New Accounting Standards and Interpretations for New Zealand Tier 1 Public Sector and Not-for-Profit Public Benefit Entities PBEs

For 30 September 2022 year-end reports

New and changed requirements

We provide you with an overview of the accounting pronouncements, for Public Benefit Entities (PBEs), issued as of 30 September 2022 that:

- **Must** be applied for the first time for 30 September 2022 year-ends. **They are contained in yellow boxes.**
- **May** be applied early for 30 September 2022 year-ends. **They are contained in grey boxes.**

Implementing new accounting standards often impacts entities beyond their financial reporting function. 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 PBEs applying the *Reduced Disclosure Requirements* are not required to disclose the possible impact of accounting pronouncements issued but not yet effective.

Remain alert to further changes

This publication is updated as of 30 September 2022. Any pronouncements issued afterwards (up until the date of authorisation of your financial report) must also be considered. EY Eye on Reporting publications will keep you informed of further changes.

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[1] For full access to PBE Standards please visit https://www.xrb.govt.nz/.
[2] Effective for 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] PBE IFRS 17 *Insurance Contracts* and its amendments only apply to not-for-profit public benefit entities.

Catalogue of IFRIC agenda decisions

Key requirements

Financial instruments

Amendments to PBE IPSAS 29, PBE IPSAS 30, PBE IPSAS 41, PBE IFRS 9 - PBE Interest Rate Benchmark Reform - Phase 2

Effective for annual reporting periods beginning on or after 1 January 2021

The amendments address the accounting issues that arise when financial instruments that reference interbank offered rates (IBOR) transition to nearly risk-free rates. The main elements of the amendments are that the effective interest rate on financial instruments must be adjusted, and hedge accounting will continue on the transition to risk-free rates, but only to the extent that the modifications made to financial instruments are those necessary to implement IBOR Reform and that the new basis for calculating cash flows is "economically equivalent" to the previous basis.

The amendments also introduced some significant new disclosure requirements.

PBE IPSAS 41 Financial Instruments

Effective for annual reporting periods beginning on or after 1 January 2022

This Standard, when applied, supersedes parts of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and supersedes PBE IFRS 9 *Financial Instruments*.

This new standard:

- Introduces a classification and measurement model for financial assets that considers the characteristics of the asset's cash flows and the objective for which the asset is held
- Applies a forward-looking expected credit loss model that is applicable to all financial instruments subject to impairment testing
- Introduces a hedge accounting model that broadens the hedging arrangements in the scope of the guidance. The model develops a strong link between an entity's risk management strategies and the accounting treatment for instruments held as part of the risk management strategy

Requirements on transition depend on whether the entity is transitioning from PBE IPSAS 29 or PBE IFRS 9.

Transitional provisions require mostly retrospective application with some exceptions.

Along with PBE IPSAS 41, *Effective date of PBE IFRS 9* was also issued. This amendment limits the early adoption of PBE IFRS 9 to annual periods beginning before 1 January 2020. For periods beginning on or after that date, entities can only early adopt PBE IPSAS 41.

Earlier application is permitted. If an entity elects to apply this Standard early, it must disclose that fact.

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Key requirements

Group accounts

PBE IPSAS 40 PBE Combinations

Effective for annual reporting periods beginning on or after 1 January 2021

This Standard was issued in July 2019 and replaces PBE IFRS 3 *Business Combinations*.

PBE IFRS 3 excludes combinations under common control and combinations arising from local authority reorganisations from its scope.

The new Standard has a broader scope, and establishes requirements for accounting for both acquisitions (with similar requirements to PBE IFRS 3) and amalgamations (using the modified pooling of interests method).

In general, the Standard is to be applied prospectively to PBE combinations for which the amalgamation date or acquisition date is on or after 1 January 2021.

Key requirements

Insurance contracts

PBE IFRS 17 Insurance Contracts (only applies to not-for-profit PBEs)

Effective for annual reporting periods beginning on or after 1 January 2023

This Standard was issued in July 2019 and establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts.

PBE IFRS 17 applies to **not-for-profit** PBEs ONLY and is applied to:

- Insurance contracts, including reinsurance contracts issued by an entity
- Reinsurance contracts held by an entity
- Investment contracts with discretionary participation features issued by the entity, provided the entity also issues insurance contracts

PBE IFRS 17 will be mandatory from 1 January 2023 for not-for-profit PBEs, with early adoption permitted for entities that apply PBE IPSAS 41 *Financial Instruments* on or before the date of initial application of PBE IFRS 17.

Amendments to PBE IFRS 17 Insurance Contracts

Effective for annual reporting periods beginning on or after 1 January 2023

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

- Deferring the effective date of PBE IFRS 17 for insurers by one year to annual periods beginning on or after 1 January 2023
- Excluding additional contracts from the scope of PBE 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 cash flows (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

Insurance contracts

Amendments to PBE IFRS 17 Insurance Contracts – Initial Application of PBE IFRS 17 and PBE IPSAS 41 – Comparative Information

Effective for annual reporting periods beginning on or after 1 January 2023

When insurers apply PBE IFRS 17 and PBE IPSAS 41 for the first time in 2023[5], PBE IFRS 17 requires restatement of comparatives. However, under PBE IPSAS 41, insurers may restate the comparatives only when hindsight is not required but cannot restate for financial assets derecognised before the application date of PBE IPSAS 41. The accounting mismatch caused by financial assets derecognised during the comparative period is potentially significant and could make financial statements more difficult to understand.

The NZASB amended PBE IFRS 17 to add a transition option "classification overlay". The overlay addresses the above accounting mismatches between financial assets and insurance contract liabilities in the comparative information presented on initial application of PBE IFRS 17.

If an entity elects to apply the classification overlay, it can only do so for comparative periods to which it applies PBE IFRS 17 (i.e., from transition date to the date of initial application of PBE IFRS 17). An entity that applies the classification overlay to a financial asset should:

- Use reasonable and supportable information available at the transition date to determine how the entity expects a financial asset would be classified and measured on initial application of PBE IPSAS 41 (for example, using preliminary assessments performed to prepare for initial application of PBE IPSAS 41)
- Present comparative information as if the classification and measurement requirements of PBE IPSAS 41 had been applied to that financial asset.

[5] Entities that have already applied PBE IPSAS 41 are allowed, or in some cases required, under the transition guidance in PBE IFRS 17, to redesignate financial assets on initial application of PBE IFRS 17 in order to reduce accounting mismatches. However, this redesignation cannot be applied to financial assets derecognised in the comparative period, since it applies only from the date of initial application of PBE IPSAS 41. The classification overlay can also be applied to such financial assets for the purpose of presenting comparative information, as if the redesignation guidance in PBE IFRS 17 had been applied to them based on how the entity expects the assets would be designated at the date of initial application of PBE IFRS 17.

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Other topics

Amendments to PBE IPSAS 2 Cash Flow Statements

Effective for annual reporting periods beginning on or after 1 January 2021.

The amendments require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

When the entity first applies these amendments, it is not required to provide comparative information for preceding periods.

Amendments to PBE FRS 47 - Withdrawal of PBE FRS 46

Revocation of PBE FRS 46

Effective for annual reporting periods beginning on or after 1 January 2021

PBE FRS 46 and PBE FRS 47 were developed to address the needs of entities adopting PBE Standards for the first time. There are now few entities that fall within the scope of PBE FRS 46 (i.e., entities that previously applied NZ IFRS and are transitioning to PBE Standards).

Further, the increasing differences between NZ IFRS and PBE Standards mean that the approach taken in PBE FRS 46 is no longer the most appropriate approach for entities moving from NZ IFRS to PBE Standards.

Consequently, the NZASB issued *Revocation of PBE FRS 46*, and issued *Amendments to PBE FRS 47*, as a result of the withdrawal of PBE FRS 46, in February 2020.

The Amendments to PBE FRS 47 mainly include a change in scope meaning that PBE FRS 47 will be the sole standard for first time adoption of PBE Standards by Tier 1 and Tier 2 PBEs.

The revocation and amendments are effective from 1 January 2021.

Key requirements

Other topics

PBE FRS 48 Service Performance Reporting

Effective for annual reporting periods beginning on or after 1 January 2022

This Standard was issued in November 2017 and establishes requirements for PBEs to select and present service performance information.

PBEs within the scope of this Standard will need to provide users with:

- Sufficient contextual information to understand why the entity exists, what it intends to achieve in broad terms over the medium to long term, and how it goes about this
- Information about what the entity has done during the reporting period in working towards its broader aims and objectives

This Standard applies to:

(a) All not-for-profit PBEs

(b) Public sector PBEs required by legislation to provide information in respect of service performance in accordance with generally accepted accounting practice (GAAP). If an entity is required by legislation to report service performance information on only some of its activities, this Standard applies only to those activities.

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Interpretations and agenda decisions

The XRB has noted that "although, [the IFRS Interpretations committee's (IFRIC's)] agenda decisions are specifically developed with for-profit entities in mind, PBEs applying Tier 1 or Tier 2 PBE Standards may also consider applicable explanatory material in the IFRIC interpretations and agenda decisions when developing and applying accounting policies in accordance with PBE IPSAS 3". Therefore, on this basis this publication outlines recent activities of the IFRIC for consideration by PBEs.

During calendar year 2021, the IFRIC issued no interpretations. However, it issued several agenda decisions on matters brought to its attention.

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 are effective when issued. However, entities are entitled to sufficient time[6] to assess impacts and make required changes.

Below we summarise all IFRIC agenda decisions published during the period from 1 January 2021 to 30 June 2022.

Configuration or Customisation Costs in a Cloud Computing Arrangement – March 2021

The IFRIC discussed accounting for costs of configuring or customising a supplier's application software in a Software as a Service (SaaS) arrangement.[7]

The Committee noted that configuration and customisation costs cannot be capitalised when the customer does not control the software or when the configuration/ customisation does not create an asset separate from the software. Such costs need to be expensed as and when incurred.

This agenda decision has an impact not only on costs in current and future periods but could also impact previously incurred costs that should, or should not have been capitalised.

Resource [8]

[*Applying IFRS -Accounting for cloud computing costs (July 2021)*]

Attributing Benefits to Periods of Service – May 2021

The IFRIC discussed how an entity attributes retirement benefits to periods of service for a defined benefit plan when the entitlement is subject to a minimum retirement age, and the benefit amount is capped by reference to a maximum period of service. Due to these constraints, services rendered before reaching a particular age do not affect the amounts of the benefits to be received on retirement.

Under IAS 19 *Employee Benefits*, benefits should be attributed to the periods of service commencing from the day when employee's services first lead to the benefit entitlement. This period should end when further service will not lead to a material further benefit.

Consequently, the Committee concluded that the entity attributes no retirement benefit for periods before reaching the entitlement age and after reaching the retirement age.

Hedging Variability in Cash Flows due to Real Interest Rates – May 2021

The IFRIC discussed whether a hedge of the variability in cash flows arising from changes in a real interest rate could be accounted for as a cash flow hedge.

[6] 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.

[7] Configuration involves the setting of various 'flags' or 'switches' within the software, or defining parameters, to set up the software's code to function in a specified way. Customisation involves modifying the software to change or create more functionalities within the software.

[8] Further to EY publication, the Treasury also issued a guidance on accounting for SaaS for public sector PBEs, please see here.

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In this situation, an entity with a floating rate instrument enters into an inflation swap[9], While not contractually specified, a nominal interest rate economically includes both a real interest rate and an inflation component.

An entity may designate an item in its entirety, or a component of an item, as a hedged item. A risk component may be designated if the risk component is separately identifiable and reliably measurable. However, the IFRIC observed that inflation risk cannot be considered as separately identifiable and reliably measurable unless it is contractually specified. To support its eligibility as a separate risk component, the real interest rate must represent an identifiable pricing element in setting the floating benchmark interest rate.

For the fact pattern discussed, the IFRIC concluded that there is no exposure to variability in cash flows that is attributable to changes in the real interest rate. As a result, the real interest rate does not meet the requirements in IFRS 9 to be designated as an eligible hedged item.

Costs Necessary to Sell Inventories – June 2021

The IFRIC discussed what costs need to be included when estimating net realisable value of inventories.

In this discussion, the IFRIC noted that IAS 2 *Inventories* requirements do not permit an entity to limit costs necessary to sell inventories to only those that are incremental. There is a range of possibilities beyond the incremental cost approach: from direct costs at the point of sale (which might include, for example, a portion of the cost of internal sales staff or the cost of a special promotion campaign) to full costs (which might include costs such as depreciation or amortisation).

Therefore, an entity uses its judgment to determine which costs are necessary to complete the inventory and make the sale, considering specific facts and circumstances, including the nature of the inventory.

Resource

IFRS Developments issue 193 – Costs necessary to sell inventories (July 2021)

Preparation of Financial Statements when an Entity is No Longer a Going Concern – June 2021

The IFRIC discussed the accounting by an entity that is no longer a going concern. The IFRIC noted the following:

- When an entity is no longer a going concern, it cannot prepare financial statements (including those for prior periods that have not yet been authorised for issue) on a going concern basis.
- The IFRIC did not address whether such an entity restates comparative information, previously prepared on a going concern basis, to reflect the basis of accounting used for the current period's financial statements. No diversity in the application of IFRS Standards with respect to this issue was noted.

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.

[9] Which swaps the variable interest cash flows of the floating rate instrument for variable cash flows based on an inflation index.

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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 condition[10] 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 issues 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

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 TLTRO 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 TLTRO's 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 TLTRO's 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

[10] Derivative financial instruments settled only by the issuer exchanging a fixed amount of cash (or another financial assets) for a fixed number of own equity instruments are classified as equity.

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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, the 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 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.

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EYSCORE 008972-22-AUNZ

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