New Accounting Standards and Interpretations for Tier 1 For-profit Entities

For 30 June 2023 year-end reports

New and changed requirements

We provide you with an overview of the accounting pronouncements issued by the New Zealand Accounting Standards Board (NZASB or the Board) as of 30 June 2023, which:

- Must be applied for the first time for 30 June 2023 year-ends. They are contained in yellow boxes.
- May be applied early for 30 June 2023 year-ends if specific criteria are met. They are contained in grey boxes.

Implementing new accounting standards often impacts entities beyond their financial reporting functions. We hope that this publication will:

- Support you in having better conversations about accounting changes with your stakeholders
- Help you respond in a timely manner to all accounting changes in your next financial report
- Keep you focused on future changes in financial reporting, and their impact on your implementation efforts

Accounting change disclosures

Financial statements are required to:

- Present the impact of the initial application of new accounting standards applied
- Disclose the possible impact of the initial application of forthcoming accounting standards not yet applied, or if the impact is not known or estimable, a statement to that effect

Please note that Tier 2 for-profit entities applying the *Reduced Disclosure Requirements* are not required to disclose the possible impact of accounting pronouncements issued, but adoption has not yet commenced.

Remain alert to further changes

This publication is updated as of 30 June 2023. Any pronouncements issued afterwards (up until the date of authorisation of your financial report) must also be considered. Our Eye on Reporting publications will keep you informed of further changes.

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[1] For full access to NZ IFRSs please visit https://www.xrb.govt.nz/.
[2] Commences annual reporting periods beginning on or after this date
[3] Assuming that the entity has not early adopted the pronouncement according to specific provisions in the Standard.

[4] The ability to early adopt new standards and amendments will depend on the specific commencement and application date requirements of each new standard or amendment.

Catalogue of IFRIC agenda decisions

Financial instruments

Amendment to NZ IFRS 9 - Fees in the '10 per cent' Test for Derecognition of Financial Liabilities (Part of Annual Improvements NZ IFRSs 2018-2020 Cycle[5])

Commences to apply for annual reporting periods beginning on or after 1 January 2022

Under NZ IFRS 9, an existing financial liability that has been modified or exchanged is considered extinguished when the contractual terms of the new liability are substantially different, measured by the '10 per cent' test. That is, when the present value of the cash flows under the new terms, including any fees paid or received, is at least 10 per cent different from the present value of the remaining cash flows of the original financial liability.

The amendment to NZ IFRS 9 clarifies that fees included in the '10 per cent' test are limited to fees paid or received between the borrower, and the lender, including amounts paid or received by them on the other's behalf. When assessing the significance of any difference between the new, and old contractual terms, only the changes in contractual cash flows between the lender, and borrower are relevant. Consequently, fees incurred on the modification or exchange of a financial liability paid to third parties are excluded from the '10 per cent' test.

[5] Refer to the New Pronouncements for the title and topics covered by this standard.

Group accounts

Amendments to NZ IFRS 10, NZ IAS 28 - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

Commences to apply annual reporting periods beginning on or after 1 January 2025

The amendments to NZ IFRS 10 *Consolidated Financial Statements* and NZ IAS 28 *Investments in Associates and Joint Ventures* clarify that a full gain or loss is recognised when a transfer to an associate or joint venture involves a business as defined in NZ IFRS 3. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture.

These amendments are applied prospectively. Earlier application is permitted if requirements are met.

Insurance contracts

NZ IFRS 17 Insurance Contracts

Commences to apply annual reporting periods beginning on or after 1 January 2023

NZ IFRS 17 replaces NZ IFRS 4 *Insurance Contracts*. NZ IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance, and re-insurance), regardless of the type of entity that issues them, as well as to certain guarantees, and financial instruments with discretionary participation features.

In contrast to the requirements in NZ IFRS 4, which are largely based on grandfathering previous local accounting policies, NZ IFRS 17 provides a comprehensive accounting model for insurance contracts. The core of NZ IFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach)
- A simplified approach (the premium allocation approach) mainly for short-duration contracts

The main features of the new accounting model for insurance contracts are as follows:

- The measurement of insurance liabilities at the present value of future cash flows, incorporating an explicit risk adjustment, remeasured every reporting period (the fulfilment cash flows)
- The concept of a Contractual Service Margin (CSM), representing the unearned profit on the insurance contracts to be recognised in profit or loss over the coverage period
- Certain changes in the expected present value of future cash flows are adjusted against the CSM and thereby recognised in profit or loss over the remaining coverage period
- The effect of changes in discount rates is reported in either profit or loss or other comprehensive income, determined by an accounting policy choice
- Amounts that the policyholder will always receive, regardless of whether an insured event happens (non-distinct investment components) are not presented in the income statement, but are recognised directly on the balance sheet

Entities are allowed to adopt NZ IFRS 17 using either a full retrospective approach, modified retrospective approach or fair value approach.

Earlier application is permitted, if requirements are met, and provided that the entity also applies NZ IFRS 9, and NZ IFRS 15 *Revenue from Contracts with Customers* on or before the date it first applies NZ IFRS 17.

Resources

Insurance Accounting Alerts (March 2023)

Insurance Accounting Alert (June 2020)

Applying IFRS 17: A closer look at the new Insurance Contracts Standard (June 2021)

Insurance Accounting Alert (July 2021)

Good Life Insurance (International) Limited (November 2021)

Insurance Accounting Alert (December 2021)

Insurance Accounting Alert (February 2022)

Insurance Accounting Alert (March 2022)

Insurance Accounting Alert (June 2022)

Insurance Accounting Alert (September 2022)

Disclosure of expected impacts of IFRS 17 and IFRS 9 prior to initial application (November 2022)

Insurance contracts

Amendments to NZ IFRS 17 Insurance Contracts

Commences to apply for annual reporting periods beginning on or after 1 January 2023

To simplify implementation of NZ IFRS 17, the NZASB made the following key amendments:

- Deferring the commencement date of NZ IFRS 17 and NZ IFRS 9 for insurers by two years to annual periods beginning on or after 1 January 2023
- Excluding additional contracts from the scope of NZ IFRS 17, such as loans that include an agreement by the lender to compensate the borrower - by waiving some or all the payments due from the borrower - if a specified uncertain event occurs (for example, if the borrower dies), and credit card contracts that provide insurance coverage for purchases made using the credit card
- Permitting policy acquisition costs (such as commissions paid to brokers) to be allocated to related expected contract renewals, recognising those costs as an asset until contract renewal takes place
- Requiring the expected profit on insurance contracts to be recognised in a pattern acknowledging both insurance coverage and any included investment activity services
- Allowing the use of the risk mitigation accounting option when reinsurance contracts or non-derivative financial instruments measured at fair value through profit or loss, are used to mitigate the effects of the time value of money and other financial risks
- Reducing a potential accounting mismatch for reinsurance contracts by requiring the holder of a reinsurance contract to recognise a gain on that contract when it recognises a loss on initial recognition of an onerous group of insurance contracts covered by the reinsurance contract, or on the addition of further onerous contracts to that group
- Simplifying the presentation of insurance contract assets and liabilities in the statement of financial position using broader portfolios of insurance contracts rather than narrower groups of insurance contracts
- Introducing additional transition relief mechanisms

In January 2022, the NZASB added a transition option for a ‘classification overlay’ to address possible accounting mismatches between financial assets and insurance liabilities in the comparative information presented on initial application of NZ IFRS 17.

If an entity elects to apply the classification overlay, it can only do so for comparative periods to which it applies NZ IFRS 17 (i.e., from application date to the date of initial application of NZ IFRS 17).

The amendments are applied when an entity applies NZ IFRS 17.

Leases

Amendments to NZ IFRS 16 - Lease Liability in a Sale and Leaseback

Commences to apply for annual reporting periods beginning on or after 1 January 2024

In November 2022, the Board issued Lease Liability in a Sale and Leaseback (Amendments to NZ IFRS 16).

The amendment to NZ IFRS 16 specifies the requirements that a seller-lessee uses in measuring the lease liability arising in a sale and leaseback transaction, to ensure the seller-lessee does not recognise any amount of the gain or loss that relates to the right of use it retains.

After the commencement date in a sale and leaseback transaction, the seller-lessee applies paragraphs 29 to 35 of NZ IFRS 16 to the right-of-use asset arising from the leaseback, and paragraphs 36 to 46 of NZ IFRS 16 to the lease liability arising from the leaseback. In applying paragraphs 36 to 46, the seller-lessee determines 'lease payments' or 'revised lease payments' in such a way that the seller-lessee would not recognise any amount of the gain or loss that relates to the right of use retained by the seller-lessee. Applying these requirements does not prevent the seller-lessee from recognising, in profit or loss, any gain or loss relating to the partial or full termination of a lease, as required by paragraph 46(a) of NZ IFRS 16.

The amendment does not prescribe specific measurement requirements for lease liabilities arising from a leaseback. The initial measurement of the lease liability arising from a leaseback may result in a seller-lessee determining 'lease payments' that are different from the general definition of lease payments in Appendix A of NZ IFRS 16. The seller-lessee will need to develop, and apply an accounting policy that results in information that is relevant, and reliable in accordance with NZ IAS 8.

Transition

A seller-lessee applies the amendment to annual reporting periods beginning on or after 1 January 2024. Earlier application is permitted if specific criteria is met, and that fact must be disclosed.

A seller-lessee applies the amendment retrospectively in accordance with IAS 8 to sale and leaseback transactions entered into after the date of initial application (i.e., the amendment does not apply to sale and leaseback transactions entered into prior to the date of initial application). The date of initial application is the beginning of the annual reporting period in which an entity first applied IFRS 16.

Resource

IFRS Developments Issue 206: IASB amends IFRS 16 for lease liability measurement in a sale and leaseback transactions (September 2022)

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Other topics

Amendments to NZ IFRS 3 - Reference to the Conceptual Framework

Commences to apply for annual reporting periods beginning on or after 1 January 2022

The assessment of applying the revised definitions of assets and liabilities in the *Conceptual Framework* to business combinations showed that the problem of day 2 gains or losses would be significant only for liabilities that an acquirer accounts for after the acquisition date by applying NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IFRIC 21 *Levies*. The Board updated NZ IFRS 3 in May 2020 for the revised definitions of an asset and a liability and excluded the application of the *Conceptual Framework* to liabilities and contingent liabilities within the scope of NZ IAS 37 or IFRIC 21.

The NZASB released the equivalent amendments to NZ IFRS 3 in June 2020.

These amendments are applied prospectively. Earlier application is permitted, if requirements are met and if the entity adopts the *Conceptual Framework* at the same time or earlier.

Resource

IFRS Developments Issue 169: Amendments to IFRS 3 - Reference to the Conceptual Framework (May 2020)

Amendments to NZ IAS 16 - Property, Plant and Equipment: Proceeds before Intended Use

Commences to apply for annual reporting periods beginning on or after 1 January 2022

Under NZ IAS 16 *Property, Plant and Equipment*, net proceeds from selling items produced while constructing an item of property, plant and equipment[6] are deducted from the cost of the asset. The research indicated practical diversity in interpreting this requirement. As a result, NZ IAS 16 was amended to prohibit an entity from deducting from the cost of an item of property, plant and equipment, the proceeds from selling items produced before that asset is available for use. An entity is also required to measure production costs of the sold items by applying NZ IAS 2 *Inventories*. Proceeds from selling any such items, and the cost of those items, are recognised in profit or loss in accordance with applicable standards.

These amendments are applied retrospectively, but only to items of property, plant and equipment that are 'ready to use' on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendments – 'ready to use' meaning the asset is in the location and condition necessary to be capable of operating in the manner intended by management.

Earlier application permitted if requirements met.

Resource

IFRS Developments Issue 155: Revenue earned before an asset is ready for its intended use (November 2019)

[6] An item of property, plant and equipment under construction may be capable of producing saleable items (e.g., samples produced when testing whether the asset is functioning properly) while not yet capable of operating in the manner intended by management (i.e., before depreciation of the asset begins).

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Other topics

Amendment to NZ IAS 41 -Taxation in Fair Value Measurements (Part of Annual Improvements NZ IFRSs 2018-2020 Cycle [7])

Commences to apply for annual reporting periods beginning on or after 1 January 2022

When using a present value technique to measure fair values of assets within the scope of NZ IAS 41 *Agriculture*, taxation cash flows are not included. While NZ IFRS 13 *Fair Value Measurement* does not prescribe an entity to use a particular present value technique [8] to measure fair value, it requires assumptions about cash flows and discount rates to be internally consistent. Depending on facts and circumstances, an entity applying a present value technique might measure fair value by discounting after-tax cash flows using an after-tax discount rate or pre-tax cash flows at a pre-tax discount rate.

The NZASB has removed from NZ IAS 41 the requirement to exclude taxation cash flows when measuring fair value. Such removal aligns with the principles of fair value measurement in NZ IFRS 13.

The amendment is applied prospectively. Earlier application is permitted if requirements are met.

Amendments to NZ IAS 37 - Onerous Contracts - Cost of Fulfilling a Contract

Commences to apply for annual reporting periods beginning on or after 1 January 2022

NZ IAS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Unavoidable cost is the lower of the:

- Cost of fulfilling the contract and
- Any compensation or penalties arising from failure to fulfil it

NZ IAS 37 does not specify which costs to include in determining the cost of fulfilling a contract. Consequently, NZ IAS 37 was amended to clarify that when assessing whether a contract is onerous, the cost of fulfilling the contract comprises all costs that relate directly to the contract, which includes both the:

- Incremental costs of fulfilling that contract (e.g., materials and labour) and
- An allocation of other costs that relate directly to fulfilling contracts (e.g., depreciation of property, plant and equipment)

An entity shall apply these amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments (the date of initial application).

Comparative information is not restated. Instead, the cumulative effect of initially applying the amendments is recognised as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application.

Earlier application permitted if requirements met.

[7] Refer to the New Pronouncements for the title and topics covered by this standard.

[8] Present value techniques differ in how they adjust for risk and in the type of cash flows they use.

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Other topics

Amendment to NZ IFRS 1 - Subsidiary as a First-time Adopter (Part of Annual Improvements to NZ IFRSs 2018-2020 Cycle [9])

Commences to apply for annual reporting periods beginning on or after 1 January 2022

Under NZ IAS 21 *The Effects of Changes in Foreign Exchange Rates*, an entity is required to determine its own functional currency, being the currency of the primary economic environment in which it operates. Where a group contains individual entities with different functional currencies, the group's consolidated financial statements are presented in a common currency through a translation process prescribed by NZ IAS 21. Exchange differences arising from translating the results and financial position of the individual entities or foreign operations[10], commonly known as 'cumulative translation differences', are accumulated in a separate component of equity.

A subsidiary that adopts NZ IFRSs later than its parent is required to recognise cumulative translation differences at its date of transition to NZ IFRSs either at zero or on a retrospective basis under NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards*. Consequently, the subsidiary might have been required to keep two parallel sets of accounting records for cumulative translation differences based on different dates of transition to NZ IFRSs.

Acknowledging that some entities find this requirement burdensome, the NZASB simplified the application of NZ IFRS 1, permitting a subsidiary to measure cumulative translation differences for all foreign operations at the carrying amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to NZ IFRSs, excluding the impact of any adjustments made for consolidation procedures and for the business combination in which the parent acquired the subsidiary.

This exemption is also available to an associate or joint venture adopting NZ IFRSs later than its investor.

Earlier application is permitted if requirements are met.

[9] Refer to the New Pronouncements for the title and topics covered by this standard.
[10] A foreign operation is an entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

Other topics

Amendments to NZ IAS 1 - Classification of Liabilities as Current or Non-current

Amendments to NZ IAS 1 Non-current Liabilities with Covenants

Commences to apply for annual reporting periods beginning on or after 1 January 2024

A liability is classified as current if the entity has no right at the end of the reporting period to defer settlement for at least 12 months after the reporting period. The NZASB recently issued amendments to NZ IAS 1 to clarify the requirements for classifying liabilities as current or non-current. Specifically:

- The amendments specify that the conditions which exist at the end of the reporting period are those which will be used to determine if a right to defer settlement of a liability exists.
- Management intention or expectation does not affect classification of liabilities.
- In cases where an instrument with a conversion option is classified as a liability, the transfer of equity instruments would constitute settlement of the liability for the purpose of classifying it as current or non-current.

A consequence of the first amendment is that a liability would be classified as current if its repayment conditions failed their test at reporting date, despite those conditions only becoming effective in the 12 months after the end of the reporting period.

In response to this possible outcome the NZASB issued Amendments to NZ IAS 1 *Non-current Liabilities with Covenants* in May 2023.

The updated amendments:

- Clarify that only covenants with which an entity must comply on or before the reporting date will affect a liability's classification as current or non-current
- Add presentation, and disclosure requirements for non-current liabilities subject to compliance with future covenants within the next 12 months
- Clarify specific situations in which an entity does not have a right to defer settlement for at lease 12 months after reporting date

Management expectations

NZ IAS 1.75A clarifies that the 'classification of a liability is unaffected by the likelihood that the entity will exercise its right to defer settlement of the liability for at least twelve months after the reporting period'. That is, management's intention to settle in the short run does not impact the classification. This applies even if settlement has occurred when the financial statements are authorised for issuance.

These amendments are applied prospectively. Earlier application permitted if requirements met.

IFRS Developments Issue 209: The IASB amends the requirements for classification of non-current liabilities with covenants (November 2022)

Other topics

Amendments to NZ IAS 1 - Disclosure of Accounting Policies

Commences to apply for annual reporting periods beginning on or after 1 January 2023

In the absence of a definition of the term 'significant' in NZ IFRS, the NZASB decided to replace it with 'material' in the context of disclosing accounting policy information. 'Material' is a defined term in NZ IFRS and is widely understood by the users of financial statements.

Material accounting policy information is defined as follows in paragraph 117 of NZ IAS 1 "Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements."

Earlier application is permitted if requirements are met.

Resource

IFRS Developments Issue 187: The Disclosure Initiative - IASB amends the accounting policy requirements

Amendments to NZ IAS 8 - Definition of Accounting Estimates

Commences to apply for annual reporting periods beginning on or after 1 January 2023

The amendments are designed to clarify the distinction between changes in accounting estimates, and changes in accounting policies, and the correction of errors.

In the amended standard, accounting estimates are now defined as, "monetary amounts in financial statements that are subject to measurement uncertainty".

Earlier application is permitted if requirements are met.

Resource

IFRS Developments Issue 186: The IASB defines accounting estimates

Other topics

Amendment to NZ IAS 12 - Deferred Tax related to Assets and Liabilities arising from a Single Transaction

Commences to apply for annual reporting periods beginning on or after 1 January 2023

The amendment narrows the scope of the recognition exemption under NZ IAS 12 *Income Taxes* so that it would not apply to transactions that give rise to equal amounts of taxable, and deductible temporary differences.

Such situations can arise on the recognition of a right of use asset, and a lease liability when commencing a lease. It can also arise on the recognition of decommissioning, restoration, and similar liabilities with corresponding amounts included in the cost of the related asset.

The amendment clarifies that where payments that settle a liability are deductible for tax purposes, it is a matter of judgement (having considered the applicable tax law) whether such deductions are attributable for tax purposes to the liability recognised in the financial statements (and interest expense) or to the related asset component (and interest expense). This judgement is important in determining whether any temporary differences exist on initial recognition of the asset, and liability.

In the amended standard, the initial recognition exception does not apply to transactions that, on initial recognition, give rise to equal taxable, and deductible temporary differences. It only applies if the recognition of a lease asset, and lease liability (or other liability, and asset such as decommissioning obligations) gives rise to taxable, and deductible temporary differences that are not equal.

Nevertheless, it is possible that the resulting deferred tax assets and liabilities are not equal (e.g., if the entity is unable to benefit from the tax deductions or if different tax rates apply to the taxable and deductible temporary differences). In such cases, which is expected to occur infrequently, an entity would need to account for the difference between the deferred tax asset and liability in profit or loss.

Earlier application is permitted if requirements are met.

Resource

IFRS Developments Issue 191: IASB clarifies deferred tax accounting for leases and decommissioning obligations

Other topics

Amendment to NZ FRS 44 - Disclosure of Fees for Audit Firms' Services

Commences to apply for annual reporting periods beginning on or after 1 January 2024

The amendment aims to address concerns about the quality, and consistency of disclosures an entity provides about fees paid to its audit or review firm for different types of services.

The enhanced disclosures are expected to improve the transparency, and consistency of disclosures about fees paid to an entity's audit or review firm.

Entities are required to disclose the fees incurred for services received from their audit or review firm, and a description of each service, using the following specified categories:

- Audit or review of the financial statements
- Other services:
  - audit or review related services
  - other assurance services, and other agreed-upon procedures engagements
  - taxation services
  - other services

Tier 2 entities have reduced requirements, and are required to disclose:

- the total fee incurred for the audit or review of the financial statements; and
- the total fees for any other services together with a general description of those services

Resource

Disclosure of fees for audit firms' services - illustrative example

Interpretations and agenda decisions

The IFRS Interpretations committee (IFRIC) issued no recent interpretations. However, it issued several agenda decisions on matters brought to its attention. Whilst IFRIC agenda decisions do not add or change requirements in NZ IFRS, entities are required to consider explanatory material in an applicable agenda decision when applying NZ IFRS.

Entities need to consider the impact of each agenda decision, based on their circumstances, and possibly adopt a change in policy. Agenda decisions do not have commencement dates and so commence when issued. However, entities are entitled to sufficient time[11] to assess impacts and make required changes.

Below we summarise all IFRIC agenda decisions published during the period from 1 July 2021 to 30 June 2023.

Non-refundable Value Added Tax on Lease Payments – October 2021

The IFRIC discussed lessee accounting for any non-refundable value added tax (VAT) charged on lease payments. The question is whether the lessee includes non-refundable VAT as part of the lease payments of a lease.

Outreach conducted by the IFRIC and comment letters on the tentative agenda decision provided limited evidence as to whether the issue is material or receiving diverse accounting treatment. For this reason, the IFRIC provided no guidance.

Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition – October 2021

The IFRIC discussed warrants that give the holder a right to buy a fixed number of the issuer's own equity instruments for an exercise price that will be fixed at a future date. Such warrants are initially classified by the issuer as a financial liability as the fixed-for fixed condition12 is not met.

The question was whether the warrants should be reclassified as equity once the exercise price is fixed, as the fixed-for-fixed condition would at that stage be met.

The IFRIC noted that IAS 32 *Financial Instruments: Presentations* contains no general requirement for reclassifying financial liabilities or equity instruments when their contractual terms are unchanged.

However, the issue has been identified as a practice issue to be considered in Financial Instruments with Characteristics of Equity (FICE) project.

Economic Benefits from Use of a Windfarm – December 2021

The IFRIC discussed whether an agreement between an electricity retailer and a windfarm generator contains a lease under IFRS 16.

Both parties are registered participants in an electricity market and make purchases and sales via the electricity grid. The agreement:

- Swaps the spot price received by the windfarm for electricity supplied to the grid for a fixed price for a 20- year period
- Transfers to the retailer all the renewable energy credits earned by the windfarm

[11] The IASB advised that 'sufficient time' will depend on the particular facts and circumstances. Refer IFRS feature article: Agenda decisions - time is of the essence.

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The agreement, however, conveys neither the right nor the obligation for the retailer to obtain any of the electricity the windfarm produces and supplies to the grid. The agreement results in the retailer settling the difference between the fixed price and the spot price of electricity the windfarm supplies to the grid.

Therefore, the IFRIC noted that this agreement does not contain a lease.

Targeted longer-term refinancing operations (TLTROs) transactions – March 2022

The IFRIC discussed how to account for the third program of the TLTROs of the European Central Bank. The TLTROs link the amount that a participating bank can borrow, and the interest rate the bank pays on each tranche of borrowings, to the volume and amount of loans it makes to non-financial corporations and households.

The IFRIC discussed whether the TLTROs transactions should be accounted for by the borrowing bank applying IFRS 9 or IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, given they may have below-market interest rates.

The IFRIC observed that:

- IFRS 9 is the starting point, while IAS 20 provides an adequate basis to assess whether the TLTROs transactions contain a portion that is treated as a government grant, such as a below-market interest rate.
- Determining whether an interest rate is a below market rate requires judgement based on the specific facts and circumstances.

The IFRIC further considered the impact of conditions creating uncertainty about future interest rates, impacting the estimation of effective interest rates and measurement of the financial liability. This issue was considered too broad for IFRIC, which recommended that it be considered as a part of the post-implementation review of IFRS 9.

Demand Deposits with Restrictions on Use arising from a Contract with a Third Party – April 2022

The IFRIC discussed whether a demand deposit which is subject to contractual restrictions on use is a part of cash and cash equivalents.

In this situation, terms and conditions of the demand deposit do not restrict the use of the funds. However, the entity has a contractual obligation with a third party to keep specified amounts in the deposit account and to use the funds only for specified purposes.

The IFRIC noted that third party restrictions on use do not change the nature of the deposit. Therefore, it concluded that this demand deposit forms a part of cash and cash equivalents. When relevant, the entity presents this as an additional line item within the cash and cash equivalents note. The deposit should be classified as a current asset, unless restrictions over its exchange or use to settle a liability apply for at least 12 months from the reporting date.

Principal versus Agent: Software Reseller– May 2022

The IFRIC discussed whether a reseller of software licences is operating as a principal or agent.

In the situation considered, the reseller provides pre-sale advice to customers, negotiates price and places orders on behalf of each customer.

Should the reseller order software licences that do not meet the customer needs, the customer can reject the order. If this happens, the reseller bears the loss as it cannot return the licences or resell them to another customer.

The software manufacturer provides the software licence under an agreement between the manufacturer and the customer.

The IFRIC noted that pre-sale advice is not an implicit promise in the contract with the customer. Therefore, the software licence is the only promised good and service in the reseller's contract with the customer.

The IFRIC noted that the reseller would be a principal if it controlled the software licences before transferring them to customers.

It also noted that assessing whether the reseller obtains control of the software before transferring it to customers requires consideration of all facts and circumstances, which include the terms and conditions of the contracts between the reseller and the customer, the reseller and the software manufacturer, and the software manufacturer and the customer.

It was concluded that IFRS accounting standards provide an adequate basis to determine whether the reseller was a principal; however, no conclusion was reached for the fact pattern discussed.

Negative Low Emission Vehicle Credits – July 2022

The IFRIC discussed whether particular government measures to encourage reductions in vehicle carbon emissions give rise to obligations that meet the definition of a liability under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

In the situation considered, entities receive positive or negative credits for produced or imported vehicles whose average fuel emissions are lower or higher than a government target. Entities are required to eliminate negative credits by surrendering or obtaining, either by purchasing from another entity or by generating more in the next year, positive credits. Failing to eliminate negative credits could result in government - imposed sanctions such as restricting access to the market. The sanctions would not involve fines or penalties, or any other outflow of economic benefit resources.

In considering whether an entity that has negative credits has a present obligation that represents an IAS 37 liability, the IFRIC noted that either method of settling the negative credits would result in an outflow of resources.

It also noted that if an entity has produced or imported vehicles that do not meet the government target, an obligation has arisen from past events and exists independently of the entity's future actions.

The IFRIC concluded that the government measures could create a legal obligation if accepting the sanctions for non-settlement is not a realistic alternative for the entity. It also observed, however, that determining whether accepting sanctions is a realistic alternative requires judgement and will depend on the nature of the sanctions and the entity's specific circumstances. If an entity determines that it has no legal obligation to eliminate its negative credits, it will then need to consider whether it has a constructive obligation to do so.

It was concluded that IFRS accounting standards provide an adequate basis to determine whether the entity has an obligation that meets the definition of a liability under IAS 37; however, no conclusion was reached for the fact pattern discussed.

Special Purpose Acquisition Companies (SPAC): Classification of Public Shares as Financial Liabilities or Equity – July 2022

The IFRIC considered an issue relating to the assessment of shareholders' contractual rights when classifying public shares issued by a SPAC as financial liabilities or equity. A SPAC is a listed entity established to acquire a yet-to-be-identified target entity.

In the fact pattern discussed, a SPAC issues two classes of shares, class A (founder shares) and class B (public shares). Class B shareholders, along with class A shareholders, have the contractual right to extend the SPAC's life indefinitely if no target entity is acquired, avoiding a reimbursement of the Class B shares. The question asked is whether the shareholders' decision to extend the SPAC's life is considered to be within the control of the SPAC.

The IFRIC observed that IAS 32 includes no requirements on how to assess whether a decision of shareholders is treated as a decision of the entity and also acknowledged that similar questions about shareholder decisions arise in other circumstances.

However, the issue has been identified as a practice issue to be considered in the Financial Instruments with Characteristics of Equity (FICE) project.

Transfer of Insurance Coverage under a Group of Annuity Contracts - July 2022

The IFRIC discussed the method to determine the amount of the contractual service margin (CSM) to be recognised in a period for a group of annuity contracts. The amount of CSM recognised needs to reflect the provision of insurance services during the period.

Under the groups of annuity contracts described, policyholders pay the premium upfront with no right to cancel or seek a refund. They receive periodic payments from the start of the annuity period for as long as they survive but receive no other services under the contracts. The group includes both contracts that have an immediate annuity and those that have a deferred annuity.

In considering an appropriate method for determining the benefits of insurance coverage provided in the current period and expected to be provided in the future, the IFRIC observed that the benefits of insurance coverage under the contracts are the policyholders' right to claim a periodic amount as long as they survive. The policyholders have no right to claim before the start of the annuity period and their right to claim in future years is contingent on them surviving in those future years.

The IFRIC considered a method under which the benefits in the current period are determined based on the annuity payments in the current period and the benefits in the future are determined based on the present value of the annuity payments expected in the future. The IFRIC concluded that such a method met the requirement of IFRS 17 *Insurance Contracts* by assigning the quantity of benefits only to periods in which an insured event (survival) can occur, resulting in a policyholder having the right to claim and aligning the quantity of benefits in a period with the amount that could be claimed in that period.

The IFRIC also noted that for the annuity contracts described, the entity accepts insurance risk related to the uncertainty about how long the policyholders will survive. The entity would apply other requirements in IFRS 17 to recognise in profit or loss, separately from the CSM, the risk adjustment for that non-financial risk.

Multi-currency Groups of Insurance Contracts –October 2022

The IFRIC considered how an entity accounts for insurance contracts with cash flows in more than one currency. Two specific questions asked were whether currency exchange rate risks should be considered when identifying portfolios of insurance contracts under IFRS 17, and how to apply IAS 21 *The Effects of Changes in Foreign Exchange Rates* in conjunction with IFRS 17 when measuring a multi-currency group of insurance contracts.

In relation to the first question, the IFRIC concluded that an entity is required to consider all

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risks, including currency exchange rate risks, when assessing whether insurance contracts are 'subject to similar risks' for the purpose of identifying portfolios of insurance contracts. However, 'similar risks' does not mean 'identical risks' and therefore an entity could identify portfolios of contracts that include contracts subject to different currency exchange rate risks. The IFRIC observed that what an entity considers to be 'similar risks' will depend on the nature and extent of risks in the insurance contracts.

In relation to the second question, the IFRIC observed that both IFRS 17 and IAS 21 refer to single currency transactions or items. IFRS Accounting Standards include no explicit requirements on how to determine the currency denomination of transactions or items with cash flows in more than one currency.

The IFRIC therefore observed that an entity, based on its specific circumstances, and the terms of the contracts in the group, uses judgement to develop, and apply an accounting policy that determines the currency denomination of the group, including the contractual service margin (CSM), which could be a single currency or multiple currencies. The entity cannot simply presume that the CSM is denominated in the functional currency.

In measuring a multi-currency group of insurance contracts, the IFRIC observed that an entity applies IFRS 17 to treat that group, including the CSM, as a monetary item, and applies IAS 21 to translate their carrying amounts into the entity's functional currency.

A multi-currency denomination treats all changes in exchange rates as exchange differences accounted for under IAS 21.

The IFRIC also considered and decided not to add a standard-setting project on how to account for the foreign currency aspects of insurance contracts to the workplan.

Lessor Forgiveness for Lease Payments – October 2022

The IFRIC discussed the application of IFRS 9, and IFRS 16 in accounting for forgiveness of lease payments in an operating lease. In the fact pattern considered, the lease payments forgiven include both amounts due, but not paid, and amounts not yet due, and no other changes are made to the lease contract.

The IFRIC discussed three issues:

- *Applying the IFRS 9 expected credit loss (ECL) model to the operating lease receivable (amounts due, but not paid) before the rent forgiveness is granted*: The IFRIC concluded that before the rent forgiveness is granted, the lessor measures ECL on the operating lease receivable considering its expectation of forgiving the lease receivables.
- *Applying IFRS 9 derecognition requirements to the operating lease receivables forgiven*: on granting the forgiveness, the derecognition requirements under IFRS 9 are met. On the grant date, the lessor remeasures ECL and derecognises the operating lease receivable and associated ECL allowance.
- *Applying IFRS 16 modification requirements to future lease payments*: the forgiveness of lease payments meets the definition of a lease modification and the lessor accounts for the modified lease as a new lease from the grant date. Neither the due-but-not-paid lease payments nor their forgiveness are considered part of the lease payments for the new lease.

Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition – October 2022

The IFRIC discussed how an entity accounts for warrants issued on acquisition of a SPAC. In the fact pattern discussed:

- An entity acquires control of a SPAC that has raised cash in an IPO. The purpose of the acquisition is to obtain the cash, and the SPAC's stock exchange listing. The SPAC has no assets other than cash, and is not a business under the definition of IFRS 3 *Business Combinations*.
- Before the acquisition, in addition to ordinary shares, the SPAC had issued warrants to founder shareholders for their services, and warrants to public shareholders along with ordinary shares at the IPO.
- The entity issues new ordinary shares, and new warrants to the SPAC's shareholders in exchange for the SPAC's ordinary shares, and the legal cancellation of the SPAC warrants, and replaces the SPAC as the entity listed on the stock exchange.
- The SPAC's shareholders are not SPAC employees, nor will they provide any services to the entity after the acquisition.
- The fair value of instruments the entity issues to acquire the SPAC exceeds the fair value of the SPAC's identifiable net assets.

The IFRIC considered key questions in accounting for the transaction, and noted:

- The acquisition is an asset acquisition, and not a business acquisition. The entity recognises individual identifiable assets acquired, and liabilities assumed.
- In identifying individual liabilities assumed as part of the acquisition, the entity assesses whether it assumes the SPAC warrants as a part of the acquisition. If so, the entity issues only the ordinary shares to acquire the SPAC, and assume the SPAC warrants, then issues new warrants to replace the SPAC warrants. If not, the entity issues both ordinary shares, and new warrants to acquire the SPAC.
- The fair value of the instruments issued to acquire the SPAC may exceed the fair value of net assets acquired. If so, in applying IFRS 2 requirements relating to unidentifiable goods or services, the IFRIC concluded that the entity receives a stock exchange listing service as part of a share-based payment transaction, and measures the service received as the difference between the fair value of the instruments issued, and the fair value of net assets acquired.
- The entity applies IFRS 2 *Share-based Payment* to account for instruments issued to acquire the stock exchange listing service.
- The entity applies IAS 32 *Financial Instruments: Presentation* to account for instruments issued to acquire cash, and assume any liability related to the SPAC warrants.

The IFRIC also provided some additional accounting considerations if the entity concludes that, as part of the acquisition, it assumes the SPAC warrants, specifically how to account for the SPAC warrants assumed and the replacement warrants issued, and accounting considerations if it concludes that it does not assume the SPAC warrant, specifically which types of instruments were issued for the SPAC's net assets and which were issued for the listing service.

Definition of a Lease – Substitution Rights – April 2023

The IFRIC discussed how to determine whether there is an identified asset when an arrangement contains a substitution right. In the situation considered:

- A customer enters into a 10-year contract with a supplier for a number of similar assets (batteries), each of them
  is used together with other readily available resources (buses) of the customer
- The supplier has the practical ability to substitute alternative assets throughout the contract term. The supplier, however, is

required to compensate the customer for any revenue lost or costs incurred while the substitution takes place

- Whether substitution is economically beneficial for the supplier at a point in time depends on both the amount of compensation payable to the customer and the condition of the battery
- At inception of the contract, it is expected that the supplier would not benefit economically from substituting a battery that has been used for less than 3 years, but could benefit economically from substituting a battery that has been used for 3 years or more.

The IFRIC concluded that:

- The level at which to assess whether the contract contains a lease is individual assets, since each battery is specified, either explicitly in the contract or implicitly at the time is it made available to the customer
- Because the supplier is not expected to benefit economically from its right to substitute a battery for at least the first 3 years of the contract, the supplier does not have the substantive right to substitute a battery throughout the period of use

The IFRIC also observed that:

- The standard sets a high hurdle to conclude that there is no identified asset when an asset is explicitly or implicitly specified
- Determining whether a supplier's right to substitute an asset is substantive throughout the period of use requires judgement
- A supplier can have the practical ability to substitute alternative assets throughout the period of use even if the supplier does not already have alternative assets but could source those assets within a reasonable period of time. This illustrates that the term 'throughout the period of use' does not mean 'at all times' within that period

Key contacts

New Zealand

Lara Truman
Partner
Ernst & Young, New Zealand
Tel: +64 274 899 896
lara.truman@nz.ey.com

Alex Knyazev
Associate Director
Ernst & Young, New Zealand
Tel: +64 21 853 152
alex.knyazev@nz.ey.com

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