Introduction

For most public benefit entities (PBEs), the transition to the PBE Standards is now complete. However, there are future changes on the horizon for PBEs, as the New Zealand Accounting Standards Board (NZASB) seeks to further improve the PBE Standards’ suite.

In December 2016, the NZASB approved a number of new PBE Standards on:
- Accounting for, and reporting on, interests in other entities (PBE IPSAS 34-38), and;
- Accounting for financial instruments (PBE IFRS 9)

In addition, in 2016 the NZASB has issued an exposure draft for a new PBE Standard on service performance reporting. At the time of writing, this proposed new standard is yet to be finalised.

The above new standards will introduce several changes in accounting and reporting requirements in the PBE space.

The new standards on interests in other entities introduce more comprehensive accounting requirements, guidance and disclosure in this area – including an amended definition of control, a new concept of “investment entity”, and an updated joint arrangements’ standard.

The new standard on financial instruments introduces a new model for classifying financial assets, a new hedge accounting model that will allow a wider range of risk management strategies to be accounted for as hedges, and a new and more forward-looking impairment model. These requirements are based on the new for-profit standard NZ IFRS 9 Financial Instruments.

The proposed new standard on service performance reporting will require not-for-profit PBEs, such as charities, to report on their service performance for the first time. For public sector PBEs that already report on service performance to comply with legislation, the proposed new standard is expected to provide more guidance with a framework for determining information to include when reporting on service performance.

By introducing the new standards on interest in other entities and on financial instruments, the NZASB is working towards keeping PBE Standards aligned as much as possible with for-profit standards and with standards recently issued by the International Public Sector Accounting Standards Board (IPSASB), which form the basis of many PBE Standards. The new standards also eliminate some of the differences that currently exist between PBE Standards and NZ IFRS, making it easier for “mixed groups” to prepare financial statements.

Importantly, the above new standards (including the proposed standard on service performance reporting) provide improvements in accounting requirements and disclosures. The new standards will benefit you as preparers of PBE financial statements as well as benefiting the users of your financial statements.

To be able to apply these new standards, you will need to understand their requirements and plan for their implementation ahead of time. To help you with this, our publication summarises the key requirements and changes introduced by the new standards, highlights considerations and potential next steps when preparing for the standards, and explains how EY can help you with implementing these new standards.

Please note: Our commentary on the detail of the proposed new standard on service performance reporting is based on the NZASB’s progress to date in developing this standard, including the conclusions reached at the NZASB meeting held in December 2016. These discussions included tentative decisions made by the NZASB after the consideration of comment letters received on the proposed new standard. The finalised standard on service performance reporting could be different to the tentative decisions made to date and should be reviewed when issued.
## Interests in other entities

### At a glance:

<table>
<thead>
<tr>
<th>Name of new standards</th>
<th>The NZASB issued the following new standards:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• PBE IPSAS 34 Separate Financial Statements</td>
</tr>
<tr>
<td></td>
<td>• PBE IPSAS 35 Consolidated Financial Statements</td>
</tr>
<tr>
<td></td>
<td>• PBE IPSAS 36 Investments in Associates and Joint Ventures</td>
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<tr>
<td></td>
<td>• PBE IPSAS 37 Joint Arrangements</td>
</tr>
<tr>
<td></td>
<td>• PBE IPSAS 38 Disclosure of Interests in Other Entities</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Standards' issue date:</th>
<th>12 January 2017</th>
</tr>
</thead>
</table>

| Why were these standards issued | To incorporate the equivalent standards issued by the IPSASB into the PBE Standards, which reflect the reforms introduced by IFRS 10, 11 and 12 in the for-profit sector in 2011. The new standards introduce into PBE Standards more comprehensive accounting requirements, guidance and disclosure around control and interests in other entities. Updating the PBE Standards for these changes will assist those “mixed groups” containing both PBEs and for-profit entities to prepare financial statements, as they remove differences that currently exist. |

<table>
<thead>
<tr>
<th>What do the standards change</th>
<th>The new standards on interests in other entities:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Introduce an amended definition of control, including extensive new guidance and examples on control. These changes could impact the determination of which entities are controlled by a PBE.</td>
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<tr>
<td></td>
<td>• Introduce the concept of “investment entity” and exempt investment entities from consolidating controlled entities (controlled entities must be recognised at fair value instead).</td>
</tr>
<tr>
<td></td>
<td>• Introduce a new classification of joint arrangements, set out the accounting requirements for each type of arrangement (joint operations and joint ventures), and remove the option of using the proportionate consolidation method.</td>
</tr>
<tr>
<td></td>
<td>• Require PBEs to disclose information on their interests in other entities, including some additional disclosures that are not currently required.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Who will these new standards apply to</th>
<th>All PBEs (public sector and not-for-profit) in Tiers 1 and 2</th>
</tr>
</thead>
</table>

| Effective date | Periods beginning 1 January 2019 (with early adoption permitted) |
Key new requirements:

1. Amended definition of control:
Control is currently defined as the power to govern the financial and operating policies of another entity to obtain benefits from that entity’s activities. The amended definition also requires the elements of power and benefit, but there is a more explicit link between these two elements:

- **Power**: Rights that give the current ability to direct another entity’s relevant activities
- **Benefits**: The advantages an entity obtains from its involvement with the other entity, which can be financial or non-financial
- **Linkage**: Ability to use power to affect nature or amount of benefits from the entity’s involvement with the other entity

The new standards also provide guidance around:
- Substantive rights, which give rise to power and may lead to control
- Protective rights, which do not constitute power or lead to control
- Network and partner agreements, and whether the right conferred by such agreements are merely protective rights that do not lead to control, or substantive rights that lead to control
- Pre-determination of another entity’s relevant activities upon establishment, which may give the establishing entity power over the entity it established and lead to control

2. New concept of “investment entity”:
Under the new standards, an investment entity is an entity that:
- Obtains funds from one or more investors for the purpose of providing them with investment management services
- Has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both
- Measures and evaluates the performance of substantially all of its investments on a fair value basis

For example, a managed investment fund would normally meet the definition of an investment entity.

Under the new standards, an a PBE that is investment entity will not consolidate its controlled entities, but must account for them as financial assets at fair value through surplus or deficit. Importantly, we note that this is different to the requirements in the for-profit space, where the fair value accounting must be unwound at the parent level and consolidation entries recognised.
3. Joint arrangements

Under current PBE Standards there are three types of joint arrangements: jointly-controlled assets, jointly-controlled operations and jointly-controlled entities. However, under the new standard there are only two types of joint arrangement: joint operations (JOs) and joint ventures (JVs). The classification of a joint arrangement as either a JO or a JV depends on the rights and obligations of the parties in the arrangement.

The following table shows how these joint arrangements are accounted for under the new standard:

<table>
<thead>
<tr>
<th>Types of joint arrangement under PBE IPSAS 37:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Joint Operations</strong></td>
</tr>
<tr>
<td><strong>Definition:</strong> Joint arrangement where the parties have rights to the assets, and obligations for the liabilities, of the arrangement.</td>
</tr>
<tr>
<td><strong>Accounting:</strong> The joint operator recognises its assets, liabilities, revenue and expenses incurred in relation to the JO, and/or share thereof incurred jointly.</td>
</tr>
</tbody>
</table>

| **Joint Ventures**                           |
| **Definition:** Joint arrangement where the parties have rights to the net assets of the joint arrangement. |
| **Accounting:** A joint venturer must recognise its interest in the JV as an investment, using the equity method of accounting. |

Please note:
Under the new standards, the proportionate consolidation method (which currently may be used under PBE IPSAS 8) will not be allowed for any type of joint arrangement.

4. Disclosure of interests in other entities

Under the new standards, a PBE should provide disclosures about:
- The nature of its interests in other entities and risks associated with them
- The effect of these interests on the PBE’s financial performance, position and cash flows
- The assessments and judgements made when determining the classifications of these interests
- Other key disclosures (e.g. judgement used to determine that the PBE is an investment entity)
Key impact for your PBEs:

- **Control:** Because of the amended definition of control and the additional PBE-specific guidance, you may need to consolidate additional entities in your PBE’s financial statements under the new standards (or, potentially, to stop consolidating certain entities).

- **Investment entities:** If your PBE is an investment entity, you will account for the entities that you control as investments at fair value through surplus or deficit, instead of completing consolidation entries. If your subsidiary is an investment entity, you will need to recognize the entities controlled by your subsidiary as investments at fair value through surplus or deficit.

- **Joint arrangements:** You will need to re-classify your joint arrangements as either a JO or a JV. Jointly-controlled assets and jointly-controlled operations are likely to be classified as JOs, whereas a jointly-controlled entity would be classified as either a JO or a JV, depending on your and the other parties' rights and obligations in relation to the arrangement. If you currently use the proportionate consolidation method to account for a joint venture, you will have to transition to the equity method, which may result in significant differences.

- **Additional disclosures:** You may need to provide additional disclosures that you do not currently provide, including about your assessment of control, non-controlling interests in your subsidiaries, and your interests in consolidated and unconsolidated structured entities.

Next steps and key considerations:

- Identify those entities over which you have control, joint control or significant influence, bearing in mind that this assessment may lead to different conclusions than the ones you previously reached under current PBE Standards.

- If you have joint arrangements, determine their classification (i.e. joint operations or joint ventures), as per the requirements of the new standards.

- Ascertain the applicable accounting requirements for your controlled entities, joint arrangements and associates, bearing in mind that these may be different to the requirements that you currently apply (note that such differences may require you to restate prior period information in your financial statements).

- Assess whether there are any structured entities among those entities that you control, and among those entities in which you have interests but no control.

- Identify whether you need to collect any additional information to be able to comply with the accounting and disclosure requirements of the new standards (e.g. your information system may need to be updated to capture additional information about interests in other entities).

Recommended EY publications:

We intend to issue a publication on the new standards on interests in other entities. This publication will provide further information on the requirements of these new standards, and will be available on the [EY PBE publications webpage](#).
# Financial instruments: PBE IFRS 9

## At a glance:

<table>
<thead>
<tr>
<th><strong>Standard’s issue date</strong></th>
<th>12 January 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Why was this standard issued</strong></td>
<td>To improve the quality and the cost-benefit aspect of accounting for and reporting on financial instruments by PBEs, reflecting the reforms introduced by NZ IFRS 9 in the for-profit sector. As the new standard may be early-adopted, it will remove complications for PBEs consolidating for-profit subsidiaries, which will have to adopt NZ IFRS 9 from 1 January 2018.</td>
</tr>
<tr>
<td><strong>What does the standard change</strong></td>
<td>The new standard:</td>
</tr>
<tr>
<td></td>
<td>• Introduces a new classification model for financial assets, which may cause PBEs to change the classification and subsequent measurement of certain financial assets</td>
</tr>
<tr>
<td></td>
<td>• Introduces a more flexible and less rules-based hedge accounting model, which will allow PBEs to apply hedge accounting to a wider range of risk management strategies</td>
</tr>
<tr>
<td></td>
<td>• Introduces a more forward-looking impairment model for financial assets, based on expected credit loss, which may cause certain assets to be impaired earlier than they would be under the current “incurred loss” model (however, this is only likely to be a significant issue for PBEs that are banks or financial institutions)</td>
</tr>
<tr>
<td></td>
<td>• Requires PBEs to provide additional disclosures about hedge accounting and impairment</td>
</tr>
<tr>
<td><strong>Who will this new standard apply to</strong></td>
<td>• All PBEs (public sector and not-for-profit) in Tiers 1 and 2</td>
</tr>
<tr>
<td><strong>Effective date</strong></td>
<td>Periods beginning 1 January 2021 (with early adoption permitted – bearing in mind that for-profit entities must apply NZ IFRS 9 in periods beginning 1 January 2018)</td>
</tr>
</tbody>
</table>
Key new requirements:

1. Classification and measurement

Financial assets:

Under PBE IFRS 9, classification of financial assets depends on the nature of the contractual cash flows to be generated from the asset and the use of assets within an entity’s business model.

Depending on these two criteria, financial assets are classified as one of the following categories, which determine how these assets are measured (amortised cost or fair value), and how the related gains and losses are presented (in surplus or deficit, or in other comprehensive revenue and expense):

- Amortised cost
- Fair value through surplus or deficit
- Fair value through other comprehensive revenue and expense (“OCRE”) – debt instruments
- Fair value through OCRE – equity instruments

The table below shows the measurement requirements and gains/losses presentation for some examples of typical financial assets under PBE IFRS 9:

<table>
<thead>
<tr>
<th>Financial assets</th>
<th>Subsequent measurement</th>
<th>Presentation of gains/losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Many simple debt instruments</td>
<td>Continue to be measured at amortised cost</td>
<td>In surplus or deficit (e.g. impairment losses)</td>
</tr>
<tr>
<td>(e.g. short-term receivables from exchange and non-exchange transactions, basic loans to other entities, basic concessionary loans, basic deposits)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More complex debt instruments, where the cash flows that you are entitled to are not solely principal and interest (e.g. convertible bonds)</td>
<td>Measured at fair value</td>
<td>In surplus or deficit</td>
</tr>
<tr>
<td>Derivatives</td>
<td>Measured at fair value</td>
<td>In surplus or deficit*</td>
</tr>
<tr>
<td>Equity instruments that are held for trading (e.g. shares/units in other entities that are held for trading)</td>
<td>Measured at fair value</td>
<td>In surplus or deficit</td>
</tr>
<tr>
<td>Equity instruments that are not held for trading and are designated as fair value through OCRE (e.g. shares/units in other entities, including unlisted entities, which are not held for trading)</td>
<td>Measured at fair value</td>
<td>In other comprehensive revenue and expense (No impairment through surplus or deficit; gains/losses never “recycle” through surplus or deficit)</td>
</tr>
</tbody>
</table>

* If hedge accounting is not applied

Financial liabilities:

The only change in respect of financial liabilities is that for those designated at fair value through surplus or deficit, fair value changes attributable to own credit risk are presented in other comprehensive revenue and expense instead of profit or loss.
2. Impairment

PBE IFRS 9 introduces a new ‘expected credit loss’ (ECL) impairment model, which replaces the current ‘incurred loss’ model in PBE IPSAS 29. Under the ECL impairment model in PBE IFRS 9, an entity is required to identify possible future defaults by the counterparty, and recognise the expected credit loss arising from these possible defaults as impairment.

The new model applies to financial assets measured at amortised cost, debt instruments measured at fair value through other comprehensive revenue and expense, financial guarantees, loan commitments, lease receivables.

The table below shows the approaches under the new impairment model for typical financial assets:

<table>
<thead>
<tr>
<th>Receivables from exchange and non-exchange transactions, lease receivables</th>
<th>Accounting policy choice - may choose either:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simplified approach, under which impairment losses are recognised based on the “lifetime” expected losses (i.e. future defaults expected to occur over the lifetime of the asset).</td>
<td>OR: General approach (please see below)</td>
</tr>
</tbody>
</table>

| Most loans, debt securities, loan commitments and financial guarantee contacts | General approach (more complex approach), under which impairment losses are recognised initially based on the expected losses for the next 12 months. However, if the credit risk associated with the asset deteriorates, impairment losses are recognised based on the “lifetime” expected losses. |
3. Hedge accounting
PBE IFRS 9 aims to:

• Simplify the existing hedge accounting rules
• Allow entities to better reflect in their financial statements how the entity manages its risk and the extent to which hedging mitigates those risks
• Allows more risks to be hedged for accounting purposes

The table below shows some advantages, neutral impacts and disadvantages of the new hedge accounting rules.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>No change or neutral impact</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Hedging of risk components is permitted</td>
<td>• Hedge documentation required at inception</td>
<td>• Must continue hedge accounting if the qualifying criteria still met; voluntarily de-designation of hedging relationship is prohibited if risk management objective remains the same</td>
</tr>
<tr>
<td>• Less volatility in surplus or deficit due to the exclusion of time value of options, forward points of forward contacts and FX basis spread</td>
<td>• 3 types of hedge relationships remain the same</td>
<td>• Disclosure (PBE IPSAS 30) is more onerous</td>
</tr>
<tr>
<td>• Elimination of the 80-125% quantitative threshold for recognising effectiveness</td>
<td>• Cash Flow Hedge</td>
<td></td>
</tr>
<tr>
<td>• No retrospective effectiveness testing</td>
<td>• Fair Value Hedge</td>
<td></td>
</tr>
<tr>
<td>• Expanded ability to hedge net positions / hedge layers of hedged items in fair value hedges</td>
<td>• Net Investment Hedge</td>
<td></td>
</tr>
<tr>
<td>• Ability to hedge components of risk such as the oil component of ship fuel purchases</td>
<td>• Ineffectiveness is still measured and booked</td>
<td></td>
</tr>
</tbody>
</table>

Key impact for your PBEs:

► Classification of financial assets: The new financial asset classification model in PBE IFRS 9 is somewhat different to the current classification model in PBE IPSAS 29 - in terms of the categories themselves, the criteria that assets must meet to fall into these categories, and the accounting treatment of the categories. This means that you may need to change how you account for certain financial assets

► Hedge accounting: The new hedge accounting requirements in PBE IFRS 9 should result in more risk management strategies qualifying for hedge accounting, which should better reflect your risk management strategy in your financial statements. You may be allowed to apply hedge accounting in certain areas where you currently do not apply hedge accounting. However, there will also be a significant increase in disclosure relating to hedges

► Impairment of financial assets: Many receivables and simple loans are unlikely to be significantly affected by the new impairment model in PBE IFRS 9. However, more complex financial assets (e.g. certain bonds) may become impaired sooner under the new standard than under current PBE Standards, and you will need to keep track of the credit risk arising from these assets

Next steps and key considerations:

• Determine what category your financial assets will be classified as under PBE IFRS 9, and whether you must change your accounting or presentation for any of these assets

• For your debt instruments measured at amortised cost, determine whether you can use the “simplified” approach to impairment, or whether you need to use the “general” approach and therefore keep track of changes in credit risk

• Assess whether certain risks and risk management strategies that you do not currently apply hedge accounting to will be eligible for hedge accounting under PBE IFRS 9, and determine whether it is beneficial to designate them as hedges

• Ascertain the differences between your current disclosure requirements for financial instruments and the requirements under PBE IFRS 9

• Identify whether you need to collect any additional information to be able to comply with the accounting and disclosure requirements of PBE IFRS 9 (e.g. information about changes in credit risk)

Recommended EY publications:

• We intend to issue a publication about PBE IFRS 9. This publication will provide further information on the requirements of this new standard, and will be available on the EY PBE publications webpage.
Service Performance Reporting (proposed standard)

At a glance:

| Why is this standard being issued | The primary objective of a PBE is to provide goods and services for community or social benefit. Service performance information that shows how an entity achieves its primary objective will enhance a PBE’s accountability to users of its financial statements, and assists these users’ decision-making. However, currently there is no specific PBE Standard that focuses on service performance reporting. |
| What will the standard require | The standard is expected to require PBEs to report on their service performance by disclosing both contextual information about the entity’s mission and purpose, and information about its service performance during the year, such as what the entity did during the year (in terms of goods produced and services delivered), and other quantitative or qualitative measures and descriptions of its service performance. |
| Who will this new standard apply to | • All not-for-profit PBEs in Tiers 1 and 2 • All public sector PBEs whose legislation requires them to provide service performance information • (Public sector PBEs whose legislation does not require the preparation of service performance information are encouraged, but not required, to apply this standard) |
| Proposed effective date | • To be determined; potentially 2020. The standard is expected to be approved in 2017, and it is expected to have at least a two-year implementation period |

Key impact for your entity:

• Service performance reporting (as part of the general purpose financial report) will be a new requirement for most not-for-profit PBEs. Therefore not-for-profit PBEs will need to determine and collate information on their service performance

• Most public sector PBEs already report on their service performance to comply with legislation. However, the proposed new standard is expected to provide additional guidance for public sector PBEs, with a framework for determining information to include when reporting on service performance

Next steps:

The NZASB is expected to continue its discussions on service performance reporting at its March 2017 meeting.

Recommended EY publications:

We intend to issue a publication about the new standard on service performance reporting, once this standard is approved. This publication will provide further information on the requirements of the new standard, and will be available on the EY PBE publications webpage.
Next steps

In EY’s experience, planning is vital for projects on implementation of new accounting standards. We encourage all PBEs, as a minimum, to complete a diagnostic phase. The scope of this phase depends on each entity and the complexity of its organisational structure and operations. An effective diagnostic phase will set the stage and help facilitate the availability of sufficient resources. It is advisable to perform this phase as early as possible.

How EY can help

Based on EY’s experience, the most effective approach to projects on implementation of new standards is to proceed step-by-step and involve a wide range of functions, including accounting, tax (if applicable), systems and IT professionals.

We have deep experience in the implementation of new accounting standards and have developed insights on different aspects of the major changes, both global and local, for the new PBE Standards.

We can support your organisation through any and all stages of the project using our experience and various proprietary tools.

We approach transition to the new standards in practical steps …

… so you stay in control from the beginning to the end.
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