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

For 31 March 2024 year-end reports

EY
Building a better working world

New and changed requirements

We provide you with an overview of the accounting pronouncements, for Public Benefit Entities (PBEs), issued as of 31 March 2024 which:

- **Must** be applied for the first time for 31 March 2024 year-ends. **They are contained in yellow boxes.**
- **May** be applied early for 31 March 2024 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 PBEs 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 31 March 2024. 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] 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] PBE IFRS 17 *Insurance Contracts* and its amendments apply to not-for-profit public benefit entities and Public Sector PBEs that have elected to early apply PBE IFRS 17 where criteria for early application is met. The amendments to PBE IFRS 17 issued in 2023 make PBE IFRS 17 applicable to public sector entities from 1 July 2026.
[5] *2022 Omnibus Amendments to PBE Standards* also amended the application guidance or the implementation guidance in some other standards to clarify certain requirements which are not included in this publication, for full access to the amendments, please visit 2022 Omnibus Amendments to PBE Standards » XRB
[6] 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

Key requirements

Insurance contracts

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

Commences to apply 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 relevant for 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.

PBE IFRS 17 provides a comprehensive accounting model for insurance contracts. The core of PBE 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 required to adopt PBE IFRS 17 using the full retrospective approach; however, if this is impracticable for a group of insurance contracts, either the modified retrospective approach or fair value approach may be used.

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

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Insurance contracts

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

Commences to apply 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[7], 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

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[7] 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.

Insurance contracts

Amendments to PBE IFRS 17 - Insurance Contracts in the Public Sector

Commences to apply for annual reporting periods beginning on or after 1 January 2026.

The amending standard Insurance Contracts in the Public Sector adds public sector modifications to PBE IFRS 17 *Insurance Contracts* to include public sector entities within its scope from periods beginning on or after 1 January 2026.

Amendments are also made to ensure the Standard is suitable for this sector. This includes the following modifications:

- Information on how to identify arrangements to which PBE IFRS 17 should apply – specifically when an arrangement is in substance a contract
- Specific exemptions relating to sub-grouping contracts. Public sector entities are not required to divide contracts into onerous, no possibility of being onerous and all remaining contracts. A public sector entity is also not required to sub-group insurance contracts based on the date they were issued. The portfolio of insurance contracts will be the unit of account
- An amendment to the timing of initial recognition. A public sector entity will recognise an insurance contract at the earlier of the beginning of the coverage period and the date when the first payment is due
- Guidance on coverage periods in the public sector
- An accounting policy choice to allow the public sector to apply the premium allocation approach to all insurance contracts
- Additional application guidance with specific public sector examples

Early application is permitted if requirements are met. These amendments require comparative information to be provided in respect of the preceding accounting period.

Resource

Insurance Contracts in the Public Sector

Other topics

Amendments to PBE IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets

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

PBE IPSAS 19 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

PBE IPSAS 19 does not specify which costs to include in determining the cost of fulfilling a contract. Consequently, PBE IPSAS 19 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.

Early application is permitted if specific requirements are met.

Amendments to PBE IPSAS 17 Property, Plant and Equipment

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

Under PBE IPSAS 17 *Property, Plant and Equipment*, net proceeds from selling items produced while constructing an item of property, plant and equipment[1] are deducted from the cost of the asset. The research indicated practical diversity in interpreting this requirement. As a result, PBE IPSAS 17 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 PBE IPSAS 12 *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.

Early application is permitted if specific requirements are met.

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Other topics

Amendments to PBE IAS 12 Income taxes

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

The amendment narrows the scope of the recognition exemption under PBE 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 leased asset and the associated lease obligation when commencing a finance lease for a lessee. 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 leased asset and lease obligation under a finance lease (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 surplus or deficit.

Earlier application is permitted if specific requirements are met.

Amendments to PBE IPSAS 27 Agriculture

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

When using a present value technique to measure fair values of assets within the scope of PBE IPSAS 27 *Agriculture*, taxation cash flows are not included. PBE IPSAS 27 does not prescribe an entity to use a particular present value technique 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 PBE IPSAS 27 the requirement to exclude taxation cash flows when measuring fair value.

Earlier application is permitted if specific requirements are met.

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Other topics

Amendments to PBE IPSAS 1 Disclosure of Fees for Audit Firms' Services

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

The amendments to PBE IPSAS 1 aim 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 report
- Other non-audit and non-review 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

Earlier application of the amendments is permitted if specific requirements are met.

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Disclosure of fees for audit firms' services - illustrative example

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.

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[8] to assess impacts and make required changes.

Below we summarise all IFRIC agenda decisions published during the period from 1 January 2023 to 31 March 2024.

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

[8] 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.

- 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

Premium Receivable from an Intermediary (IFRS 17 and IFRS 9) – October 2023

The IFRIC discussed how an insurer should account for the premium receivable from an intermediary who arranges an insurance contract between the insurer and a policyholder.

In the fact pattern considered, the policyholder has paid premiums to the intermediary, upon which, the insurer is obliged to provide insurance services to the policyholder. The insurer, however, has not yet received the premiums from the intermediary.

The question asked is whether the premiums receivable from the intermediary are future cash flows within the boundary of an insurance contract and included in the measurement of the "group of insurance contracts" under IFRS 17 ('View 1') or are a separate financial asset under IFRS 9 ('View 2').

The IFRIC observed that:

- IFRS 17 does not distinguish between premiums to be collected directly from a policyholder and those to be collected through an intermediary.
- IFRS 17 is silent on whether future cash flows within the boundary of an insurance contract are removed from the measurement of a group of insurance contracts only when those cash flows are settled in cash.

The IFRIC therefore concluded that an insurer should develop an accounting policy under IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to determine when to remove the cash flows from the measurement of insurance contracts, either when the premiums are received from the intermediary (View 1) or when the policyholder has paid the premium (View 2).

Homes and Home Loans Provided to Employees – October 2023

The IFRIC received a question on how an entity accounts for:

- Employee home ownership plans where the entity provides its employee with a house that it constructed and owns. Repayments are deducted from the employee's salary until the agreed sale price is fully repaid. The right to the house will be forfeited if the employee leaves within five years, in which case they recover the salary deductions. If the employee leaves after five years, they can choose to keep the house and repay the outstanding balance immediately; and
- Employee home loans where the entity provides a loan to its employee to buy a house which the entity does not own. The loan is typically at a below-market rate of interest or interest free and is repaid through salary deductions. Upon termination of employment, the outstanding balance becomes repayable.

Based on evidence gathered, the IFRIC concluded that the matters above do not have widespread effect and decided not to add a standing-setting project to the work plan.

Guarantee over a Derivative Contract (IFRS 9) – October 2023

The IFRIC received a question about whether, in applying IFRS 9, an entity accounts for a guarantee it issued over a derivative contract as a financial guarantee or as a derivative. Such guarantee reimburses the holder, who is a party to a derivative contract, for the actual loss incurred, up to a close-out amount, in an event of default of the other party to the derivative contract. The close-out amount is determined based on a valuation of the remaining contractual cash flows of the derivative immediately prior to default.

Based on evidence gathered, the IFRIC concluded that the matter does not have widespread effect and it does not have (nor is it expected to have) a material effect on those affected and decided not to add a standing-setting project to the work plan.

Merger Between a Parent And Its Subsidiary In Separate Financial Statements – January 2024

The IFRIC received a request about how a parent entity that prepares separate financial statements applying IAS 27 accounts for a merger with its subsidiary in its separate financial statements.

In the fact pattern described in the request: a parent entity prepares separate financial statements applying IAS 27 and recognises an investment in a subsidiary applying paragraph 10 of IAS 27; the subsidiary contains a business (as defined by IFRS 3 Business Combinations); and the parent entity merges with the subsidiary, resulting in the subsidiary's business becoming part of the parent entity (merger transaction).

The request asked how the parent entity should account for the merger transaction in its separate financial statements. In particular, the request asked whether, in the context of the parent entity's separate financial statements, the merger transaction: constitutes a business combination as defined in IFRS 3 and consequently, whether an entity should apply the acquisition method (and related requirements) in IFRS 3; or should not be accounted for as a business combination, applying this view, the parent entity—in its separate financial statements—recognises the subsidiary's assets and liabilities at previous carrying amounts.

Evidence gathered by the IFRIC indicates little, if any, diversity in determining whether to apply the acquisition method (and related requirements) in IFRS 3 to the merger transaction described in the request. In accounting for the merger transaction described in the request in their separate financial statements, parent entities generally do not apply the acquisition method (and related requirements) in IFRS 3.

Based on its findings, the IFRIC concluded that the matter described in the request does not have widespread effect. Consequently, the IFRIC decided not to add a standard-setting project to the work plan.

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