or liability exists. In some cases, that uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of an asset or liability, necessarily measured at a single amount, would not provide relevant information. Whether or not the asset or liability is recognised, explanatory information about the uncertainties associated with it may need to be provided in the financial statements.

Low probability of an inflow or outflow of economic benefits

5.15 An asset or liability can exist even if the probability of an inflow or outflow of economic benefits is low (see paragraphs 4.15 and 4.38).

5.16 If the probability of an inflow or outflow of economic benefits is low, the most relevant information about the asset or liability may be information about the magnitude of the possible inflows or outflows, their possible timing and the factors affecting the probability of their occurrence. The typical location for such information is in the notes.

5.17 Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or liability may provide relevant information beyond the information described in paragraph 5.16. Whether that is the case may depend on a variety of factors. For example:

(a) if an asset is acquired or a liability is incurred in an exchange transaction on market terms, its cost generally reflects the probability of an inflow or outflow of economic benefits. Thus, that cost may be relevant information, and is generally readily available. Furthermore, not recognising the asset or liability would result in the recognition of expenses or income at the time of the exchange, which might not be a faithful representation of the transaction (see paragraph 5.25(a)).

(b) if an asset or liability arises from an event that is not an exchange transaction, recognition of the asset or liability typically results in recognition of income or expenses. If there is only a low probability that the asset or liability will result in an inflow or outflow of economic benefits, users of financial statements might not regard the recognition of the asset and income, or the liability and expenses, as providing relevant information.

Faithful representation

Paragraph 5.18 was included in the ED's BC – see point (a), (b) and (c) at the top of this Appendix for an explanation of why that paragraph was included and the remaining paragraphs in this section were excluded.

5.18 Recognition of a particular asset or liability is appropriate if it provides not only relevant information, but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. Whether a faithful representation can be provided may be affected by the level of measurement uncertainty associated with the asset or liability or by other factors.

Measurement uncertainty

5.19 For an asset or liability to be recognised, it must be measured. In many cases, such measures must be estimated and are therefore subject to measurement uncertainty. As noted in paragraph 2.19, the use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information.

5.20 In some cases, the level of uncertainty involved in estimating a measure of an asset or liability may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. The level of measurement uncertainty may be so high if, for example, the only way of estimating that measure of the asset or liability is by using cash-flow-based measurement techniques and, in addition, one or more of the following circumstances exists:

(a) the range of possible outcomes is exceptionally wide and the probability of each outcome is exceptionally difficult to estimate.

(b) the measure is exceptionally sensitive to small changes in estimates of the probability of different outcomes—for example, if the probability of future cash inflows or outflows occurring is exceptionally low, but the magnitude of those cash inflows or outflows will be exceptionally high if they occur.

(c) measuring the asset or liability requires exceptionally difficult or exceptionally subjective allocations of cash flows that do not relate solely to the asset or liability being measured.

5.21 In some of the cases described in paragraph 5.20, the most useful information may be the measure that relies on the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. This is especially likely to be the case if that measure is the most relevant measure of the asset or liability. In other cases, if that information would not provide a sufficiently faithful representation of the asset or liability and of any resulting income, expenses or changes in equity, the most useful information may be a different measure (accompanied by any necessary descriptions and explanations) that is slightly less relevant but is subject to lower measurement uncertainty.

5.22 In limited circumstances, all relevant measures of an asset or liability that are available (or can be obtained) may be subject to such high measurement uncertainty that none would provide useful information about the asset or liability (and any resulting income, expenses or changes in equity), even if the measure were accompanied by a description of the estimates made in producing it and an explanation of the uncertainties that affect those estimates. In those limited circumstances, the asset or liability would not be recognised.

5.23 Whether or not an asset or liability is recognised, a faithful representation of the asset or liability may need to include explanatory information about the uncertainties associated with the asset or liability's existence or measurement, or with its outcome—the amount or timing of any inflow or outflow of economic benefits that will ultimately result from it (see paragraphs 6.60–6.62).

Other factors

5.24 Faithful representation of a recognised asset, liability, equity, income or expenses involves not only recognition of that item, but also its measurement as well as presentation and disclosure of information about it (see Chapters 6–7).

5.25 Hence, when assessing whether the recognition of an asset or liability can provide a faithful representation of the asset or liability, it is necessary to consider not merely its description and measurement in the statement of financial position, but also:

(a) the depiction of resulting income, expenses and changes in equity. For example, if an entity acquires an asset in exchange for consideration, not recognising the asset would result in recognising expenses and would reduce the entity's profit and equity. In some cases, for example, if the entity does not consume the asset immediately, that result could provide a misleading representation that the entity's financial position has deteriorated.

(b) whether related assets and liabilities are recognised. If they are not recognised, recognition may create a recognition inconsistency (accounting mismatch). That may not provide an understandable or faithful representation of the overall effect of the transaction or other event giving rise to the asset or liability, even if explanatory information is provided in the notes.

(c) presentation and disclosure of information about the asset or liability, and resulting income, expenses or changes in equity. A complete depiction includes all information necessary for a user of financial statements to understand the economic phenomenon depicted, including all necessary descriptions and explanations. Hence, presentation and disclosure of related information can enable a recognised amount to form part of a faithful representation of an asset, a liability, equity, income or expenses.

Derecognition

This section was excluded from the ED's BC – see point (b) at the top of this Appendix.

5.26 Derecognition is the removal of all or part of a recognised asset or liability from an entity's statement of financial position. Derecognition normally occurs when that item no longer meets the definition of an asset or of a liability:

(a) for an asset, derecognition normally occurs when the entity loses control of all or part of the recognised asset; and

(b) for a liability, derecognition normally occurs when the entity no longer has a present obligation for all or part of the recognised liability.

5.27 Accounting requirements for derecognition aim to faithfully represent both:

(a) any assets and liabilities retained after the transaction or other event that led to the derecognition (including any asset or liability acquired, incurred or created as part of the transaction or other event); and

(b) the change in the entity's assets and liabilities as a result of that transaction or other event.

5.28 The aims described in paragraph 5.27 are normally achieved by:

(a) derecognising any assets or liabilities that have expired or have been consumed, collected, fulfilled or transferred, and recognising any resulting income and expenses. In the rest of this chapter, the term 'transferred component' refers to all those assets and liabilities;

(b) continuing to recognise the assets or liabilities retained, referred to as the 'retained component', if any. That retained component becomes a unit of account separate from the transferred component. Accordingly, no income or expenses are recognised on the retained component as a result of the derecognition of the transferred component, unless the derecognition results in a change in the measurement requirements applicable to the retained component; and

(c) applying one or more of the following procedures, if that is necessary to achieve one or both of the aims described in paragraph 5.27:

(i) presenting any retained component separately in the statement of financial position;

(ii) presenting separately in the statement(s) of financial performance any income and expenses recognised as a result of the derecognition of the transferred component; or

(iii) providing explanatory information.

5.29 In some cases, an entity might appear to transfer an asset or liability, but that asset or liability might nevertheless remain an asset or liability of the entity. For example:

(a) if an entity has apparently transferred an asset but retains exposure to significant positive or negative variations in the amount of economic benefits that may be produced by the asset, this sometimes indicates that the entity might continue to control that asset (see paragraph 4.24); or

(b) if an entity has transferred an asset to another party that holds the asset as an agent for the entity, the transferor still controls the asset (see paragraph 4.25).

5.30 In the cases described in paragraph 5.29, derecognition of that asset or liability is not appropriate because it would not achieve either of the two aims described in paragraph 5.27.

5.31 When an entity no longer has a transferred component, derecognition of the transferred component faithfully represents that fact. However, in some of those cases, derecognition may not faithfully represent how much a transaction or other event changed the entity's assets or liabilities, even when supported by one or more of the procedures described in paragraph 5.28(c). In those cases, derecognition of the transferred component might imply that the entity's financial position has changed more significantly than it has. This might occur, for example:

(a) if an entity has transferred an asset and, at the same time, entered into another transaction that results in a present right or present obligation to reacquire the asset. Such present rights or present obligations may arise from, for example, a forward contract, a written put option, or a purchased call option.

(b) if an entity has retained exposure to significant positive or negative variations in the amount of economic benefits that may be produced by a transferred component that the entity no longer controls.

5.32 If derecognition is not sufficient to achieve both aims described in paragraph 5.27, even when supported by one or more of the procedures described in paragraph 5.28(c), those two aims might sometimes be achieved by continuing to recognise the transferred component. This has the following consequences:

(a) no income or expenses are recognised on either the retained component or the transferred component as a result of the transaction or other event;

(b) the proceeds received (or paid) upon transfer of the asset (or liability) are treated as a loan received (or given); and

(c) separate presentation of the transferred component in the statement of financial position, or provision of explanatory information, is needed to depict the fact that the entity no longer has any rights or obligations arising from the transferred component. Similarly, it may be necessary to provide information about income or expenses arising from the transferred component after the transfer.

5.33 One case in which questions about derecognition arise is when a contract is modified in a way that reduces or eliminates existing rights or obligations. In deciding how to account for contract modifications, it is necessary to consider which unit of account provides users of financial statements with the most useful information about the assets and liabilities retained after the modification, and about how the modification changed the entity's assets and liabilities:

(a) if a contract modification only eliminates existing rights or obligations, the discussion in paragraphs 5.26–5.32 is considered in deciding whether to derecognise those rights or obligations;

(b) if a contract modification only adds new rights or obligations, it is necessary to decide whether to treat the added rights or obligations as a separate asset or liability, or as part of the same unit of account as the existing rights and obligations (see paragraphs 4.48–4.55); and

(c) if a contract modification both eliminates existing rights or obligations and adds new rights or obligations, it is necessary to consider both the separate and the combined effect of those modifications. In some such cases, the contract has been modified to such an extent that, in substance, the modification replaces the old asset or liability with a new asset or liability. In cases of such extensive modification, the entity may need to derecognise the original asset or liability, and recognise the new asset or liability.

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Agenda item 3.2

PBE Conceptual Framework Update

Proposed amendments to Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in General Purpose Financial Reports*

Exposure Draft

Submissions close [XX June] 2024

March 2024

PBE Conceptual Framework Update – Amendments to Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in General Purpose Financial Reports*

Issued [date]

This [draft] Authoritative Notice amends Chapter 3 and Chapter 5 of the *Public Benefit Entities' Conceptual Framework*, based on amendments issued by the International Public Sector Accounting Standards Board (IPSASB). Amendments include updates to the guidance on materiality, clarification of the role of prudence in the context of faithful representation, updates to the definitions of an asset and a liability and the related guidance, and new guidance on the unit of account and on binding arrangements that are equally unperformed.

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

Legal status of amending Standard

This [draft] Authoritative Notice was issued on [date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(c) of the Financial Reporting Act 2013.

This amending Standard is secondary legislation for the purposes of the Legislation Act 2019.

The [draft] Authoritative Notice, pursuant to section 27(1) of the Financial Reporting Act 2013, takes effect on the 28th day after the date of its publication. The Authoritative Notice was published under the Legislation Act 2019 on [date] and takes effect on [date].

Commencement and application

The [draft] Authoritative Notice has a mandatory date of [1 January 2028], meaning it must be applied for accounting periods that begin on or after this date (see Part B and Appendix A for more information).

Application to an earlier accounting period is permitted for accounting periods that end after this amending Standard takes effect – refer to paragraphs A2–A5 of this [draft] Authoritative Notice.

COPYRIGHT

ISBN XXX-X-XX-XXXXXX-X

CONTENTS

Part A – Introduction

This Authoritative Notice amends Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in General Purpose Financial Reports* of the *Public Benefit Entities' Conceptual Framework*, based on the IPSASB's updates to Chapters 3 and 5 of its Conceptual Framework.

Amendments include updates to the guidance on materiality, clarification of the role of prudence in the context of faithful representation, updates to the definitions of an asset and a liability and to the related guidance, and new guidance on the unit of account and on binding arrangements that are equally unperformed.

Part B – Scope

This Authoritative Notice applies to Tier 1, Tier 2 and Tier 3 public benefit entities to the same extent that the *Public Benefit Entities' Conceptual Framework* (PBE Conceptual Framework) applies to such entities, as explained below.

This Authoritative Notice amends the PBE Conceptual Framework. The PBE Conceptual Framework establishes the concepts to be applied by the NZASB in developing Public Benefit Entity Standards (PBE Standards), which apply to Tier 1 and Tier 2 public benefit entities. The PBE Conceptual Framework does not override the requirements of PBE Standards. However, the PBE Conceptual Framework's roles include assisting preparers of general purpose financial reports that apply PBE Standards. For example, it may assist preparers in developing consistent accounting policies when dealing with topics that have yet to form the subject of a PBE Standard, or when a Standard allows a choice of accounting policy. In addition, in certain circumstances, public benefit entities applying *Reporting Requirements for Tier 3 Not-for-Profit Entities* (Tier 3 (NFP) Standard) or *Reporting Requirements for Tier 3 Public Sector Entities* (Tier 3 (PS) Standard) may also refer to, and consider the applicability of the definitions and concepts in the PBE Conceptual Framework, to the extent that they do not conflict with those Standards.

Part C – Amendments to the *Public Benefit Entities' Conceptual Framework*

Chapter 3 *Qualitative Characteristics*

Paragraphs 3.14A and 3.14B are added. Paragraph 3.32 is amended and part of the paragraph is relocated to new paragraph 3.33A. Paragraphs 3.10–3.14, 3.15–3.16 and 3.33–3.34 are not amended, but are included for context. New text is underlined, deleted text is struck through, and relocated text is double-underlined.

[…]

Faithful Representation

3.10 To be useful in financial reporting, information must be a faithful representation of the economic and other phenomena that it purports to represent. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form.

3.11 In practice, it may not be possible to know or confirm whether information presented in GPFRs is complete, neutral, and free from material error. However, information should be as complete, neutral, and free from error as is possible.

3.12 An omission of some information can cause the representation of an economic or other phenomenon to be false or misleading, and thus not useful to users of GPFRs. For example, a complete depiction of the item "plant and equipment" in GPFRs will include a numeric representation of the aggregate amount of plant and equipment together with other quantitative, descriptive and explanatory information necessary to faithfully represent that class of assets. In some cases, this may include the disclosure of information about such matters as the major classes of plant and equipment, factors that have affected their use in the past or might impact on their use in the future, and the basis and process for determining their numeric representation. Similarly, prospective financial and non-financial information and information about the achievement of service performance objectives and outcomes included in GPFRs will need to be presented with the key assumptions that underlie that information and any explanations that are necessary to ensure that its depiction is complete and useful to users.

3.13 Neutrality in financial reporting is the absence of bias. It means that the selection and presentation of financial and non-financial information is not made with the intention of attaining a particular predetermined result—for example, to influence in a particular way users' assessment of the discharge of accountability by the entity or a decision or judgement that is to be made, or to induce particular behaviour.

3.14 Neutral information faithfully represents the economic and other phenomena that it purports to represent. However, to require information included in GPFRs to be neutral does not mean that it is not without purpose or that it will not influence behaviour. Relevance is a qualitative characteristic and, by definition, relevant information is capable of influencing users' assessments and decisions.

3.14A Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and revenue are not overstated, and liabilities and expense are not understated. Equally, the exercise of prudence does not allow for the understatement of assets or revenue or the overstatement of liabilities or expense. Such misstatements can lead to the overstatement or understatement of revenue or expense in future reporting periods.

3.14B The exercise of prudence does not imply a need for asymmetry; for example, a systematic need for more persuasive evidence to support the recognition of assets or revenue than the recognition of liabilities or expense. Particular standards may contain asymmetric requirements where this is a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to represent.

3.15 The economic and other phenomena represented in GPFRs generally occur under conditions of uncertainty. Information included in GPFRs will therefore often include estimates that incorporate management's judgement. To faithfully represent an economic or other phenomenon, an estimate must be based on appropriate inputs, and each input must reflect the best available information. Caution will need to be exercised when dealing with uncertainty. It may sometimes be necessary to explicitly disclose the degree of uncertainty in financial and non-financial information to faithfully represent economic and other phenomena.

3.16 Free from material error does not mean complete accuracy in all respects. Free from material error means there are no errors or omissions that are individually or collectively material in the description of the phenomenon, and the process used to produce the reported information has been applied as described. In some cases, it may be possible to determine the accuracy of some information included in GPFRs—for example, the amount of a cash transfer to another entity, the volume of services delivered or the price paid for the acquisition of plant and equipment. However, in other cases it may not—for example, the accuracy of an estimate of the value or cost of an item or the effectiveness of providing particular services may not be able to be determined. In these cases, the estimate will be free from material error if the amount is clearly described as an estimate, the nature and limitations of the estimation process are explained, and no material errors have been identified in selecting and applying an appropriate process for developing the estimate.

[…]

Constraints on Information Included in General Purpose Financial Reports

Materiality

3.32 Information is material if ~~its omission or misstatement~~ omitting, misstating or obscuring it could reasonably be expected to ~~could~~ influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. ~~GPFRs may encompass qualitative and quantitative information about service performance achievements during the reporting period, and expectations about service performance objectives and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material~~.

3.33 Assessments of materiality will be made in the context of the legislative, institutional and operating environment within which the entity operates and, in respect of prospective financial and non-financial information, the preparer's knowledge and expectations about the future. Disclosure of information about compliance or non-compliance with legislation, regulation or other authority may be material because of its nature—irrespective of the magnitude of any amounts involved. In determining whether an item is material in these circumstances, consideration will be given to such matters as the nature, legality, sensitivity and consequences of past or anticipated transactions and events, the parties involved in any such transactions and the circumstances giving rise to them.

3.33A GPFRs may encompass qualitative and quantitative information about service performance achievements during the reporting period, and expectations about service performance objectives and financial outcomes in the future. Consequently, it is not possible to specify a uniform ~~quantitative threshold~~ characteristic or a uniform set of characteristics at which a particular type of information becomes material.

3.34 Materiality is classified as a constraint on information included in GPFRs in the PBE Conceptual Framework. In developing PBE Standards, the NZASB will consider the materiality of the consequences of application of a particular accounting policy, basis of preparation or disclosure of a particular item or type of information. Subject to the requirements of any PBE Standard, entities preparing GPFRs will also consider the materiality of, for example, the application of a particular accounting policy and the separate disclosure of particular items of information.

Chapter 5 *Elements in General Purpose Financial Reports*

> Paragraphs 5.8–5.10, 5.13, 5.14, 5.15, 5.17, 5.31 and the headings above paragraphs 5.11, 5.15, 5.16 and 5.17 are amended. Paragraphs 5.6A, 5.6B, 5.7A–5.7G, 5.12A, 5.14A, 5.16A–5.16F, 5.17A, 5.26A–5.26J and headings above paragraphs 5.7A, 5.8, 5.26A, and 5.26I are added. The content of paragraphs 5.18–5.23 is relocated as new paragraphs 5.15A–5.15F, with paragraphs 5.15A–5.15C being amended, and paragraphs 5.24–5.26 are relocated as new paragraphs 5.17B–5.17D and amended. Paragraphs 5.7, 5.16, 5.18–5.26, and the headings above paragraphs 5.13, 5.15A, 5.18 and 5.23 are deleted. Paragraphs 5.1, 5.2, 5.3, 5.5, 5.11–5.12, 5.26.1–5.26.2, and 5.29–5.30 are not amended, but are included for context. New text is underlined, relocated text is double underlined, and deleted text is struck through.

Introduction

Purpose of this Chapter

5.1 This Chapter defines the elements used in financial statements and service performance reports and provides further explanation about those definitions.

[…]

Elements of Financial Statements and their Importance

5.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting and achieves the qualitative characteristics of financial reporting while taking into account the constraints on information included in GPFRs.

5.3 The elements defined in this Chapter do not refer to the individual items that are recognised as a result of transactions and events. Sub-classifications of individual items within an element and aggregations of items are used to enhance the understandability of the financial statements. Presentation is addressed in Chapter 8 *Presentation in General Purpose Financial Reports.*

[…]

Elements of Financial Statements Defined

5.5 The elements that are defined in this Chapter are:

- Assets;
- Liabilities;
- Equity;
- Revenue;
- Expense;
- Ownership contributions; and
- Ownership distributions.

Assets

Definitions of an asset and a resource

5.6 An asset is:

A resource presently controlled by the entity as a result of ~~a~~ past events.

5.6A A resource is:

a right to either service potential or the capability to generate economic benefits, or a right to both.

5.6B This section discusses three components of these definitions:

(a) Rights (paragraphs 5.7A-5.7G);

(b) Service potential and economic benefits (paragraphs 5.8-5.10); and

(c) Present control as a result of past events (paragraph 5.11-5.13).

~~A Resource~~

5.7 [Deleted by IPSASB] ~~A resource is an item with service potential or the ability to generate economic benefits. Physical form is not a necessary condition of a resource. The service potential or ability to generate economic benefits can arise directly from the resource itself or from the rights to use the resource. Some resources embody an entity's rights to a variety of benefits including, for example, the right to:~~

- ~~Use the resource to provide services;~~
- ~~Use an external party's resources to provide services, for example, leases;~~
- ~~Convert the resource into cash through its disposal;~~
- ~~Benefit from the resource's appreciation in value; or~~
- ~~Receive a stream of cash flows.~~

Rights

5.7A Rights to service potential or to the capability to generate economic benefits take many forms, including:

(a) Rights that correspond to an obligation of another party (see paragraph 5.16C), for example:

(i) Rights to receive cash;

(ii) Rights to receive goods or services[1] ;

(iii) Rights to exchange resources with another party on favourable terms. Such rights include, for example, a forward contract to buy a resource on terms that are currently favourable; and

(iv) Rights to benefit from an obligation of another party to transfer a resource if a specified uncertain future event occurs (see paragraph 5.16A).

(b) Rights that do not correspond to an obligation of another party, for example:

(i) Rights over physical objects, such as property, plant and equipment or inventories. Examples of such rights are a right to use a physical object or a right to benefit from a leased object; and

(ii) Rights to use intellectual property.

5.7B Many rights are established by binding arrangement, legislation, or similar means. For example, an entity might obtain rights from owning or leasing a physical object, from owning a debt instrument such as a student loan, or from owning software or the right to use intellectual property. However, an entity might also obtain rights in other ways, for example:

(a) By acquiring or creating know-how that is not in the public domain, such as a traffic management plan; or

(b) Through an obligation of another party that arises because that other party has little or no realistic alternative to avoid a transfer of resources (see paragraph 5.15).

5.7C Some services—for example, employee services and services-in-kind—are received and immediately consumed. An entity's right to obtain the service potential or economic benefits produced by such services exists very briefly until the entity consumes the services.

[1] Subsequent references to 'services' in the PBE Conceptual Framework encompass 'goods' unless the context indicates otherwise.

5.7D Not all of an entity’s rights are assets of that entity. To be assets of the entity, the rights must (i) have service potential or economic benefits beyond those available to all other parties (see paragraphs 5.8-5.10) and (ii) be controlled by the entity (see paragraphs 5.11-5.12A). Rights available to all parties without significant cost—for instance, rights of access to public goods, such as public rights of way over land, or know-how that is in the public domain—are typically not assets for the entities that hold these rights.

5.7E In principle, each of an entity’s rights is a separate asset. However, for accounting purposes, related rights are often treated as a single unit of account that is a single asset (see paragraphs 5.26A–5.26J). For example, legal ownership of a physical object may give rise to several rights, including a right to:

(a) Use the object;

(b) Sell rights over the object; and

(c) Pledge rights over the object.

5.7F In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset. Conceptually, the resource is the set of rights, not the physical object. Nevertheless, describing the set of rights as the physical object will often provide a faithful representation of those rights in the most concise and understandable way.

5.7G The relationship between sovereign rights, resources and an asset is discussed in paragraph 5.13.

Service Potential and Economic Benefits

5.8 Service potential is the ~~capacity~~ capability of a resource to provide services that contribute to achieving the entity’s objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

5.9 Assets that embody service potential may include recreational, heritage, community, defence and other assets ~~which~~ that are held by public benefit entities, and which are used to provide services to third parties. Such services may be for collective or individual consumption. Many services may be provided in areas in which market competition is limited or non-existent ~~where there is no market competition or limited market competition~~. The use and disposal of such assets may be restricted as many assets that embody service potential are specialised in nature.

5.10 Economic benefits are cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from, for example:

- An asset’s use in the production and sale of services; or
- The direct exchange of an asset for cash ~~or other resources~~; or
- Extinguishing or reducing a liability by transferring an asset.

Presently Controlled by the Entity as a Result of a Past Event

5.11 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service performance or other objectives.

5.12 In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist:

- Legal ownership;
- Access to the resource, or the ability to deny or restrict access to the resource;
- The means to ensure that the resource is used to achieve its objectives; and
- The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision.

5.12A Sometimes one party (a principal) engages another party (an agent) to act on behalf of, and for the benefit of, the principal. For example, a principal may engage an agent to arrange for the distribution of goods controlled by the principal to eligible beneficiaries. If an agent has custody of a resource controlled by the principal, that resource is not an asset of the agent.

~~Past Event~~

5.13 The definition of an asset requires that a resource that an entity presently controls must have arisen from ~~a~~ one or more past transactions or other past events. The past transactions or other events that result in an entity gaining control of a resource and therefore an asset may differ. Entities can obtain assets by purchasing them in an exchange transaction or developing them. Assets may also arise through non-exchange transactions, including through the exercising of sovereign powers. The power to tax or to issue ~~licenses~~ licences and to access or restrict or deny access to the benefits embodied in intangible resources, like the electromagnetic spectrum, are examples of public sector-specific powers and rights that may give rise to assets. In assessing when an entity's control of rights to resources arise the following events may be considered: (a) a general ability to establish a power, (b) establishment of a power through a statute, (c) exercising the power to create a right, and (d) the event which gives rise to the right to receive resources from an external party. An asset arises when the power is exercised and the rights exist to receive resources.

Liabilities

Definition

5.14 A liability is:

A present obligation of the entity ~~for an outflow of~~ to transfer resources ~~that results from~~ as a result of ~~a~~ past events.

5.14A For a liability to exist, three criteria must all be satisfied:

(a) The entity has an obligation (paragraphs 5.15-5.15F);

(b) The obligation is to transfer resources (paragraphs 5.16A-5.16F); and

(c) The obligation is a present obligation arising from one or more past events (paragraphs 5.17-5.17D).

~~A Present~~ Obligations

5.15 Public benefit entities can have a number of obligations. Obligations are binding when an entity has little or no realistic alternative to avoid them. ~~A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.~~

~~Legal and Non-Legally Binding Obligations~~

5.15A Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for ~~a present~~ an obligation and a liability to exist.

5.15B Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves ~~an outflow~~ a transfer of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

Legal Obligations

5.15C A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the PBE Conceptual Framework. For some types of non-exchange transactions, judgement will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has little or no realistic alternative to avoid the obligation and that a liability exists.

5.15D Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions—or having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

5.15E Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this PBE Conceptual Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

Non-Legally Binding Obligations

5.15F Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:

- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
- As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

~~An Outflow~~ A Transfer of Resources from the Entity

5.16 [Deleted by IPSASB] ~~A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability.~~

5.16A To satisfy the definition of a liability the obligation must have the potential to require the entity to transfer resources to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer resources—the transfer may, for example, be required only if a specified uncertain future event occurs. It is only necessary that the present obligation exists, and that, at least in one circumstance, it would require the entity to transfer resources.

5.16B An obligation can meet the definition of a liability even if the probability of a transfer of resources is low. Nevertheless, that low probability might affect decisions about the information provided about the liability and how the information is provided. Chapter 6 provides guidance on recognition and Chapter 7 provides guidance on measurement.

5.16C Obligations to transfer resources include, for example:

(a) Obligations to pay cash;

(b) Obligations to provide services or deliver goods;

(c) Obligations to exchange resources with another party on unfavourable terms. Such obligations include, for example, a forward contract to sell on terms that are currently unfavourable or an option that entitles another party to purchase resources from the entity;

(d) Obligations to transfer resources if a specified uncertain future event occurs; and

(e) Obligations to issue a financial instrument if that financial instrument will oblige the entity to transfer a resource.

5.16D Instead of fulfilling an obligation to transfer resources to the party that has a right to receive resources, entities may in some circumstances:

(a) Settle the obligation by negotiating a release from the obligation;

(b) Transfer the obligation to a third party; or

(c) Replace the obligation to transfer resources with another obligation by entering into a new transaction.

5.16E In the situations identified in paragraph 5.16D an entity has an obligation to transfer resources until it has settled, transferred, or replaced that obligation.

5.16F In a principal-agent relationship (see paragraph 5.12A), if the agent has an obligation to transfer resources controlled by the principal to a third party, that obligation is not a liability of the agent. In such a case the resources that would be transferred are the principal's resources.

Present Obligation as a Result of Past Events

5.17 A present obligation is binding. To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of one or more ~~a~~ past transactions or other past events and has the potential to requires ~~an outflow of resources~~ the entity to transfer resources from the entity. ~~The complexity of the activities of public benefit entities means that a number of events in the development, implementation and operation of a particular activity may give rise to obligations. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (non-legally binding obligations), are present obligations and satisfy the definition of a liability. Where an arrangement has a legal form and is binding, such as a contract, the past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves an assessment of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity. In making such an assessment an entity considers the relevant context.~~

5.17A A present obligation exists as a result of past events only if:

(a) The entity has already obtained service potential or economic benefits or taken an action ; and

(b) As a consequence, the entity will or may have to transfer resources that it would not otherwise have had to transfer.

5.17B In the public sector, obligations may arise at a number of points. For example, in implementing a new policy or service:

- Making a political promise such as an electoral pledge;
- Announcement of a policy;
- Introduction (and approval or adoption) of the plan or budget (which may be two distinct points);
- Obtaining legal authority to take a proposed action; and
- An appropriation becoming effective.

The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability. As noted in paragraph 5.15A an entity cannot be obligated to itself as a result of a public communication.

5.17C The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgements whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid ~~an outflow~~ a transfer of resources include:

- The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;

- The ability of the entity to modify or change the obligation before it crystallises. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. ~~Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur;~~ and

- There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However the absence of a budgetary provision does not itself mean that a present obligation has not arisen.

5.17D “Economic coercion”, “political necessity” or other circumstances may give rise to situations where, although the public benefit entity is not legally obliged to incur ~~an outflow~~ a transfer of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid ~~an outflow~~ a transfer of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

~~Legal and Non-Legally Binding Obligations~~

5.18 [Deleted by IPSASB] ~~Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and a liability to exist.~~

5.19 [Deleted by IPSASB] ~~Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves an outflow of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.~~

~~Legal Obligations~~

5.20 [Deleted by IPSASB] ~~A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the PBE Conceptual Framework. For some types of non-exchange transactions, judgement will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.~~

5.21 [Deleted by IPSASB] ~~Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions – or having to take any further action – prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.~~

5.22 [Deleted by IPSASB] ~~Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this PBE Conceptual Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.~~

~~*Non-Legally Binding Obligations*~~

5.23 [Deleted by IPSASB] ~~Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:~~

- ~~The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;~~
- ~~As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and~~
- ~~The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.~~

5.24 [Deleted by IPSASB] ~~In the public sector, obligations may arise at a number of points. For example, in implementing a new policy or service:~~

- ~~Making a political promise such as an electoral pledge;~~
- ~~Announcement of a policy;~~
- ~~Introduction (and approval or adoption) of the plan or budget (which may be two distinct points);~~
- ~~Obtaining legal authority to take a proposed action; and~~
- ~~An appropriation becoming effective.~~

~~The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability.~~

5.25 [Deleted by IPSASB] ~~The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgements whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid an outflow of resources include:~~

- ~~The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;~~
- ~~The ability of the entity to modify or change the obligation before it crystallises. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur; and~~
- ~~There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However the absence of a budgetary provision does not itself mean that a present obligation has not arisen.~~

5.26 [Deleted by IPSASB] ~~"Economic coercion", "political necessity" or other circumstances may give rise to situations where, although the public benefit entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.~~

Assets and Liabilities

Unit of Account

5.26A The unit of account is the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations to which recognition criteria and measurement concepts are applied.

5.26B A unit of account is selected for an asset or liability when considering how recognition criteria and measurement concepts will apply to that asset or liability and to the related revenue and expense. In some circumstances it may be appropriate to select one unit of account for recognition and a different unit of account for measurement. For example, arrangements may sometimes be recognised individually but measured as part of a portfolio of binding arrangements. For presentation and disclosure, assets, liabilities, revenue and expense may need to be aggregated or separated into components.

5.26C If an entity transfers part of an asset or part of a liability, the unit of account may change at that time, so that the transferred component and the retained component become separate units of account.

5.26D A unit of account is selected to provide useful information, which implies that:

(a) The information provided about the asset or liability and about any related revenue and expense must be relevant. Treating a group of rights and obligations as a single unit of account may provide more relevant information than treating each right or obligation as a separate unit of account if, for example, those rights and obligations:

(i) Cannot be or are unlikely to be the subject of separate transactions;

(ii) Cannot or are unlikely to expire in different patterns;

(iii) Have similar characteristics and risks; or

(iv) Are used together in the operational activities conducted by an entity to provide services or to produce cash flows and are measured by reference to estimates of their interdependent service potential or future cash flows.

(b) Information provided about the asset or liability and about any related revenue or expense must faithfully represent the substance of a transaction or other event from which they have arisen. Therefore, it may be necessary to treat rights or obligations arising from different sources as a single unit of account, or to separate the rights or obligations arising from a single source. Equally, to provide a faithful representation of unrelated rights or obligations, it may be necessary to recognise and measure them separately.

5.26E In selecting a unit of account it is also important to consider the cost-benefit constraint of financial reporting discussed in Chapter 3. In general, the costs associated with recognising and measuring assets, liabilities, revenue and expense increase as the size of unit of account decreases. Hence, in general, rights or obligations arising from the same source are separated only if the resulting information is more useful and the benefits outweigh the costs.

5.26F One example of rights and obligations arising from the same source are binding arrangements, which establish both rights and obligations for each of the parties. If those rights and obligations are interdependent and cannot be separated, they constitute a single inseparable asset or liability and hence form a single unit of account.

5.26G Conversely, if rights are separable from obligations arising from the same source, it may sometimes be appropriate to group the rights separately from the obligations, resulting in the identification of one or more separate assets and liabilities. In other cases, it may be more appropriate to group separable rights and obligations in a single unit of account, treating them as a single asset or a single liability.

5.26H Treating a set of rights and present obligations as a single unit of account differs from offsetting assets and liabilities. Offsetting occurs when an entity recognises and measures both an asset and liability as separate units of account, but groups them into a single net amount in the statement of financial position. Offsetting classifies dissimilar items together and therefore is generally not appropriate.

Binding Arrangements that are Equally Unperformed

5.26I Some binding arrangements, or portions of binding arrangements, may be equally unperformed whereby neither party has fulfilled any of its obligations or both parties have partially fulfilled their obligations to an equal extent. Such binding arrangements establish a combined right and obligation to exchange resources. The right and obligation are interdependent and cannot be separated. Hence the combined right and obligation constitute a single asset or liability. The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable. Whether such an asset or liability is included in the financial statements depends on both the recognition criteria (see Chapter 6) and the measurement basis selected for the asset and liability (see Chapter 7).

5.26J To the extent that either party fulfils its obligations under the binding arrangement, the binding arrangement changes character. If the reporting entity performs first under the binding arrangement, that performance is the event that changes the reporting entity's right and obligation to exchange resources into a right to receive a resource. That right is an asset. If the other party performs first, that performance is the event that changes the reporting entity's right and obligation to exchange resources into an obligation to transfer a resource. That obligation is a liability.

Equity

Definition

5.26.1 Equity is:

The residual interest in the assets of the entity after deducting all its liabilities.

5.26.2 Although equity is defined as a residual, it may be sub-classified in the statement of financial position. For example, funds contributed by owners, accumulated surpluses and reserves relating to revaluations may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal, regulatory or other restrictions on the ability of the entity to distribute its equity. They may also reflect the fact that parties with ownership interests in an entity have differing rights in relation to the distribution of surpluses or the repayment of capital.

[…]

Revenue and Expense

Definitions

5.29 Revenue is:

Increases in the net financial position of the entity, other than increases arising from ownership contributions.

5.30 Expense is:

Decreases in the net financial position of the entity, other than decreases arising from ownership distributions.

5.31 Revenue and expense arise from exchange and non-exchange transactions, other events such as unrealised increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and ~~ability~~ capability to generate economic benefits through impairments. Revenue and expense may arise from individual transactions or groups of transactions.

Part B of the PBE Conceptual Framework, which was previously located after the Basis for Conclusions, is relocated to appear before the Basis for Conclusions, and is renamed as Appendix A. The existing paragraph is numbered as A1 and the heading above that paragraph is amended. Paragraphs A2–A5 are added. New text is underlined and deleted text is struck through.

~~Part B~~ Appendix A

This Appendix is an integral part of the Public Benefit Entities' Conceptual Framework.

~~Effective Date~~ Commencement and Application

A1 This Authoritative Notice […].

PBE Conceptual Framework Update – Amendments to Chapter 3 Qualitative Characteristics and Chapter 5 Elements in Financial Statements

A2 The amending Authoritative Notice *PBE Conceptual Framework Update – Amendments to Chapter 3 Qualitative Characteristics and Chapter 5 Elements in Financial Statements*, published in [date], amended Chapter 3 and Chapter 5 as follows:

(a) In Chapter 3, added paragraphs 3.14A and 3.14B, amended paragraph 3.32 and relocated part of this paragraph to new paragraph 3.33A.

(b) In Chapter 5:

(i) amended paragraphs 5.8–5.10, 5.13, 5.14, 5.15, 5.17, 5.31 and the headings above paragraphs 5.11, 5.15, 5.16;

(ii) added paragraphs 5.6A, 5.6B, 5.7A–5.7G, 5.12A, 5.14A, 5.16A–5.16F, 5.17A, 5.26A–5.26J and headings above paragraphs 5.7A, 5.8, 5.26A, and 5.26I;

(iii) relocated the content of paragraphs 5.18–5.23 and 5.24–5.26 to new paragraphs 5.15A–5.15F and 5.17B–5.17D respectively, and amended paragraphs 5.15A–5.15C and 5.17B–5.17D ;

(iv) deleted paragraphs 5.7, 5.16, 5.18–5.26, and the headings above 5.13, 5.15A, 5.18 and 5.23.

An entity shall apply those amendments in accordance with the commencement and application date provisions in paragraphs A3–A5. An entity that applies those amendments to an 'early adoption accounting period' shall disclose that fact.

When amending Authoritative Notice takes effect (section 27 Financial Reporting Act 2013)

A3 The amending Authoritative Notice takes effect on the 28th day after the date of its publication under the Legislation Act 2019. The amending Authoritative Notice was published on [date] and takes effect on [date].

Accounting period in relation to which Authoritative Notices commence to apply (section 28 Financial Reporting Act)

A4 The accounting periods in relation to which this amending Authoritative Notice commences to apply are:

(a) for an **early adopter**, those accounting periods following and including, the **early adoption accounting period**.

(b) for any other reporting entity, those accounting periods following, and including, the first accounting period for the entity that begins on or after the **mandatory date.**

A5 In paragraph A4:

early adopter means a reporting entity that applies this amending Authoritative Notice for an early adoption accounting period

early adoption accounting period means an accounting period of the early adopter:

(a) that begins before the mandatory date but has not ended or does not end before this amending Authoritative Notice takes effect (and to avoid doubt, that period may have begun before this amending Authoritative Notice takes effect); and

(b) for which the early adopter:

(i) first applies this amending Authoritative Notice in preparing its financial statements; and

(ii) discloses in its financial statements for that accounting period that this amending Authoritative Notice has been applied for that period.

mandatory date means 1 January 2028.

In the NZASB Basis for Conclusions, paragraphs BC10A–BC10C and BC17A–BC17M are added. New text is underlined.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the PBE Conceptual Framework.

[…]

Chapter 3 Qualitative Characteristics

[…]

PBE Conceptual Framework Update (2024)

BC10A. In 2023, the IPSASB updated Chapter 3 and Chapter 5 of its Conceptual Framework, in light of:

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

(b) developments in international thinking about conceptual issues since the IPSASB Conceptual Framework was approved in 2014 – specifically, the IASB's *Conceptual Framework of Financial Reporting* as issued in 2018 (IASB 2018 Conceptual Framework) and other amendments made by the IASB to its Conceptual Framework in 2018.

BC10B. The IPSASB's amendments to Chapter 3, issued by the IPSASB in October 2023, are outlined below. More information on the IPSASB's decisions is included in the IPSASB's Basis for Conclusions accompanying Chapter 3 of its Conceptual Framework, available through a link on www.xrb.govt.nz.

(a) Clarification of the role of prudence in the context of faithful representation

In the IPSASB's Conceptual Framework as issued in 2014, and in the PBE Conceptual Framework as issued in 2016, the guidance on qualitative characteristics did not refer to prudence. This was consistent with the IASB's approach at the time. In issuing the IASB 2018 Conceptual Framework, the IASB reaffirmed its decision not to refer to prudence as a qualitative characteristic – but it added a description of prudence and guidance on how prudence supports neutrality, which is an aspect of faithful representation. The IPSASB considered this guidance to be relevant for the public sector, and amended Chapter 3 of its Conceptual Framework.

(b) Amendments to the guidance on materiality

In 2018, the IASB issued *Definition of Material*, to resolve difficulties faced by reporting entities in making materiality judgments, and to align definitions in IASB literature. *Definition of Material* included amendments to the IASB 2018 Conceptual Framework. These amendments supplemented the existing guidance on materiality by adding a reference to 'obscuring' information, and softened the threshold for determining when information is material, by referring to reasonable expectation. The IPSASB considered that the IASB's amendments were relevant for the public sector, and amended Chapter 3 of its Conceptual Framework.

BC10C. The NZASB agreed that the IPSASB's clarification of the role of prudence and amendments to the guidance on materiality were relevant to public benefit entities in New Zealand. The NZASB issued equivalent amendments to the PBE Conceptual Framework in [date].

[…]

Chapter 5 Elements in General Purpose Financial Reports

[…]

PBE Conceptual Framework Update (2024)

BC17A. In 2023, the IPSASB updated Chapter 3 and Chapter 5 of its Conceptual Framework. The key drivers of this IPSASB project are explained in paragraph BC10A above. The paragraphs that follow outline the IPSASB's updates to Chapter 5, issued by the IPSASB in May 2023, and discuss the incorporation of these updates into the PBE Conceptual Framework. The NZASB issued the amendments to Chapter 5 in

[date]. More information on the IPSASB's decisions is included in the IPSASB's Basis for Conclusion accompanying Chapter 5 of its Conceptual Framework, available through a link on www.xrb.govt.nz.

Updates relating to the definition of an asset

BC17B. Key updates made by the IPSASB in relation to the definition of an asset include the following.

(a) **Definition of an asset – reference to past events:**

In the definition of an asset, the IPSASB replaced the reference to past event (singular) with 'past events' (plural), to reflect that an asset may arise from a single past event or multiple past events. This amendment is aligned with the IASB 2018 Conceptual Framework.

(b) **Definition of a resource – rights-based approach**

The IPSASB Conceptual Framework and PBE Conceptual Framework previously described a resource – which is an element of the definition of an asset – as "an item with service potential or the ability to generate economic benefits". The related guidance referred to service potential or economic benefits arising either from the resource itself, or from rights to use it. In considering the changes introduced by the IASB 2018 Conceptual Framework, the IPSASB agreed with the IASB's argument that the guidance on assets should not distinguish between benefits that arise from owning an object (or 'item') and those that arise from the right to use an object. This is because rights conferred by legal ownership of an object and rights to use the object for some of its useful life are *both types of rights*, rather than separate phenomena. Consequently, in updating Chapter 5 of its Conceptual Framework, the IPSASB adopted a rights-based approach to the description of a resource and related guidance. The IPSASB amended the description of a resource to: "*a right to either service potential or the capability to generate economic benefits, or a right to both*". The IPSASB also added guidance on rights, based on the guidance in the IASB 2018 Conceptual Framework. However, unlike the IASB, the IPSASB has referred to both economic benefits and service potential in the updated description of a resource and in the related guidance.

Updates relating to the definition of a liability

BC17C. Key updates made by the IPSASB in relation to the definition of a liability include the following.

(a) **Definition of a liability – transfer of resources**

The IPSASB updated the definition of a liability, so that it refers to the present obligation to *transfer resources* – rather than a present obligation for an *outflow of resources*. The IASB made a similar amendment to the definition of a liability in its 2018 Conceptual Framework. The IASB noted that the previously used term 'outflow of [economic] resources' was linked to guidance on expected outflow of resources. The IASB considered that this focus on expectation of outflow conflates the requirements for meeting the definition of a liability with the requirements for the recognition of a liability. Therefore, in the IASB 2018 Conceptual Framework, the IASB replaced the notion of expected outflow of resources with the notion of potential to require transfer of resources. The IPSASB found this argument persuasive, and made similar amendments to the definition of a liability and related guidance in its Conceptual Framework, with modifications to reflect the public sector context. The amended guidance on the definition of a liability includes new guidance on the concept of 'transfer of resources', which is more extensive than the previous guidance on 'outflow of resources'.

(b) **Definition of a liability – reference to past events**

Consistently with the change to the definition of an asset, in the definition of a liability, the IPSASB replaced the reference to past event (singular) with 'past events' (plural). See paragraph BC17B(a).

(c) **Rearrangement of the section on the definition of a liability**

The IPSASB rearranged the section on liabilities in Chapter 5, so that the order of topics discussed in the guidance are aligned with the new definition of a liability.

Unit of account and binding arrangements that are equally unperformed

BC17D. The IPSASB added the following new guidance into Chapter 5 of its Conceptual Framework.

(a) **Unit of account:**

The 'unit of account' is the unit to which recognition criteria and measurement concepts are applied. When originally issued, the IPSASB Conceptual Framework and the PBE Conceptual Framework did not contain specific guidance on the 'unit of account'. As part of its 2023 updates to its Conceptual Framework, the IPSASB added into Chapter 5 a new section on the 'unit of account'. The new guidance is largely based on the equivalent guidance in the IASB 2018 Conceptual Framework.

(b) **Binding arrangements that are equally unperformed**

The IPSASB added into Chapter 5 of its Conceptual Framework new guidance on 'binding arrangements that are equally unperformed'. This guidance is based on the IASB's guidance on executory contracts in the IASB 2018 Conceptual Framework. However, the IPSASB decided not to use the term 'executory contracts', because in some jurisdictions the term 'contract' is problematic in the public sector.

NZASB considerations

BC17E. In considering the IPSASB's amendments to Chapter 5 of its Conceptual Framework, the NZASB discussed potential concerns relating to the IPSASB's updates to the guidance on the definition of a liability, and the lack of enhancements to the guidance on recognition, as explained below. For most preparers of PBE financial reports, these concerns are expected to apply only in limited circumstances, given that preparers typically refer to the PBE Conceptual Framework in considering whether to recognise a liability (or an asset) for transactions that are not specifically covered by individual Standards. Nevertheless, to assist those preparers that refer to the PBE Conceptual Framework in preparing financial reports, the paragraphs that follow describe the concerns that the NZASB considered and how the NZASB mitigated these concerns.

BC17F. In the IPSASB's amended guidance on the definition of a liability, paragraphs 5.16A and 5.16B emphasise that the definition of a liability can be met even when the probability of a transfer of resources is low – and that while an obligation must have the potential to require the entity to transfer resources to meet the definition of a liability, the transfer need not be likely and may be required only if an unspecified future event occurs.

BC17G. The NZASB acknowledged that the paragraphs mentioned above are intended to avoid conflating the definition of a liability with the recognition criteria (and measurement requirements) for liabilities, and are aligned with the IASB 2018 Conceptual Framework.

BC17H. However, in issuing the IASB 2018 Conceptual Framework, the IASB also enhanced the guidance on recognition of liabilities and assets – whereas the IPSASB did not incorporate similar enhanced guidance on recognition into its Conceptual Framework. In the IPSASB Conceptual Framework, Chapter 6 *Recognition in Financial Statements* includes general references to the need to consider the qualitative characteristics and uncertainty around the existence of an element in making recognition decisions. The same applies to Chapter 6 of the PBE Conceptual Framework. By contrast, Chapter 5 of the IASB's Conceptual Framework includes specific sections on considering relevance and faithful representation when determining whether a liability (or an asset) is recognised – including specific discussion on low probability of outflow (and inflow) of economic resources.

BC17I The paragraphs on recognition in the IASB Conceptual Framework that the NZASB considered of most relevance, particularly in considering whether to recognise a liability where the probability of a transfer of resources is low, are set out below (noting that these paragraphs refer to for-profit terminology, e.g. 'income' rather than 'revenue', and that where these paragraphs refer to inflows and outflows of economic benefit, a PBE would need to also consider service potential).

Recognition criteria

[…]

5.7 Not recognising an item that meets the definition of one of the elements makes the statement of financial position and the statement(s) of financial performance less complete and can exclude useful information from financial statements. On the other hand, in some circumstances, recognising some items that meet the definition of one of the elements would not provide useful information. An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with:

(a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity (see paragraphs 5.12–5.17); and

(b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity (see paragraphs 5.18–5.25).

[…]

Relevance

5.12 Information about assets, liabilities, equity, income and expenses is relevant to users of financial statements. However, recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always provide relevant information. That may be the case if, for example:

(a) it is uncertain whether an asset or liability exists (see paragraph 5.14); or

(b) an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low (see paragraphs 5.15–5.17).

5.13 The presence of one or both of the factors described in paragraph 5.12 does not lead automatically to a conclusion that the information provided by recognition lacks relevance. Moreover, factors other than those described in paragraph 5.12 may also affect the conclusion. It may be a combination of factors and not any single factor that determines whether recognition provides relevant information.

Existence uncertainty

5.14 Paragraphs 4.13 and 4.35 discuss cases in which it is uncertain whether an asset or liability exists. In some cases, that uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of an asset or liability, necessarily measured at a single amount, would not provide relevant information. Whether or not the asset or liability is recognised, explanatory information about the uncertainties associated with it may need to be provided in the financial statements.

Low probability of an inflow or outflow of economic benefits

5.15 An asset or liability can exist even if the probability of an inflow or outflow of economic benefits is low (see paragraphs 4.15 and 4.38).

5.16 If the probability of an inflow or outflow of economic benefits is low, the most relevant information about the asset or liability may be information about the magnitude of the possible inflows or outflows, their possible timing and the factors affecting the probability of their occurrence. The typical location for such information is in the notes.

5.17 Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or liability may provide relevant information beyond the information described in paragraph 5.16. Whether that is the case may depend on a variety of factors. For example:

(a) if an asset is acquired or a liability is incurred in an exchange transaction on market terms, its cost generally reflects the probability of an inflow or outflow of economic benefits. Thus, that cost may be relevant information, and is generally readily available. Furthermore, not recognising the asset or liability would result in the recognition of expenses or income at the time of the exchange, which might not be a faithful representation of the transaction (see paragraph 5.25(a)).

(b) if an asset or liability arises from an event that is not an exchange transaction, recognition of the asset or liability typically results in recognition of income or expenses. If there is only a low probability that the asset or liability will result in an inflow or outflow of economic benefits, users of financial statements might not regard the recognition of the asset and income, or the liability and expenses, as providing relevant information.

Faithful representation

5.18 Recognition of a particular asset or liability is appropriate if it provides not only relevant information, but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. Whether a faithful representation can be provided may be affected by the level of measurement uncertainty associated with the asset or liability or by other factors.

BC17J. The NZASB considered the following potential concerns associated with including in the PBE Conceptual Framework the new IPSASB paragraphs 5.16A and 5.16B, which emphasise that the definition of a liability can be met even when the probability of a transfer/outflow of resources is low, without enhancing the guidance on the recognition of liabilities in the PBE Conceptual Framework.

(a) Potential lack of clarity as to whether obligations with low probability of resource transfer should be recognised in the financial statements. The NZASB received feedback that while the PBE Conceptual Framework does not override requirements in PBE Standards, and several PBE Standards require an outflow of resources to be probable for recognition to occur, it would be unhelpful if the PBE Conceptual Framework indicated otherwise.

(b) Potential perception that the recognition of liabilities and assets is intended to work differently for public benefit entities as compared to for-profit entities, which is not the intended outcome.

BC17K. On balance, the NZASB decided that referring to the enhanced guidance on recognition from the IASB's 2018 Conceptual Framework in the Basis for Conclusions accompanying the PBE Conceptual Framework (see paragraph BC17I above), and discussing this decision in the Basis for Conclusions, is a sufficient and appropriate way to address the concerns outlined above and assist those entities that refer to the PBE Conceptual Framework in preparing financial reports. Specifically: .

(a) The NZASB considers that the IASB Conceptual Framework under paragraph BC17I may be relevant and useful for PBE preparers when accounting for transactions that are not specifically addressed by individual standards. In such situations, considering this IASB guidance may mitigate the concern about the lack of clarity regarding recognition of liabilities where the probability of a transfer of resources is low – and help avoid an unintended difference in outcomes in relation to the recognition of liabilities for PBEs as compared to for-profit entities.

(b) At the same time, it is important to safeguard the coherence of the PBE Conceptual Framework, due to its fundamental role in underpinning the development and maintenance of the entire suite of PBE Standards. As the core text of the PBE Conceptual Framework is closely based on the IPSASB Conceptual Framework, there is a risk that incorporating guidance from a different Conceptual Framework into its core text (and adapting this guidance for public benefit entity-specific concepts) could negatively affect coherence and lead to unintended consequences.

(c) PBE IPSAS 3 states that when developing accounting policies in the absence of a PBE Standard that specifically applies to a transaction or event, in addition to considering other PBE Standards and the PBE Conceptual Framework, management may also consider the most recent pronouncements of other standard-setting bodies, including the IASB. Referring to the enhanced recognition guidance from the IASB Conceptual Framework in the Basis for Conclusions of the PBE Conceptual Framework, included under paragraph BC17J, would help indicate to PBE preparers that this IASB guidance is appropriate to consider in conjunction with the core text of the PBE Conceptual Framework, when developing accounting policies for transactions that are not specifically addressed by individual accounting standards.

BC17L. In reading the IASB's references to inflows and outflows of economic benefit, PBE preparers would also need to consider service potential, take into account differences in terminology between the IASB Conceptual Framework and the PBE Conceptual Framework (e.g. 'income' vs 'revenue'), etc.

BC17M. Having mitigated the concerns discussed in the previous paragraphs, the NZASB considered that the IPSASB's amendments to Chapter 5 are relevant to public benefit entities in New Zealand and incorporated equivalent amendments into the PBE Conceptual Framework.

XRB Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Agenda item 3.3

DRAFT Consultation Document

PBE Conceptual Framework Update

Proposed Amendments to Chapters 3 and 5

Consultation document

March 2024

Consultation closes [XX] June 2024

Contents

PART ONE:
Introduction

1. What is this consultation document about?

The External Reporting Board (XRB) has issued this consultation document to seek feedback on its Exposure Draft that proposes limited-scope updates the *Public Benefit Entities Conceptual Framework* (PBE Conceptual Framework), based on recent updates issued by the International Public Sector Accounting Standards Board (IPSASB). This update will amend Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in General Purpose Financial Reports*.

What is the PBE Conceptual Framework?

- The PBE Conceptual Framework sets out the concepts underpinning the development of PBE Standards, which are applied by Tier 1 and Tier 2 public benefit entities (PBEs) in the public and not-for-profit sectors. It is also considered in developing requirements for Tier 3 PBEs.
- The PBE Conceptual Framework defines and provides guidance on key elements of the financial report, such as assets and liabilities. It also explains key concepts that form the cornerstone of financial reporting, including the 'qualitative characteristics' of useful information (e.g. relevance, faithful representation), the importance of considering materiality, etc.
- The PBE Conceptual Framework is not a Standard, but PBEs in Tiers 1, 2 and 3 may need to refer to it in certain situations when preparing financial reports – for example, when dealing with a transaction that is not specifically covered by a Standard.
- The PBE Conceptual Framework is closely based on the IPSASB Conceptual Framework.

What is changing and why?

In 2023, the IPSASB issued limited-scope updates to Chapters 3 and 5 of its Conceptual Framework.

The amendments arose from the following developments since the IPSASB Conceptual Framework was approved in 2014:

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

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

The XRB considers that incorporating the IPSASB's updates into the PBE Conceptual Framework would be useful for PBEs in New Zealand.

The following is a brief overview of the proposed amendments to the PBE Conceptual Framework.

Chapter 3 Qualitative Characteristics

Clarification of the role of prudence in the context of faithful representation. An update to the guidance on materiality to address the risk that material information can be obscured.

Chapter 5 Elements in General Purpose Financial Reports

Changes to the definitions of an asset and a liability, and the addition of new guidance on a transfer of resources, unit of account and binding arrangements that are equally unperformed.

2.

How to provide feedback?

Responding to consultation questions

We are seeking comments on the questions below. We will consider all comments received before finalising the updates to the PBE Conceptual Framework.

Q1. Do you agree with, and/or have feedback on, the proposed amendments to Chapter 3?

Q2. Do you agree with, and/or have feedback on, the proposed amendments to Chapter 5?

Q3. Do you agree with, and/or have any feedback on, the proposed amendments to the Basis for Conclusions of the PBE Conceptual Framework?

Q4. Do you agree with the mandatory date of 1 January 2028?

Q5. Do you have any other feedback on the ED proposals?

Figure 1: Timeline

March 2024

Consultation paper *PBE Conceptual Framework update* issued for public consultation

XX June 2024

Submissions due to the XRB

Nov/Dec 2024

Amendments to the PBE Conceptual Framework thresholds issued

1 Jan 2028

Amendments become mandatory to apply

Making a submission

You can provide feedback to us via:

- the consultation page on our website (where you can upload a PDF or complete an online form); or
- emailing your formal or informal comments to accounting@xrb.govt.nz

The consultation closes on **xx June 2024**

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 2020 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.

PART TWO:
Overview of proposals

3.

Overview of the proposed amendments

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

3.1 Approach to amending the PBE Conceptual Framework

3.2 Changes to Chapter 3 *Qualitative Characteristics*;

3.3 Changes to Chapter 5 *Elements of Financial Statements*;

3.4 Enhanced guidance on recognition in the Basis for Conclusions; and

3.1 Approach to amending the PBE Conceptual Framework

The proposed amendments to the PBE Conceptual Framework are closely based on the 2023 updates to Chapters 3 and 5 of the IPSAS Conceptual Framework. To amend the PBE Conceptual Framework based on the updates to the IPSAS Conceptual Framework, the NZASB has:

- aligned terminology and concepts with those used in the PBE Conceptual Framework;
- ensured coherence within PBE Conceptual Framework by considering the existence of New Zealand-specific requirements; and
- considered the need for any enhancements to make the standard more appropriate for public benefit entities in New Zealand.

Only minor modifications were required. However, we have included additional paragraphs in the NZASB Basis for Conclusions – see section 3.4.

The PBE Conceptual Framework does not override the requirements of PBE Standards. Its main purpose is to:

- assist the NZASB to develop standards that are based on consistent concepts; and
- assist preparers of financial reports – for example, to develop consistent accounting policies when no Standard applies to a particular transaction or other event, or when a Standard allows a choice of accounting policy

3.2 Changes to Chapter 3 *Qualitative Characteristics*

AT A GLANCE

- Inclusion of new guidance which explains the role of prudence
- Update to the guidance on materiality which better serves the users of financial information.

	Amendments
Prudence [ED ref: Para 3.14A –3.14B]	The amendments clarify the role of prudence in supporting neutrality, which is an aspect of faithful representation. The amendments note the following. • Prudence is the exercise of caution when making judgements under conditions of uncertainty. Exercising prudence means that assets, liabilities, revenue, and expenses are not overstated or understated. • The exercise of prudence does not imply a need for asymmetry (e.g. systematically requiring more evidence for recognising assets or revenue as compared to liabilities and expenses). However, some standards may include asymmetric requirements.
Materiality [ED ref: Para 3.32 and 3.33A]	The amendments update the guidance on materiality by adding a reference to the obscuring of information. That is, information is material if omitting, misstating *or obscuring* it could be reasonably expected to influence the discharge of accountability by the entity or the decisions made by users of the financial statements.
These proposed PBE Conceptual Framework Chapter 3 amendments are aligned with the IPSASB's and IASB's Conceptual Framework.	

?

Question 1:

Do you agree with, and/or have feedback on, the proposed amendments to Chapter 3?

3.3 Changes to Chapter 5 *Elements of General Purpose Financial Reports*

AT A GLANCE

- Minor changes to the definitions of an asset and a liability and updates to the related guidance, including new guidance on transfer of resources.
- New guidance on unit of account and binding arrangements that are equally unperformed.

	Amendments
Definition of an asset and related guidance [ED ref: para 5.6–5.13]	• Amendments to the description of and guidance on a resource, which is an element of the definition of an asset – taking a rights-based approach, as aligned with the IPSASB and IASB Conceptual Frameworks. ◦ Current description of 'resource': "an *item* with service potential or the ability to generate economic benefits" – and the related guidance discusses benefits from the *resource itself* vs benefits from *rights to use the resource*. ◦ Proposed new description of 'resource': "*a right to either service potential or the capability to generate economic benefits, or a right to both*". ◦ Change reflects the view that rights from owning an item and rights to use an item are both type of rights, not separate phenomena. • In the definition of an asset and a liability, 'past event' (singular) is replaced with 'past events' (plural) – as an asset/liability may arise from a single past event of multiple past events.
Definition of a liability and related guidance [ED ref: para 5.14–5.26]	• Updates the definition of a liability and the related guidance, to use the term 'transfer of resources' instead of 'outflow of resources'. This aligns with the IPSASB's and IASB's Conceptual Framework amendments. ◦ New definition: "A present obligation of the entity to transfer resources as a result of past events." • New guidance on the concept of 'transfer of resources' – more extensive than the previous guidance on 'outflow of resources'. • Rearrangement of the liabilities section in Chapter 5, so the order of topics aligns with the updated definition.
Unit of account [ED ref: para 5.26A–5.26H	New guidance on the 'unit of account', which is the unit to which recognition criteria and measurement concepts are applied. This aligns with the IPSASB's and IASB's Conceptual Framework amendments.
Binding arrangements that are equally unperformed [ED ref: para 5.26I–5.26J]	New guidance on 'binding arrangements that are equally unperformed', which is based on the IASB's Conceptual Framework guidance on executory contracts. The guidance applies when neither party has fulfilled any of its obligations or both parties have partially fulfilled their obligations to an equal extent.

?

Question 2:

Do you agree with, and/or have feedback on, the proposed amendments to Chapter 5?

3.4 Enhanced guidance on recognition in the Basis for Conclusions

The IPSASB's updates to Chapter 5 include new paragraphs emphasising that the definition of a liability can be met even when the probability of a transfer of resources is low. This is to help distinguish between determining whether the *definition* of a liability is met – and then considering whether the liability should be *recognised* in the financial report (where probability would be considered).

The guidance on recognition in the IASB's Conceptual Framework includes specific sections on considering relevance and faithful representation when determining whether a liability (or an asset) is recognised – including a specific discussion on low probability of outflow of resources, as well as a discussion on existence uncertainty. This guidance is not included in the IPSASB Conceptual Framework or in the PBE Conceptual Framework.

The NZASB considered the guidance on recognition of liabilities and assets from the IASB's Conceptual Framework. The NZASB's discussion of this topic, together with the extracts of the IASB guidance they considered the most relevant, is included in the Basis for Conclusions of the PBE Conceptual Framework. The purpose of including this in the Basis for Conclusions is to:

- ✓ Indicate to PBEs dealing with transactions that are not specifically addressed by individual PBE Standards that it may be relevant and useful to refer to the enhanced IASB guidance on recognition in conjunction with the 'core text' of the PBE Conceptual Framework – which should provide greater clarity to such PBEs as to whether a liability should be recognised or not when the probability of a transfer of resources is low.
- ✓ Indicate that for PBEs, decisions about recognition work similarly to for-profit entities.

[ED ref: Basis for Conclusions – para BC17E-BC17M]

The IASB guidance on recognition is discussed in the Basis for Conclusions, rather than incorporated into the core text of the PBE Conceptual Framework, to maintain the coherence of the IPSASB-based core text and to avoid unintended consequences.

Question 3:

Do you agree with, and/or have any feedback on the proposed amendments to the Basis for Conclusions of the PBE Conceptual Framework?

4. Mandatory date and other comments

Proposed mandatory date – 1 January 2028

- We propose that the amendments to the PBE Conceptual Framework have a mandatory date of 1 January 2028, meaning that they would have to be applied for accounting periods that begin on or after that date.
- Application would be permitted for accounting periods that begin before 1 January 2028 but do not end before the amendments take effect (which is 28 days after the final amendments are issued).

Rationale for the proposed mandatory date

This date is aligned with the expected mandatory date of the forthcoming PBE Standards on Revenue and Transfer Expenses, which are currently under development. Aligning the mandatory dates is intended to allow PBEs to consider the amendments to the PBE Conceptual Framework together with the requirements in the forthcoming Revenue and Transfer Expenses standards in a holistic manner.

?

Question 4:

Do you agree with the mandatory date of 1 January 2028?

Question 5:

Do you have any other feedback on the ED proposals?

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Level 6, 154 Featherston St Wellington
PO Box 11250 Manners St Central
Wellington 6142 New Zealand

www.xrb.govt.nz

Agenda Item 4.1

Memorandum

Date:	2 February 2024
To:	NZASB Members
From:	Jamie Cattell
Subject:	**PBE Tier Sizes**

COVER SHEET

Project priority and complexity

Project priority	**High** The PBE criteria have not been adjusted since they were originally set. The effects of inflation and the evolution of the suite of PBE IPSAS requirements over time presents a risk that for some PBEs the costs and benefits of reporting are no longer appropriately balanced.
Complexity of Board decision-making at this meeting	**Low** We are asking the Board to recommend to the XRB Board that they issue final amendments as proposed based on strong, clearly positive feedback.

Overview of agenda item

Project Status	Finalise amendments to XRB A1
Project purpose	Review the PBE tier size Criteria
Board action required at this meeting	AGREE to recommend to the XRB that they issue final amendments to XRB A1 to increase the tier 2 and tier 3 PBE size thresholds as proposed.

Purpose and introduction

1. The purpose of this agenda item is to:

   (a) Summarise the feedback and the staff analysis and recommendations on the proposed amendments to the size criteria for PBEs applying Tier 2 and Tier 3 standards in the ASF; and

   (b) Seek the Board's agreement to recommend to the XRB Board that they issue amendments to XRB A1 to increase the PBE tier size criteria as proposed.

Background

2. At its meeting in August 2023, the Board agreed to recommend to the XRB Board that they consult on increasing the PBE Tier size criteria in the Accounting Standards Framework (ASF) from:

   (a) $30 million to $33 million total expenses for Tier 2; and

   (b) $2 million to $5 million total expenses for Tier 3.

3. In September 2023, the XRB Board agreed to consult publicly on the proposed amendments to the size criteria and subsequently issued the consultation document *Public Benefit Entity Tier Sizes* in October 2023. The consultation period closed on 26 January 2024. The XRB received 35 submissions from a range of stakeholders. The content of these submissions is considered below and the content of the submissions is replicated in Appendix A.

Structure of this memo

4. The remaining sections in this memo are:

   (a) Responses to the proposed thresholds;

   (b) Other comments on PBE Tier Sizes; and

   (c) Staff recommendations.

Responses to the proposed thresholds

Consultation questions

5. The following questions were asked in the consultation document

Q1.	Do you agree with the proposal to increase the tier 2 PBE size threshold from $30 million to $33 million? Why or why not?
Q2.	Do you agree with the proposal to increase the tier 3 PBE size threshold from $2 million to $5 million? Why or why not?
Q3.	Do you have any other comments you would like to make on the PBE tier size thresholds?

6. Of the 35 submissions received by the XRB, 29 respondents answered question 1 regarding the proposed tier 2 threshold and 33 respondents answered question 2 regarding the proposed tier 3

threshold. Of these responses, almost all agreed with the proposals. A breakdown of these responses is provided in table 1 below.

Table 1 – Summary of responses to questions 1 and 2

	Answered	% of all respondents	% Agreed	% Neither agree nor disagree	% Disagreed
Question 1	29	83%	100%		-
Question 2	32	94%	94%	3%	3%

Respondents that agreed with questions 1 and 2

7. Respondents which agreed with either or both questions that provided additional comments generally agreed with the proposals for one of the following reasons

   (a) ***Alignment with Legislative Definitions***: These respondents support the alignment of the PBE tier size thresholds with legislative definitions such as 'large' as per the Financial Reporting Act 2013.

   (b) ***Inflationary pressure***: These respondents agreed that the thresholds should account for inflation because static thresholds can become outdated and thereby place undue burden on entities. Some of these respondents suggested that a requirement to review the thresholds more regularly should be established as part of the ASF to ensure it continues to be fair and proportionate.

   (c) ***Cost/benefit***: These respondents considered that while transparency and accountability are crucial, the compliance burden should be balanced and agreed that the proposed thresholds reflected that balance. Some respondents noted that the ability to opt up provides sufficient flexibility to account for entities that require greater transparency.

   (d) ***Practicality for Small and Medium-Sized Entities***: These respondents emphasised the need for reporting requirements to be practical and manageable for smaller entities and that complex reporting can be challenging for entities without the resources to manage them effectively. They considered the increase in the thresholds reflected this fact.

8. One respondent that agreed with both thresholds suggested that we consider raising the thresholds further, suggesting $60 million and $10 million for the tier 2 and tier 3 thresholds respectively. However, no evidence supporting these suggested thresholds was provided. We also note that the Board previously considered a $10 million threshold for tier 3 when making their original recommendation to the XRB.

Respondents that neither agreed or disagreed with question 2

9. While not disagreeing with the proposed increase to the tier 3 size threshold, one respondent raised concerns with the methodology through which it was determined. Their concerns include the following

<u>Limitations on the scope of the analysis</u>

10. Specifically, that the analysis was limited to registered charities and that no detailed analysis was carried out on incorporated societies or the public sector.

11. While we understand the source of this concern, in arriving at the proposed thresholds recommended to the XRB, the NZASB took these factors into account as per the extract from the August meeting papers below:

> 26. The analysis below focuses on registered charities as a proxy for the PBE population, for the following reasons.
>
> (a) There is an absence of aggregated information available for other NFP PBEs, but given that registered charities make up approximately 95% of the current PBE NFP population by number of entities, this data provides a reasonable proxy for providing an understanding of the current spread of NFP PBEs by size based on expenditure and the impact of any changes to the current size thresholds.
>
> (b) The majority of public sector PBEs are schools, and all schools are required by the Ministry of Education to report in accordance with Tier 2. Therefore, changing the tier threshold is unlikely to significantly affect the proportion of public sector PBEs reporting under each tier.
>
> (c) A significant number of incorporated societies (approximately 6,000) are registered charities. Therefore the traits of this population are reflected in the registered charity dataset.

12. While we agree that a more thorough analysis of incorporated societies would be preferable, we are unable to perform this analysis due to limitations on the publicly available data. As the NZASB was already made aware of the limitations in the analysis, we do not consider the respondent has provided any new evidence supporting revision of the recommended tier 3 threshold.

<u>Significance of the increase and lack of alignment to legislation</u>

13. The respondent also raised concerns with the overall size of the increase and the lack of alignment to current legislative thresholds. They suggested that the incorporated societies audit and review threshold of $3 million total expenses should be considered. The respondent argued that a threshold of $3 million would account for inflation and provide headroom pending a first principles review. They also recommended that overall the thresholds should be aligned with the audit and review thresholds in legislation as doing so would make the ASF easier to apply.

14. We note that the NZASB considered a threshold of $3 million in reaching its recommendations noting part of the same rationale provided by the respondent (that $3 million would account for prior and future inflation). Overall, it was agreed that an additional adjustment above a $3 million threshold was appropriate to account for the suite of major new PBE Standards currently under consideration to ensure the costs and benefits of reporting remain balanced for tier 2 entities.

15. We do not agree that aligning with audit and review thresholds in legislation would make the ASF simpler to apply. Within the PBE Sector there are several pieces of legislation which all feature different audit and assurance thresholds. These thresholds are outlined in table 2 below.

Table 2 – Audit thresholds of different types of PBEs

Legislation	Audit requirement	Review requirement
Charities Act 2005[1]	> $1.1 million total operating expenditure in the preceding two periods	> $550,000 total operating expenditure
Incorporated Societies Regulations 2023[2]	> $3 million total operating expenditure	N/A
Friendly Societies and Credit Unions Act 1982[3]	All specified not-for-profit entities (> $140,000 total operating payments)	N/A
Public Audit Act 2001[4]	By class of entity or as specifically defined	N/A

16. We note that there is already little consistency between the various audit and review thresholds, predominantly because factors other than size (based on total expenditure) underpin the rationale for requiring different types of entities to be audited. We do not consider these rationale should be transposed over to the PBE tier sizes without a clear articulation of why those rationale would also apply to all PBEs.

17. Further, we consider that aligning with one specific threshold to the exclusion of others creates a greater, rather than lesser, risk of confusion for entities. For example, applying the audit thresholds in the Incorporated Societies Regulations 2023 as the tier 3 threshold for all PBEs would likely raise further questions about why that threshold should be applied to registered charities, friendly societies, or credit unions whose audit thresholds are much lower.

18. We consider that selectively applying one audit threshold as the tier 3 size threshold also could lead to calls for different sets of thresholds for different PBE subsectors. The NZASB previously agreed not to recommend creating different sets of thresholds for incorporated societies at its August meeting on the basis that the incremental benefit of establishing a different set of criteria is insufficient to justify the costs and risks inherent in increasing the complexity of the ASF.

Respondents that disagreed with question 2

[1] Charities Act 2005 sections 42C and 42D
[2] Incorporated Societies Regulations 2023 section 16
[3] Friendly Societies and Credit Unions Act 1982 section 64A
[4] Public Audit Act 2001 section 15, schedule 1, schedule 2

19. One respondent disagreed with the proposal to increase the tier 3 threshold to $5 million. They provided the following comment:

> *"The way that tier 2 reporting is laid out, in line with IFRS, makes the annual financial reports generated much easier to read and use for reporting purposes. Across the Hospice sector there are more organisations who report at tier 1 and tier 2 than at tier 3 or tier 4. Having more organisations reporting their results in a more standardised way is much better for the entire sector."*

20. While we agree that standardised reporting offers greater comparability, we do not consider a sector specific weighting towards one end of the scale provides any justification for mandating complex reporting by small entities or entities from other sectors. While subsector specific thresholds are a possible solution, adding additional thresholds is a fundamental change to the framework best considered as part of a first-principles review.

Other comments

21. Few comments were made by respondents outside of their responses to consultation questions 1 and 2. However the following additional comments were made.

    (a) Two respondents expressed concern with the continued use of a single financial measure—expenditure— as the sole tier size criterion. They considered a dual measure model including total assets would provide a better reflection of an entity's size and complexity. They considered that the current single measure approach allows too many entities with significant assets to apply tier 4 requirements due to their low expenditure. One respondent also noted that a dual measure test had already been introduced for small societies in the Incorporated Societies Regulations 2023.

    (b) The same respondent also highlighted that despite audit and assurance thresholds being outside the scope of the current consultation, there is a wider sentiment within the sector that these thresholds are linked to the tier size criteria in the ASF as well as increasing calls for them to be re-evaluated.

    (c) DIA – Charities Services highlighted that they intend to release the new annual return forms by 1 April 2024. They therefore supported increasing the size criteria as soon as possible because doing so would allow affected charities who wish to do so to report under the revised thresholds and use their new annual return forms immediately. They also reaffirmed their commitment to support registered charities to understand how they are affected by the new tier size criteria.

    (d) One respondent requested "urgent clarification" of the date from which the new PBE tier thresholds will be effective to give affected entities certainty around their future compliance obligations.

    (e) One respondent raised concerns that the changes to the tier 3 size criteria could result in some entities implementing new processes unnecessarily by exceeding the existing size thresholds before the revised thresholds take effect. We do not agree with this specific concern as no change to the tier 4 threshold is being proposed. However, we consider that both this comment and comment (d) above highlight the importance of clear communication of any final amendment to the size criteria. First, to make affected entities aware that they now have an option to apply a lower tier of reporting (or that they will no longer be required to apply a higher tier) and second, that there has been no change to the tier 4 criteria.

Staff recommendations

PBE tier sizes

22. We consider that the feedback provides strong support for the proposed changes to the PBE tier size criteria. We therefore recommend that the NZASB make a recommendation to the XRB Board that they issue amendments to the PBE tier size criteria in XRB A1 as proposed.

23. While there is merit in the views expressed by respondents that a regular inflation adjustment should be baked into the framework, we consider that this is a fundamental change to the ASF that is beyond the intended scope of these amendments.

24. As noted at the Board's August meeting, the XRB have previously considered introducing an asset-based threshold as part of the targeted review of the ASF. Although they agreed that an asset-based threshold could lead to higher transparency due to entities with large asset holdings having to report in higher tiers, they highlighted that the tier 4 Standard already required disclosure of significant assets. Therefore, they considered that the costs of the complexity an asset-based threshold would add to the ASF outweighed the benefits it would provide.

25. While we do not recommend considering introducing a regular inflation adjustment or an asset-based threshold to the ASF at this time, we recommend retaining these comments for consideration under the first principles review of the ASF which the XRB has committed to begin by 2029. We consider that this first principles review is the appropriate avenue through which fundamental changes to the ASF should be considered.

Draft amending standard

26. Attached as Agenda item 4.2 is the draft amending standard *Updated PBE Tier Sizes*

Commencement and application

27. *Updated PBE Tier Sizes* will be applicable for annual reporting periods beginning on or after 1 January 2025 with earlier application permitted for accounting periods that begin before this date, but which do not end before it takes effect.

Questions for the Board

Q1. Does the Board agree to recommend to the XRB Board that they approve amendments to the PBE tier size criteria, increasing the thresholds to:

- $33 million for tier 2?
- $5 million for tier 3?

Attachments

Agenda item 4.2: Draft amending standard *Updated PBE Tier Size Criteria*

Appendix A

Table of comments received

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
1	Adrian Palmer	Liminal 8024 Limited	N/A	Yes We operate a charitable company, donating our profits - this means high expenditure relative to donations as opposed to a donation gathering Charitable Entity. We can end up having the same impact as a smaller donation gathering Charitable entity but with a significantly higher compliance and reporting burden. Shifting the Tier 2 threshold from $3m to $5m gives good and fair breathing space for entities like us running Social Enterprises with business-like expenditure, and many others out there, while still retaining a fit for purpose burden of transparency and accountability that a charitable entity requires.		Email
2	Adrienne Dempsey	AuditPLUS	N/A	Yes		Email
3	Anthony Rohan	Fairground Ltd	Yes	Yes		Feedback Form

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
4	Carmel Veitch	New Zealand Fish and Game	Yes	Yes Can entities that are currently in Tier 2 but have expenditure over 2 mill move back into the Tier 3 as the expenditure is below $5mill.		Feedback Form
5	Chandel Emerson	Every Nation Ministries	N/A	N/A	Does this mean Tier 4 would be for charities with an income up to but not exceeding $2-million? If so, will there be clearly defined information about the changes for charities that were Tier 3 but would be Tier 4, if the Tier change commences as suggested? Or does Tier 4 remain as is, and the Tier 3 broadens to include expenses over $140,000 up to $5,000,000?[5]	Email
6	Charmaine Meyers	Fairground Accounting	Yes	Yes		Feedback Form
7	Craig Fisher		Yes This move seems appropriate and the logic of linking to the definition of large in the Financial Reporting act appears	Yes While initially felt like a big jump proportionally, on reflection I am comfortable with the suggested threshold. An important safety valve remains the ability of any	It has always disappointed me that a single measure threshold was set for these tiers. I and others lobbied at the outset for a mixed model where asset size could also be	Email

[5] Note; we responded to this submitter's question and asked whether they supported the proposals however no further information was received.

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
			logical and appropriate. Interestingly, if there was not this change within the FRA and I was asked to provide a figure I would have opted for $35m. This is unscientific but based on my perception of inflation since originally set and what feels about right for the cost, compliance, trade-off.	entity to opt up to a higher level should they so choose. Hence, I see this proposed change will be greeted positively by the sector.	taken into account to provide a more fulsome and balanced size and complexity proxy. It continues to frustrate me that there are some PBEs with very significant asset bases yet reporting under a small tier due to a lack of expenditure and hence meeting that criteria. I do not personally think this serves the accountability function to the NZ general public well given the at times economic significance of some of these entities given their asset holding. I appreciate that the audit and assurance thresholds are not within the scope of this consultation. However I would highlight that many in the sector see these as linked and there appears to be a perception from comments made to me that there is an appetite for the audit and assurance thresholds to be	

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
					reviewed and possibly updated also. I note my interest as chair of the XRAP for the XRB. I personally do not see this impacts my ability to make a submission.	
8	Debra Ridgway	Lake Taupo Hospice	Yes	Yes This level is what would affect us. I support the change because we have approached the threshold and while the business of what we do has not really changed the costs have increased exponentially which moves us up a category of reporting complexity without there being any real business reason per se to require a tighter level of reporting.		Feedback Form
9	J Kennedy	The Forest Bridge Trust	Agree - takes account of recent inflationary pressures.	Yes This is considered to be much needed as a result of recent inflationary pressures. The proposed increase to the reporting tiers will benefit those smaller entities by reducing the burdens associated with a transition to tier 2 (including additional preparation and audit		Feedback Form

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
				time / cost) that provide limited benefit to the users of the financial statements. We strongly support this proposed change and would like to see it implemented as soon as possible.		
10	James Tripe	Tamfacs	N/A	N/A	Just a small comment. Although you state in the consultation document that accounting standards are outside the scope of this consultation. I would still like to say that recent changes to the accounting standards have required that tier 3 entities start to recognise the income from grants as they expend it. This is something that a lot of tier 3 charities will have to make internal changes to comply with, but if the tier sizes then change a lot of these organisations will drop down to tier 4 and then the extra process that they have put in place to comply with the new tier 3 regulation will no longer be valid and they may end up reversing some of the work which they have already	Website

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
					done. ie, current tier 3's will have to do extra compliance work for a limited period of time which will then become invalid if they then drop back down to tier 4.	
11	[Withheld]	[Withheld]	Yes, we support this increase. We agree with the comments and support you have given, particularly around inflationary increases.	Yes We agree with this increase. We support the acknowledgement of inflationary increases since the thresholds were originally set in 2012. Where charities have a large asset base, depreciation can be a significant portion of operating expenditure and be a determining factor in moving up tier levels. The increased tier 2 requirements may bring no additional benefit for such an organisation. We support the need for a cost benefit balance – increased reporting requirements will not only bring increased costs in and of themselves but increased costs in relation to audit. We think useability of accounts also needs to be considered – the complexity of the accounting standards at tier 2 level will mean		Email

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
				many non-accountant users, may struggle to understand. We find that many of our users already struggle with understanding tier 3 reporting.		
12	Jon Riordan	El Rancho	Yes	Yes Love the proposed changes to the Tier 2 and Tier 3 to $33m & $5m respectively. As previously stated, I think consideration needs to be given for inflation and these figures should continue to be adjusted say every 2-3 years in line with a benchmark such as CPI or similar.		Website
13	Jonathon Hagger	Rotorua Community Hospice	Yes	No The way that tier 2 reporting is laid out, in line with IFRS, makes the annual financial reports generated much easier to read and use for reporting purposes. Across the Hospice sector there are more organisations who report at tier 1 and tier 2 than at tier 3 or tier 4. Having more organisations reporting their results in a more standardised way is much better for the entire sector.		Feedback Form
14	Lucy Williams	Account 4 Ltd	Yes	Yes		Feedback Form

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
15	Maree Matthews	New Zealand Nursing Council	I agree with the proposal to increase Tier 2 PBE from the threshold size of $30m to $33m as it makes sense to align this with the definition of "large" as per the Financial Reporting Act 2013.	Yes I agree with the proposal to increase Tier 3 PBE from the threshold size of $2m to $5m. Our organisation prepares financial accounts for 11 Tier 3 organisations and one Tier 2 organisation. Three of the Tier 3 organisations are now at the $2m threshold, so will need to transition to Tier 2 in the next few years if the expense limit of $2 million remains. These organisations are still quite small as they employee between 8 and 12 employees. The cost of moving to Tier 2 would outweigh any additional disclosures provided by the organisations under Tier 2. Also, the additional ongoing costs of annual audits of Tier 2 versus Tier 3 could in some cases be onerous on an organisation with just over $2m in expenses. The threshold of $5m for expenses is more appropriate as the organisation would be considered 'medium' in size, Grant Thornton defined a medium size business in	Possibly it would be a good idea to build in a regular review of the threshold sizes of all the Tiers to ensure they continue to be appropriate going forward.	Email

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
				New Zealand as "having revenue between $5m and $30m, and/or employing between 20 and 99 people" (Grant Thornton: The power and potential of the mid-size business 2019"). As stated above, organisations with $2 million in expenses would tend not to employee 20 to 99 people, so would be considered small.		
16	Mark Styles	Liminal 8024 Limited	Yes	Yes		Feedback Form
17	Matthew Underwood	17	Yes	Yes How about pushing the limits even further. I suggest doubling them both. At the smaller end there is also a massive gulf between what is required to be presented in the financial statements and the ability of readers to understand them. The requirement to include revaluations in the financial statements is one specific area that only leads to confusion. Disclosure by note seems more than adequate.		Website

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
				For both Charities and Incorporated Societies the complexity of these XRB compliant financial statements can make them quite inaccessible to even smart wealthy businessmen who regularly receive Accrual based Financial Statements about their own businesses.		
18	Matthew Wall	Top Edge Advisory	N/A	Yes As an accountant for Charitable organisations, I am wholly in support for the increase in the Tier-3 threshold. Many Tier-3's that hover around the $2m mark do not, in my opinion, need to prepare disclosures required by the Tier-2 framework.		
19	Memo Musa	Platform	Yes This is based on the understanding that whilst not in scope there would be no additional reporting and compliance costs arising from accounting, auditing and assurance requirements.	Yes This is based on the understanding that whilst not in scope there would be no additional reporting and compliance costs arising from accounting, auditing and assurance requirements.		Feedback Form

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
20	Moira Paewai	MCI & Associates	Yes	Yes I act for many Charities and NFP's & several Tier 3's who are just over the $2m tier and incur additional accountancy & audit fees to comply with Tier 2, without any real benefit.		Feedback Form
21	Nick Andrews	Creative Northland	Yes	Yes		Feedback Form
22	peter rendell	peter rendell chartered accountant	Yes	Yes		Feedback Form
23	Rachel Harbrow	Able Charitable Trust (Southern Family Support)	Yes	Yes		Feedback Form
24	Richard Baxter	Open Polytechnic	Yes Consistent with For-Profit thresholds	Yes Hopefully will reduce compliance costs for many entities performing much-needed services to community		Feedback Form
25	Rick Loughnan	Catholic Parish of Christchurch North	Yes	Yes As Parish Priest of the Catholic Parish of North Christchurch I wish to make a submission supporting		Email

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
				consultation document out from the XRB (the accounting standard setting body in NZ) with proposed increases to thresholds One , Two, and Three. Currently our income enables us to fit into Tier 2. This enables a thorough but simpler process and less cost of auditing. This is still a close and helpful investigation of our accounting methods. With the proposed increases to Tiers one two and three we would be able to remain in Tier two.		
26	Sarah Jones	Charity Accountant	Yes	Yes		Feedback Form
27	Sarah Doherty	Sarah Doherty Ltd	Yes 2015 was a long time ago, a lot has changed. Increasing threshold seems like a good idea. Trust XRB to have put good thought into this suggested level.	Yes Trust that XRB thinking is solid on this and also, from personal experience alongside my husband who was Business Manager of a T3 moved to T2 entity - the difference between 1.9m and 2.1m is not great within an organisation. At 2m opex they could not cover the cost of a fulltime accountant. They had outside advice and a contracted part-time accountant but the workload was onerous and the		Feedback Form

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
				stress load huge, on top of frontline stressful kaupapa. By $5m we could safely expect an accountant on staff, if not more than one, so the step up would have more inhouse expertise and support to navigate the change. Good idea.		
28	Sarah Vrede	The New Zealand Financial Markets Association	N/A	Yes NZFMA agrees with the proposed increase in tier 3 PBE size threshold from $2 million to $5 million for the following reasons: • The $2 million total expenditure threshold level was introduced in 2012 and inflation since then has meant that many entities (55%) that did not meet the $2 million total expenditure threshold in 2012 now do so without a corresponding increase in their scale of activity. • An increase to $5 million total expenditure better reflects the original policy intent behind the tier 3 threshold level, while also providing a degree of future proofing for any further inflationary effects while the XRB	The consultation document does not clearly outline when any new PBE tier size thresholds would likely take effect. “April 2024” is referred to in a diagram in the consultation document as the date at which “Amendments to the PBE tier size thresholds (will be) issued”. Urgent clarification of the date from which the any new PBE tier thresholds will be effective (rather than issued) would be helpful, as this would give affected organisations some certainty around future compliance requirements.	Email

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
				carries out its first principles review. • There are significant additional reporting costs when an entity is required to apply tier 2 standards and these costs, for those types of organisations operating at a lower scale of activity, far exceed any assurance benefits gained from the additional reporting.		
29	Tracey Presland	The Fred Hollows Foundation NZ	Yes The Fred Hollow Foundation NZ agrees with the proposal to increase the tier 2 PBE size threshold to $33 million because it aligns with the definition of 'large' as defined in the Financial Reporting Act 2013. The Fred Hollow Foundation NZ recommends that an entity would only move to tier 1 whereby in the 2 preceding accounting periods, the total revenue exceeded $33m each year. This would align to the Financial Reporting Act 2013 regarding the	Yes This proposed tier 3 PBE size threshold change to $5 million does not impact The Fred Hollows Foundation NZ but in principle we are happy to support it noting the balance of costs and benefits and inflationary factors.	No	Long Form

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
			conditions of 'large' entities reporting obligations.			
30	Vincent Ardern		Yes Minor change. Seems fine.	Yes Inflation adjustment seems perfectly reasonable. Can it be locked in as an annual adjustment?		Feedback Form
31	[Withheld]	[Withheld]	Yes	Yes Our operating expenditure in the past two years has been 2023: $1.2m and 2022: $1.4m. With increasing rates of inflation and if there were any new builds with increased depreciation, it's possible that under the current thresholds [we] would move into the more arduous reporting requirements of Tier 2. We thank you for the consultation document and the feedback process from the XRB (the accounting standard setting body in NZ) with the proposed increases to these thresholds, seeing the $2m threshold moved up to $5m. I am in favour of the increased threshold, as it would be great if our		Email

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
				parish didn't need to report under the Tier 2 requirements as not only would they require significantly more work in terms of account compilation, but there would also be more to audit and therefore an increased audit cost, which we could certainly do without.		
32	Yvonne Styles	Kilmarnock Enterprises Limited	Yes	Yes		Feedback Form
33	Zachariah Hardy	Ara Taiohi Incorporated	Yes	Yes Less red tape for still reasonably small charities is a good idea so I am in support of this change and would like to know the outcome.		Feedback Form
34	Charlotte Stanley	DIA - Charities Services	Yes We agree with the proposal to increase the Tier 2 threshold from $30 million total operating expenditure to $33 million total operating expenditure. While the proposed change to the tier 2 threshold is likely to have little impact on current registered charities, with a very small	Yes We agree with the proposal to increase the Tier 3 threshold from $2 million total operating expenditure to $5 million total operating expenditure. This proposed tier threshold change would impact a significant number of charities. The proposed change, alongside the recent changes to the tier 3 reporting standards, would make reporting simpler and	Charities Services is intending to release the new annual return forms by 1 April 2024. There will be a transition period where both the old and new Annual Return forms are available. The proposed threshold change is likely to align with the new annual return forms being released, meaning charities impacted by the threshold change would be able to report using the new	Long Form

Number	Name	Organisation	Q1 Response	Q2 Response	Q3 Comments	Submission Method
			number of charities meeting this threshold, over time this change may impact more charities as we see further effects of inflation and growth in the sector.	consequently reduce the cost of reporting for many charities. We are in support of any changes that reduce the reporting burden on charities, whilst retaining transparency and comparability.	forms immediately. Charities Services remains committed to supporting charities to transition through, and adopt, changes to reporting requirements, including any changes to the tier threshold for PBEs.	

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Updated PBE Tier Sizes

Mandatory 1 January 2025

Issued March 2024

Updated PBE Tier Sizes

Issued XXXX 2024

This amending Standard increases the Public Benefit Entity tier size thresholds applicable to entities that are required (or opt under an enactment) to prepare, general purpose financial reports in accordance with accounting standards issued by the External Reporting Board.

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

Legal status of amending Standard

This amending Standard was issued on XX March 2024 by the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This amending Standard is secondary legislation for the purposes of the Legislation Act 2019.

The amending Standard, pursuant to section 27(1) of the Financial Reporting Act 2013, takes effect on the 28th day after the date of its publication. The amending Standard was published under the Legislation Act 2019 on XX March 2024 and takes effect on XX March 2024.

Commencement and application

The amending Standard has a mandatory date of 1 January 2025, meaning it must be applied by reporting entities for accounting periods that begin on or after this date.

Application to an earlier accounting period is permitted for accounting periods that end after this amending Standard takes effect – refer to paragraphs NZ 78 – 81 of this amending Standard.

ISBN xxx-xxx-xxx-xxx

CONTENTS

Part A – Introduction

This amending Standard amends the PBE Tier Size Criteria in XRB A1 *Application of the Accounting Standards Framework* as it applies to the entities that are required (or opt under an enactment) to prepare general purpose financial reports in the public benefit entities sector. It also makes editorial corrections to XRB A2 *Meaning of Specified Statutory Size Thresholds* to reflect the references to XRB Standards in the Incorporated Societies Regulations 2023.

Part B – Scope

An entity shall apply this Standard when it prepares, or when it opts under an enactment to prepare, GPFR in accordance with accounting standards issued by the External Reporting Board.

Part C – Amendments to XRB A1 *Application of the Accounting Standards Framework*

Paragraphs 38 and 40 and the heading of part D are amended, paragraph 37 is not amended but is included for context. Paragraphs 78 – 81, and BC46 – BC49 are added. Deleted text is struck through and new text is underlined.

C. PUBLIC BENEFIT ENTITIES

Tier structure

...

Tier 1 criteria

37. Subject to the requirements on moving between tiers (set out in paragraphs 47 to 72), a PBE shall report in accordance with Tier 1 PBE Accounting Requirements if it:

(a) (i) has public accountability[3] at any time during the reporting period; or

(ii) is large; or

(b) is eligible to report in accordance with the accounting requirements of another tier but does not elect to report in accordance with that other tier.

38. For the purpose of applying the Tier 1 size criteria, a PBE is large if it has total expenses over $~~30~~<u>33</u> million. Total expenses means the total expenses (including losses and grant expenses), recognised in its surplus or deficit by an entity in accordance with Tier 1 PBE Accounting Requirements, where surplus or deficit is defined as the total of revenue less expenses, excluding the components of other comprehensive revenue and expense. Where revenue and expense are offset as required or permitted by a relevant accounting standard, any net expense is included in total expenses. Where the entity reporting is a group, total expenses is that of the group comprising the controlling entity and all its controlled entities.

…

[3] The term "public accountability is used here with the meaning specified in this document. It is different from the manner in which it was used prior to 2011 in the Accounting Standards Framework. This meaning is also different from the way in which "publicly accountable" is normally used in the public sector and not-for-profit sector. While entities in the public sector and not-for-profit sector are generally considered to be publicly accountable, it does not mean that all entities in those sectors have public accountability (and are therefore in Tier 1). The definition of public accountability has a particular technical meaning and is narrower than the generic term publicly accountable as it is commonly used.

Tier 3 criteria

40. Subject to the requirements on moving between tiers (set out in paragraphs 47 to 72), a PBE may elect to report in accordance with Tier 3 PBE Accounting Requirements if it:

(a) does not have public accountability; and

(b) has total expenses less than or equal to $~~2~~5 million.

...

D. ~~EFFECTIVE DATE~~ COMMENCEMENT AND APPLICATION

78 *Updated PBE Tier Sizes*, issued in March 2024, amended the PBE tier size criteria in paragraphs 38 and 40. An entity shall apply those amendments in accordance with the commencement and application date provisions in paragraphs 79 - 81. An entity that applies the amendments to an 'early adoption accounting period' shall disclose that fact.

When amending Standard takes effect (section 27 Financial Reporting Act 2013)

79 The amending Standard takes effect on the 28th day after the date of its publication under the Legislation Act 2019. The amending Standard was published on XX March 2024 and takes effect on XX March 2024.

Accounting period in relation to which standards commence to apply (section 28 Financial Reporting Act)

80 The accounting periods in relation to which this amending Standard commences to apply are:

(a) for an **early adopter**, those accounting periods following and including, the **early adoption accounting period**.

(b) for any other reporting entity, those accounting periods following, and including, the first accounting period for the entity that begins on or after the **mandatory date.**

81 In paragraph 80:

early adopter means a reporting entity that applies this amending Standard for an early adoption accounting period

early adoption accounting period means an accounting period of the early adopter:

(a) that begins before the mandatory date but has not ended or does not end before this amending Standard takes effect (and to avoid doubt, that period may have begun before this amending Standard takes effect); and

(b) for which the early adopter:

(i) first applies this amending Standard in preparing its financial statements; and

(ii) discloses in its financial statements for that accounting period that this amending Standard has been applied for that period.

mandatory date means 1 January 2025.

...

BASIS FOR CONCLUSIONS ON STANDARD XRB A1 *APPLICATION OF THE ACCOUNTING STANDARDS FRAMEWORK*

…

Updated PBE tier sizes

BC46. In August 2023 the New Zealand Accounting Standards Board (NZASB) made a recommendation to the External Reporting Board that they consult publicly on increasing the Tier 2 and Tier 3 size thresholds for PBEs in the Accounting Standards Framework. They made this recommendation noting that the thresholds had not been adjusted since they were originally set in 2012. They therefore highlighted a risk that the thresholds were no longer appropriate due to the effects of inflation over time which may cause entities to be required to report in a higher tier despite not having become larger or more complex in real terms.

BC47. The NZASB recommended consulting on increasing the:

(a) Tier 2 PBE size threshold from $30 million to $33 million. In their recommendation, the NZASB noted that the legislative threshold on which the tier 2 threshold is based (the legislative definition of a "large" entity) has recently been amended from $30 million to $33 million and this change will maintain alignment; and

(b) Tier 3 PBE size threshold from $2 million to $5 million. In their recommendation, the NZASB highlighted that the legislative measure on which the tier 3 threshold was originally based is no longer in effect and that judgement would be required to determine a tier 3 threshold which would correct for the effects of inflation since 2012, future proof the Accounting Standards Framework until the External Reporting Board carries out a first-principles review, and reflect the objective for the benefits to exceed the costs of reporting for smaller tier 2 PBEs.

In October 2023 the XRB issued the Consultation Document *Public Benefit Entity Tier Sizes* which proposed increases to the Tier 2 and Tier 3 PBE size thresholds in accordance with the NZASB's recommendations.

BC48. In February 2024 the NZASB considered the submissions received on *Public Benefit Entity Tier Sizes.* They noted that respondents were in strong support of the proposals. The NZASB therefore made a final recommendation to the External Reporting Board.

BC49. In February 2024 the External Reporting Board agreed to proceed with the proposals and issued *Updated PBE Tier Sizes* in March 2024.

Agenda Item 4.3

Memorandum

Date:	2 February 2024
To:	NZASB Members
From:	Alex Stainer
Subject:	**Update to XRB A2**

COVER SHEET

Project priority and complexity

Project priority	**Medium** Amending XRB A2 for new legislative references to specified terms provides completeness and clarity for incorporated societies reregistering under the new Act from October 2023.
Complexity of Board decision-making at this meeting	**Low** We are asking the Board to agree with our analysis that the amendments proposed to XRB A2 are consequential arising from legislative changes and do not need separate consultation.

Overview of agenda item

Project Status	Finalise amendments to XRB A2
Project purpose	Update XRB A2 for specified terms used in the Incorporated Societies Act 2022 and the Incorporated Societies Regulations 2023
Board action required at this meeting	AGREE to recommend to the XRB that they issue amendments to XRB A2 to update for the recent Incorporated Societies Act 2022 and Incorporated Societies Regulations 2023. AGREE that the amendments are not necessary to be consulted on per section 22 of the Financial Reporting Act 2013.

Purpose and introduction

1. The purpose of this agenda item is to:

   (a) Outline to the Board the proposed amendments to XRB A2 (see Appendix A)

   (b) Seek the Board's agreement that the proposed amendments do not need consultation

   (c) Seek the Board's agreement to recommend to the XRB Board that they issue amendments to XRB A2

Background

2. With the introduction of the Incorporated Societies Act 2022 and the Incorporated Societies Regulations 2023, there are now additional instances of specified[1] terms used in both size and assurance thresholds.

   (a) section 103(2)(b)(i) of the Incorporated Societies Act 2022 refers to "total operating payments" (See Appendix B); and

   (b) section 16(2)(b) of the Incorporated Societies Regulations 2023 refers to "total operating expenditure" and "control" (See Appendix B).

3. XRB A2 *Meaning of Specified Statutory Size Thresholds* sets out the meaning of specified terms which are used in particular Acts (Financial Reporting Act 2013, Companies Act 1993, Friendly Societies and Credit Unions Act 1982, Charities Act 2005) for size and assurance thresholds.

4. As the new Incorporated Societies Act 2022 and the Incorporated Societies Regulations 2023 introduce 'total operating payments' in the determination of whether a society is a 'small society' and 'total operating expenditure' and 'control' in determination of whether a society is required to be audited, XRB A2 should be amended to specify the definitions in context of this legislation.

Structure of this memo

5. The remaining sections in this memo are:

   (a) Nature of the changes
   (b) Consultation considerations

Nature of the changes

6. Appendix A outlines the proposed changes to XRB A2. The changes include:

   (a) Noting the use of specified terms in the Incorporated Societies Act 2022 and Incorporated Societies Regulations 2023

   (b) Linking 'total operating payments' in the Incorporated Societies Act 2022 and providing a definition consistent with what has been established already in XRB A2

[1] The term is defined in an issued financial reporting standard rather than in the legislation itself.

(c) Linking 'total operating expenditure' in the Incorporated Societies Regulations 2023 and providing a definition consistent with what has been established already in XRB A2

(d) Linking 'control' in the Incorporated Societies Regulations 2023 to the definitions used in XRB Standards

(e) Acknowledge the use of Tier 3 (where applicable) in the calculation of 'total operating expenditure' for the audit threshold for **PBE incorporated societies**, as it will be below the threshold for Tier 2 as a result of the updated PBE size thresholds[2]

(f) Linking definitions for the specified terms to for-profit and public-benefit-entity instances (already defined in XRB A2 under other sets of legislation) as incorporated societies may include both for-profit and public-benefit entities.

7. We note that these amendments include the insertion of additional text to XRB A2. However:

   (a) no new definitions have been added;

   (b) no changes have been made to already established definitions; and

   (c) there are no substantive changes to the application of XRB A2 aside from the fact incorporated societies are now included within the scope of the Standard.

8. The additional text is required as XRB A2 sets out definitions in the context of each Act rather than defining the terms on a stand-alone basis. The format of XRB A2 contributes to the extent of the insertions rather than the nature of the update itself.

9. We consider that the amendments to XRB A2 are consequential to the introduction of the legislation and are editorial in nature. They merely provide clarity and completeness to our literature in response to legislative references. We have included a proposed Basis for Conclusions paragraph (BC11.) to explain our rationale.

Consultation considerations

10. Notwithstanding our view that the amendments are editorial in nature, we have considered XRB requirements to consult when issuing amendments.

11. We note that section 22 of the Financial Reporting Act 2013 stipulates that the XRB must not issue an amendment unless reasonable steps have been taken to consult those who will be substantially affected.

[2] This particular amendment arises from the in progress update to the PBE tier sizes threshold. Under the existing threshold $3 million of operating expenditure results in an entity applying Tier 2 standards.

22 Consultation

(1) The Board must not issue a standard, an authoritative notice, an amendment, or a revocation unless the Board has taken reasonable steps to consult the persons or representatives of persons who, in the opinion of the Board, would be substantially affected by the issue of the standard, notice, amendment, or revocation.

(2) The Board must not issue a standard, an authoritative notice, or an amendment that is likely to require the disclosure of personal information unless the Board has consulted the Privacy Commissioner.

(3) Any failure to comply with subsection (1) or (2) does not affect the validity of the standard, authoritative notice, amendment, or revocation.

(4) This section does not limit section 16 or 17 of the Crown Entities Act 2004.

Compare: 1993 No 106 s 26

12. It would then follow, that any amendments that do not substantially affect users would not require consultation.

13. In analysing whether users would be substantially affected by these amendments we have considered the following points in the table below.

Table 1 – Factors in analysing whether amendments to XRB A2 substantially affect users

Consideration	Explanation
MBIE have worked through an extensive consultation process during the drafting and assent of the Incorporated Societies Bill and the Incorporated Societies Regulations. There was focus on both the small society criteria and assurance criteria throughout both the consultation and drafting processes providing opportunity for those substantially affected to raise their concerns and to become familiar with the specified terms used.	*Small society criteria and the term 'total operating payments'* The initial drafting of the Incorporated Societies Bill did not include any separate provisions for 'small societies' as per s83(2)(a)(b). **Extract from the draft Bill for consultation from 2015** *Financial reporting* **83 Annual financial statements must be prepared and registered** (1) The committee of a society must ensure that, within 6 months after the end of the accounting period of the society, financial statements are— (a) completed in relation to the society and that accounting period; and (b) dated and signed by or on behalf of the committee by 2 members of the committee. (2) The financial statements must be prepared in accordance with,— (a) in the case of a specified not-for-profit entity, generally accepted accounting practice; or (b) in any other case, either generally accepted accounting practice or a non-GAAP standard that applies for the purposes of this section. (3) Every society must ensure that, within 6 months after the balance date of the society, copies of the financial statements of the society for the period ending on that date are given to the Registrar for registration. (4) In this section,— **generally accepted accounting practice** has the same meaning as in section 8 of the Financial Reporting Act 2013 **non-GAAP standard** has the same meaning as in section 5 of the Financial Reporting Act 2013. Feedback received from consultation of the Bill raised concerns of the disruption and compliance cost involved with the application of XRB Standards for smaller societies[3]. As a result, the Minister proposed that smaller societies be exempted from applying XRB Standards, and suggested incorporated societies who have less

[3] Detailed assessment of this issue was undertaken by MBIE in response to consultation – see this document Reform of the Incorporated Societies Act 1908: Annex 2 (Impact assessment) (mbie.govt.nz)

than $10,000 of annual payments or less than $30,000 of total assets for the year become exempt[4].

At the drafting of the next version of the Bill, the term 'total operating payments' was used in place of annual payments, to align with the use of the term in the criteria for a 'specified not-for-profit entity' (see extract below)[5] which is also referenced in the same section of the Incorporated Societies Bill.

Extract from Cabinet paper – Reform of the Incorporated Societies Act – Impact Analysis

> Annual payments have been chosen over annual income because they tend to be less "lumpy" than income (which can be affected by one-off donations). Charities Services also believes that annual payments would represent a more accurate measure of the true size of an IS-NRAS by representing their usual activities. Annual payments (or, when accrual accounting is used, annual expenditure) is also the threshold adopted by the External Reporting Board for the different "tiers" of standards that they develop (e.g. Tier 4 accounting standards apply to public-benefit entities with annual payments under $125,000).[12]
>
> For the annual payments threshold, we have considered $10,000, $50,000, and $125,000 (the last threshold level corresponding to the threshold for Tier 4 entities under the External Reporting Board rules). To adjust the thresholds for inflation over time, a similar mechanism as that set out in section 48 of the Financial Reporting Act 2013 (Minister reviews at least every 8 years) could be envisaged.

Extract from the first version of the Bill 17 March 2021

> (2) In this subpart, a society is, in respect of an accounting period,—
>
> (a) a **specified not-for-profit entity** if it is such an entity in respect of that period under section 46 of the Financial Reporting Act 2013:
>
> (b) a **small society** if,—
>
> (i) in each of the 2 preceding accounting periods of the society, the total operating payments of the society are less than $10,000; and
>
> (ii) as at the balance date of each of the 2 preceding accounting periods, the total assets of the society are less than $30,000; and
>
> (iii) at the balance date of the accounting period, the society is not an entity described in section LD 3(2) of the Income Tax Act 2007 (a donee organisation).

Following submissions received, commentary contained in the second version of the Bill noted that the amounts were too small for several reasons. It was then suggested that the 'small society' criteria be updated to include a $50,000 threshold for 'total operating payments' and 'total current assets'[6].

These amounts were ultimately used in the final version of the criteria which was included in the Bill and the legislation that was passed.

The steps undertaken and revisions made throughout the process of drafting the legislation display the extent of consultation and assessment undertaken by MBIE in developing the small society criteria. The term 'operating payments' was used consistently and there has been intentional and deliberate use of this term in line with the definition already established by XRB in the criteria of a 'specified not-for-profit entity'.

---

4 Paragraph 64 on page 12 of the **Cabinet Paper - Reform of Incorporated Societies Act**

5 The 'specified not-for-profit entity' criteria includes an entity with less than $140,000 of 'total operating payments' in the preceding two accounting periods, and is used to identify those entities that can apply Tier 4 PBE Standards/Non-GAAP Standards.

6 Page 4 second version of the **Incorporated Societies Bill** 3 November 2021

Assurance threshold

In the original Bill for consultation there was no requirement for the annual financial statements of incorporated societies to be audited. In contrast, commentary included in the Exposure Draft outlined MBIEs view that the 'large' threshold should be used to determine which societies should be audited.

Extract from the Exposure Draft 2015

Auditing or review

106 The Bill does not include any requirements for societies to have their financial statements independently assured (i.e. audited or reviewed). We intend to make recommendations to the Government on assurance-related matters following this consultation process.

107 Societies that are registered under the Charities Act 2005 and meet or exceed the size criteria in section 42D of the Charities Act 2005 (annual revenue of $500,000 in both of the last two financial years) do have independent assurance requirements. The rationale is that all registered charities are accountable to wider society because of the tax exemptions associated with being a registered charity.

108 This reasoning does not apply to many societies that are not registered charities, so there is no reason to impose the same assurance requirements at $500,000. We consider that those societies should instead be treated the same for assurance purposes as other entities that are not publicly accountable. The relevant criteria appear section 45 of the Financial Reporting Act 2013 (i.e. total assets of $60 million or annual revenue of $30 million, or both for each of the two preceding accounting periods).

109 This will mean that the great bulk of societies that are not registered charities would be left to decide whether to obtain assurance. We expect that societies' decisions on this matter will take into consideration the costs of engaging a qualified accountant, the benefits (e.g. improved accountability to members), and whether assurance is needed to obtain funding from philanthropic organisations and government agencies.

Accordingly, in the first version of the Bill the audit requirements were prescribed only for those considered as being 'large' despite the Ministers recommendation to Cabinet in 2019 prior to presenting the first version of the Bill to alter the critera[7]. The XRB also submitted on both the Exposure Draft from 2015 and the first version of the Bill, noting disagreement with the assurance threshold, and suggesting a new assurance threshold based on operating expenditure in line with the Tier sizes.

Extract from the first version of the Bill 17 March 2021

98 Annual financial statements of large societies must be audited

(1) Every society that is large within the meaning of section 45 of the Financial Reporting Act 2013 must ensure that the financial statements that are required to be prepared under **section 95** are audited by a qualified auditor.

(2) *See* sections 37 to 39 of the Financial Reporting Act 2013 (which provide for the appointment of a partnership and access to information).

(3) An auditor must, in carrying out an audit for the purposes of this section, comply with all applicable auditing and assurance standards.

Due to several submissions to the Select Committee that the thresholds were too high[8], the next version of the Bill noted that the assurance threshold should be set by regulations.

Extract from the second version of the Bill 3 November 2021

98 Annual financial statements of ~~large~~ certain societies must be audited

(1) Every society that is ~~large within the meaning of section 45 of the Financial Reporting Act 2013~~ of a kind prescribed by the regulations must ensure that the financial statements that are required to be prepared under **section 95** are audited by a qualified auditor.

(2) *See* sections 37 to 39 of the Financial Reporting Act 2013 (which provide for the appointment of a partnership and access to information).

(3) An auditor must, in carrying out an audit for the purposes of this section, comply with all applicable auditing and assurance standards.

[7] Paragraph 70 on pages 13 and 14 of the **Cabinet Paper - Reform of Incorporated Societies Act**

[8] Paragraph 86, MBIE Consultation on the Regulations

	For the 2022 Consultation on the Regulations, MBIE changed approach and noted that incorporated societies that are charities must have their financial statements audited if they meet certain expenditure thresholds[9] and that expenditure is a more stable indicator of the size of an entity such as an incorporated society[10]. Accordingly, the expenditure threshold was used as the main component in MBIE's analysis to capture the proportion of societies that are large. We note they did not refer to the specified term 'total operating expenditure' in the 2022 consultation paper but a common understanding of total expenditure does not differ materially to the technical definition in XRB A2. Prior to the Exposure Draft of the regulations being released in 2023, MBIE in a Regulatory Impact Statement referred to a threshold based on operating expenditure being appropriate for incorporated societies in context to the threshold used in the Charities Act 2025 (see extract below). **Extract from the Regulatory Impact Statement on Top-Up Regulations – April 2023** 81. Under the Charities Act 2005, incorporated societies registered as charities must already have their financial reports audited when, in each of the 2 preceding accounting periods, their total operating expenditure is $1.1 million or more. 82. A threshold based on 'operating expenditure' is appropriate for both charities and incorporated societies as their revenue can be quite variable year-to-year due to large bequests or donations in certain years. The threshold proposed by MBIE captures approximately 1% of incorporated societies that are not registered as charities. When the Exposure Draft of the Incorporated Societies Regulations was released in 2023, the terms 'total operating expenditure' and 'control' were used matching the terminology existing in the assurance thresholds specified in the Charities Act 2005. Based on the analysis presented in the Regulatory Impact Statement the definition of these terms would therefore have been expected to be in line with current literature. **Extract from the Exposure Draft of the Regulations July 2023** **16 Annual financial statements of certain societies must be audited** (1) For the purposes of section 105 of the Act, a society that meets both of the criteria described in **subclause (2)** must ensure that the financial statements required to be prepared under section 102 of the Act are audited by a qualified auditor. (2) The criteria are that— (a) the society is not a charitable entity; and (b) in each of the 2 preceding accounting periods of the society, the total operating expenditure of the society and all entities it controls (if any) is $3,000,000 or more. Feedback throughout this consultation process has clearly influenced the development of the final assurance threshold criteria. The consultation process provided multiple opportunity to users to consider and submit on the threshold and terms used. Documents such as the Regulatory Impact Statement display that MBIE had a clear intention to use specified terms that aligned with those used in the assurance criteria existing in the Charities Act 2005.

9 Paragraph 86, MBIE Consultation on the Regulations

10 See Footnote 27 on page 27, MBIE Consultation on Regulations

Would we alter the definitions for incorporated societies from what has been established for other entities?	In full consideration of the definitions for 'total operating payments', total operating expenditure' and 'control' we have not identified any reason why these would be altered for the application by incorporated societies. Given the consultation process already conducted by MBIE, any alteration of the definitions may change the impact of the legislation from the intent behind developing the specific criteria. These definitions are clear, established and in use in practice already. Any alteration of the definitions may lead to confusion and inconsistency when applied by users. Further, in the process of defining 'total current assets' as part of the 'small society' criteria MBIE considered that a separate definition for an established accounting term would only cause more uncertainty and confusion for smaller societies. They expected most incorporated societies will be considered PBE for financial reporting purposes and therefore based the definition on IPSAS[11]. Following their analysis on this definition it stands to reason that they intended the definitions of the specified terms to be applied as they are already defined. It would be unlikely that as a result of consultation we would change the definitions based on the above and there would be limited benefit in proceeding with a consultation which is duplicative of the consultation already caried out by MBIE.
The amendments to update XRB A2 are being done for completeness and clarity rather than being essential.	The amendments to update XRB A2 are driven by legislation that has widened the application of XRB Standards to incorporated societies. The amendments proposed simply update XRB A2 for legislative references and do not introduce new definitions or concepts. The form of XRB A2 follows that the definitions should be made within context of the legislative reference rather than being stand-alone terms. If we did nothing, the definitions as already established in XRB A2 would be used for application by societies.

14. Overall, we conclude that there is no substantial effect on users with the proposed amendments to XRB A2, and that reasonable steps have been taken throughout the drafting of the legislation and the regulations to consult those impacted by the legislation even if not directly undertaken by XRB.

15. The definitions of those terms were key in policy makers drafting of the relevant criteria to achieve policy objectives. Any alterations to these definitions may deviate away from the expected impact of the legislation, while also introducing inconsistency and potentially confusion to the application of these terms going forward.

16. Given the consultation performed by MBIE and the proposed amendments align XRB A2 to the legislation, we view the amendments as providing clarity and completeness to our literature that does not warrant separate consultation.

11 Paragraphs 73 and 75 on page 20, Regulatory Impact Statement: Top-up regulations under the new Incorporated Societies Act 2022

Questions for the Board

Q1. Does the Board agree the proposed amendments do not require consultation?

Q2. Does the Board recommend the proposed amendments to XRB A2 to the XRB Board?

Appendix A

Amendments to XRB A2 *Meaning of Specified Statutory Size Thresholds*

Paragraphs 1 and 3 are amended. Paragraphs 4H-I are added. Paragraphs 23I-S and their related headings are added. The heading for Part C is amended. New text is underlined and deleted text is struck through.

A. INTRODUCTION

Objective

1. The objective of this Standard is to set out the meaning of the following specified terms which are required under the Financial Reporting Act 2013, the Companies Act 1993, the Friendly Societies and Credit Unions Act 1982, ~~and~~ the Charities Act 2005, the Incorporated Societies Act 2022, and the Incorporated Societies Regulations 2023 to be defined in a financial reporting standard issued by the External Reporting Board (XRB):

   (a) Total assets;

   (b) Total revenue;

   (c) Total operating payments;

   (d) Total operating expenditure; and

   (e) Control.

   …

3. The Financial Reporting Act 2013 and the Companies Act 1993 provide for specified terminology ("total assets", "total revenue" and "total operating payments") relating to the size threshold of an entity for reporting purposes to be defined in a financial reporting standard issued by the XRB. Similarly, the Friendly Societies and Credit Unions Act 1982 and the Incorporated Societies Act 2022 ~~also~~ provide~~s~~ for the specified terms ("total operating expenditure" and "total operating payments" respectively) relating to the size thresholds in ~~that~~ those Acts to be defined in a financial reporting standard issued by the XRB. The Charities Act 2005 (as amended by the Charities Amendment Act 2014) and the Incorporated Societies Regulations 2023 provides for specified terminology ("total operating expenditure" and "control") relating to the size threshold of a charitable entity or society for assurance purposes to be defined in a financial reporting standard issued by the XRB. Relevant entities, in determining whether a particular provision of an Act applies, must apply the financial reporting standard that contains the meanings of those terms in assessing whether its particular size threshold has been met.

Scope

4. This Standard applies to an entity that is required under an enactment to apply the following provisions, as applicable:

   (a) sections 45(1)(a) and 45(2)(a) of the Financial Reporting Act 2013 (to determine "total assets");

   (b) sections 45(1)(b) and 45(2)(b) of the Financial Reporting Act 2013 (to determine "total revenue");

   (c) section 46 of the Financial Reporting Act 2013 (to determine "total operating payments");

   (d) section 204(3)(a) of the Companies Act 1993 (to determine "total assets");

   (e) section 204(3)(b) of the Companies Act 1993 (to determine "total revenue");

   (f) section 64(2) of the Friendly Societies and Credit Unions Act 1982 (to determine "total operating expenditure");

   (g) section 42D of the Charities Act 2005 (to determine "total operating expenditure" and "control");

   (h) section 103(2)(b)(i) of the Incorporated Societies Act 2022 (to determine "total operating payments"); and

(i) section 16(2)(b) of the Incorporated Societies Regulations 2023 (to determine "total operating expenditure" and "control").

B. SPECIFIED STATUTORY SIZE THRESHOLDS AND THEIR DEFINITIONS

…

Incorporated Societies Act 2022: The determination of "total operating payments"

23I For the purpose of section 103(2)(b)(i) of the Incorporated Societies Act 2022, total operating payments means the total amount of any payment (including grant payments and income tax payments, where applicable), other than a capital payment, made by the entity during the accounting period.

23J For the purpose of paragraph 23I, a capital payment is a payment during the accounting period for the purchase of a resource with an expected life greater than twelve months, to be owned or partly owned and used by the entity to support the entity's activities or to provide services or products. Capital payments do not include payments for operating purposes or payments for resources to be passed to other entities.

Incorporated Societies Regulations 2023: The determination of "total operating expenditure" and "control"

23K Section 105(1) of the Incorporated Societies Act 2022 provides that:

(a) every society that is of a kind prescribed by the regulations must ensure that the financial statements that are required to be prepared under section 102 are audited by a qualified auditor.

23L For the purposes of section 105 of the Incorporated Societies Act 2022, section 16(2)(b) of the Incorporated Societies Regulations 2023 provides that:

(a) the society is not a charitable entity; and

(b) in each of the 2 preceding accounting periods of the society, the total operating expenditure of the society and all entities it controls (if any) is $3 million or more.

23M For the purpose of section 16(2)(b) of the Incorporated Societies Regulations 2023, the amount of total operating expenditure is determined as follows:

(a) where financial statements are prepared in accordance with accounting standards issued by the XRB or its sub-board, the New Zealand Accounting Standards Board, total operating expenditure is the amount of total expenses recognised in the financial statements of the entity, prepared in accordance with the requirements of the Tier 1, Tier 2 or Tier 3 accounting standards as specified in External Reporting Board Standard A1 *Application of the Accounting Standards Framework* that are in effect and that are applied by the entity as at each of the relevant accounting periods; and

(b) where financial statements are not prepared, or where financial statements are not prepared as specified in paragraph (a), total operating expenditure is the amount of total expenses derived from the entity's accounting records, determined in accordance with the requirements of the Tier 2 accounting standards for a for-profit entity or the Tier 3 accounting standard for a public-benefit entity as specified in External Reporting Board Standard A1 *Application of the Accounting Standards Framework* that would be relevant to the entity if it was reporting in accordance with those accounting standards.

23N For a for-profit entity applying paragraph 23M, total operating expenditure includes all expenses (including losses and income tax expense) that are required to be recognised in profit or loss and excludes the components of other comprehensive income.

23O For a public-benefit-entity applying paragraph 23M, total operating expenditure includes all expenses (including losses and income tax expense, where applicable) that are required to be recognised in revenue and expense and excludes the components of other comprehensive revenue and expense.

23P Total operating expenditure is the amount recognised in the financial statements of the entity, prepared in accordance with the accounting policies adopted by the entity (where financial statements are prepared in accordance with accounting standards issued by the XRB or the New Zealand Accounting Standards Board) or with accounting policies that the entity would adopt (where financial statements are not prepared, or where financial statements are not prepared in accordance with accounting standards issued by the XRB or the New Zealand Accounting Standards Board).

23Q Net amounts are to be included in determining total operating expenditure only where accounting standards require or permit items to be accounted for, and recognised, as net amounts in the financial statements.

23R As the calculation of the thresholds covers two balance dates/accounting periods, total operating expenditure would be the amount determined based on the entity's accounting policies adopted and accounting standards effective at each of those balance dates/accounting periods. An entity is not required to adjust the amount taken from the first balance date/accounting period for any changes in its accounting policies or for standards that become effective in the second balance date/accounting period.

23S For the purposes of section 16(2) of the Incorporated Societies Regulations 2023, the meaning of the term "control" is set out in the relevant Standards issued by the New Zealand Accounting Standards Board as applicable to for-profit and public-benefit-entities.

C. ~~EFFECTIVE DATE~~ COMMENCEMENT AND APPLICATION

…

BASIS FOR CONCLUSIONS ON STANDARD XRB A2 *MEANING OF SPECIFIED STATUTORY SIZE THRESHOLDS*

This Basis for Conclusions accompanies, but is not part of, Standard XRB A2 Meaning of Specified Statutory Size Thresholds*.*

Paragraphs BC1A is added. Paragraph BC1 is not amended but provided for context. New text is underlined.

Introduction

BC1. This Standard was issued by the External Reporting Board (XRB) to give meaning to specified terminology in the Financial Reporting Act 2013, the Companies Act 1993 and the Friendly Societies and Credit Unions Act 1982 relating to the size thresholds of an entity for reporting purposes. The Standard also gives meaning to specified terminology in the Charities Act 2005 relating to the size thresholds for assurance purposes.

BC1A. This Standard also provides meaning to specified terminology in the Incorporated Societies Act 2022 and the Incorporated Societies Regulations 2023 relating to size thresholds for reporting and assurance purposes.

…

Paragraph BC3B is added. Paragraph BC3 and BC3A are not amended but provided for context. New text is underlined.

BC3. In addition, the Financial Reporting Act 2013, the Companies Act 1993 and the Friendly Societies and Credit Unions Act 1982 also include specified terminology relating to the size threshold of an entity for financial reporting purposes. The Acts provide for a financial reporting standard (or part of a standard) issued by the XRB to define the terms used for the size thresholds. The financial reporting

standard must then be applied by relevant entities in determining whether a particular provision of an Act applies.

BC3A. The Charities Act 2005 includes size thresholds (total operating expenditure) to determine whether a charitable entity or a single entity is large or medium size for the purposes of determining the entity's assurance requirements. Total operating expenditure is required to include the total operating expenditure of the entity and all entities that it controls. The Charities Act 2005 provides for a financial reporting standard (or part of a standard) to define the terms used for the size thresholds. The financial reporting standard must then be applied by the charitable entity or a single entity in determining its assurance requirements.

<u>BC3B. The Incorporated Societies Act 2022 includes specified terminology relating to the size threshold of an entity for financial reporting purposes. The Incorporated Societies Regulations 2023 include a size threshold (total operating expenditure) for the purposes of determining the entity's assurance requirements. The Acts provide for a financial reporting standard (or part of a standard) to define the terms used for the size thresholds. The financial reporting standard must then be applied by the entity in determining its assurance requirements.</u>

Paragraph BC4B and related heading are added. Paragraph BC4 and BC4A are not amended but provided for context. New text is underlined.

Size thresholds for "large" and "medium size"

BC4. To ensure that consistent and reliable measures are used by all entities to determine whether they meet the relevant size thresholds for financial reporting purposes, the XRB decided that:

(a) the measures used in legislation to determine size thresholds ("total assets", "total revenue" and "total operating expenditure") should be GAAP-based measures, regardless of whether or not an entity had previously prepared GAAP-based financial statements; and

(b) the relevant GAAP is Tier 2 accounting standards in effect and applicable to the entity as at each of the relevant balance dates or in each of the relevant accounting periods as specified in External Reporting Board Standard A1 *Application of the Accounting Standards Framework.*

BC4A. In the case of the Charities Act 2005 where financial statements are prepared, the relevant GAAP is the requirements of the accounting standards in Tier 1, Tier 2 or Tier 3 as specified in External Reporting Board Standard A1 *Application of the Accounting Standards Framework* that were applied by the entity as at each of the relevant balance dates or in each of the relevant accounting periods. Where financial statements are not prepared, the relevant GAAP is the requirements in the Tier 3 accounting standards as specified in External Reporting Board Standard A1 *Application of the Accounting Standards Framework* that would be relevant to the entity if it was reporting in accordance with those standards.

<u>*Size threshold for assurance purposes for incorporated societies*</u>

<u>BC4B. In the case of the Incorporated Societies Regulations 2023 where financial statements are prepared, the relevant GAAP is the requirements of the accounting standards in Tier 1, Tier 2 or Tier 3 as specified in External Reporting Board Standard A1 *Application of the Accounting Standards Framework* that were applied by the entity as at each of the relevant balance dates or in each of the relevant accounting periods. Where financial statements are not prepared, the relevant GAAP is the requirements in the Tier 2 accounting standards for a for-profit entity and the Tier 3 accounting standard for a public-benefit-entity as specified in External Reporting Board Standard A1 *Application of the Accounting Standards Framework* that would be relevant to the entity if it was reporting in accordance with those standards.</u>

…

Paragraph BC7B is added. Paragraph BC7A is not amended but provided for context. New text is underlined.

BC7A. In relation to the thresholds for assurance under the Charities Act 2005, where financial statements are not prepared or where financial statements are not prepared in accordance with XRB's standards, the XRB decided to link the measures to Tier 3 rather than to Tier 2 because the thresholds for assurance fall within the Tier 3 size criteria in the Accounting Standards Framework and the recognition and measurement requirements between Tier 3 and Tier 2 are similar.

BC7B. In relation to the thresholds for assurance under the Incorporated Societies Regulations 2023, where financial statements are not prepared or where financial statements are not prepared in accordance with XRB's standards, the XRB decided to link the measures for public-benefit-entities to Tier 3 rather than to Tier 2 because the thresholds for assurance fall within the Tier 3 size criteria in the Accounting Standards Framework and the recognition and measurement requirements between Tier 3 and Tier 2 are similar.

...

Paragraph BC10A is added. Paragraph BC10 is not amended but provided for context. New text is underlined.

Other statutory measure

…

BC10. The XRB decided that the term "control" for the purposes of the Charities Act 2005 should have the same meaning as that set out in the relevant PBE Standards as applicable to not-for-profit entities.

BC10A. The XRB decided that the term "control" for the purposes of the Incorporated Societies Regulations 2023 should have the same meaning as that set out in the relevant XRB Standards as applicable for for-profit entities or public-benefit-entities.

Paragraph BC11 and related heading are added. New text is underlined.

Extending XRB Standards to incorporated societies

BC11. The introduction of the Incorporated Societies Act 2022 and Incorporated Societies Regulations 2023 has widened the scope of entities that are required to apply XRB Standards to include relevant incorporated societies. This legislation includes specified terms defined in XRB A2. The XRB considers that the additional paragraphs included in XRB A2 acknowledging these legislative references are consequential amendments arising from those legislative changes. Accordingly, the resulting amendments to XRB A2 were made for clarity and for completeness and therefore were not subject to separate consultation.

Appendix B

Incorporated Societies Act 2022 – section 103(2)(b)(i) 'total operating payments'

103 Definitions relating to financial reporting

(1) In this subpart,—

applicable auditing and assurance standard has the same meaning as in section 5(1) of the Financial Reporting Act 2013

generally accepted accounting practice has the same meaning as in section 8 of the Financial Reporting Act 2013

non-GAAP standard has the same meaning as in section 5(1) of the Financial Reporting Act 2013

qualified auditor has the same meaning as in section 35 of the Financial Reporting Act 2013.

(2) In this subpart, a society is, in respect of an accounting period,—

(a) a **specified not-for-profit entity** if it is such an entity in respect of that period under section 46 of the Financial Reporting Act 2013:

(b) a **small society** if,—

(i) in each of the 2 preceding accounting periods of the society, the total operating payments of the society are less than $50,000; and

(ii) as at the balance date of each of the 2 preceding accounting periods, the total current assets of the society are less than $50,000; and

(iii) at the balance date of the accounting period, the society is not an entity described in section LD 3(2) of the Income Tax Act 2007 (a donee organisation).

(3) Subsection (4) applies for the purposes of this subpart if—

(a) a society is preparing financial statements for an accounting period (the **relevant period**); but

(b) the society does not have 2 preceding accounting periods as referred to in subsection (2)(b).

Example

A society is preparing financial statements for an accounting period ending on 31 December 2026. The society was only incorporated in 2025. The society cannot apply the test as to whether it is a small society in subsection (2)(b) because it was not in existence for 2 accounting periods before the relevant period. Instead, it may apply the test in subsection (4).

---

(4) The society is a **small society** in respect of the relevant period if,—

(a) in the relevant period, the total operating payments of the society are less than $50,000; and

(b) as at the balance date of the relevant period, the total current assets of the society are less than $50,000; and

(c) at the balance date of the relevant period, the society is not an entity described in section LD 3(2) of the Income Tax Act 2007 (a donee organisation).

(5) For the purposes of this section, **total current assets** has the meaning set out in the regulations.

Incorporated Societies Regulations 2023 – section 16(2)(b) 'total operating expenditure' and 'control'

16 Annual financial statements of certain societies must be audited

(1) For the purposes of section 105 of the Act, a society that meets both of the criteria described in subclause (2) must ensure that the financial statements for an accounting period required to be prepared under section 102 of the Act are audited by a qualified auditor.

(2) The criteria are that—

(a) the society is not a charitable entity; and

(b) in each of the 2 preceding accounting periods of the society, the total operating expenditure of the society and all entities it controls (if any) is $3 million or more.

(3) A financial reporting standard (within the meaning of the Financial Reporting Act 2013), or a part of such a standard, that is expressed as applying for the purposes of subclause (2)(b) must be applied in determining whether the criterion in subclause (2)(b) is met (for example, the standard may define operating expenditure or control).

Regulation 16(2)(b): amended, on 5 October 2023, by regulation 4(1) of the Incorporated Societies Amendment Regulations 2023 (SL 2023/273).

Regulation 16(3): amended, on 5 October 2023, by regulation 4(2) of the Incorporated Societies Amendment Regulations 2023 (SL 2023/273).