

Please note: This is an extract from the XRB’s Discussion Paper *Targeted Review of the New Zealand Accounting Standards Framework*. We recommend that you read this in the context of the full Discussion Paper, which can be downloaded [here](#).

4. SMC 1: The Importance of maintaining close alignment between PBE Standards and IPSAS

4A. What this SMC is about

- 4.1 A key element of the current ASF’s “user-needs” approach is the multi-standards approach, with separate suites of standards for two distinct sectors: for-profit entities and PBEs. Accounting standards for for-profit entities are based on IFRS Standards and accounting standard for PBEs in Tier 1 and Tier 2 are based on IPSAS. This chapter seeks constituent feedback on the importance of close alignment between IPSAS (issued by the IPSASB) and PBE Standards (issued by the XRB), being the standards applicable to Tier 1 and Tier 2 PBEs in the public and NFP sectors.
- 4.2 As discussed in Chapter 2 of the full Discussion Paper, the implementation of PBE Standards based on IPSAS by both public and NFP sector entities has broadly been a success in the first 4–5 years of application of the ASF. The introduction of a separate suite of standards for PBEs has provided a tailored approach to meet the specific user-needs of PBEs in both the public and NFP sectors.
- 4.3 However, we are hearing increased concerns from constituents about the timely development of new PBE Standards. These concerns have largely emerged from developments regarding the IPSASB’s Work Programme and its future strategy and the resulting impact on the XRB’s current strategy of maintaining relatively close alignment between PBE Standards and IPSAS to the extent appropriate.
- 4.4 While the XRB’s current strategy was effective in establishing the PBE Standards and the XRB plans to continue using IPSAS, the XRB considers that the extent of alignment between PBE Standards and IPSAS in the future is an aspect of the ASF that may need to be refined as an outcome of this targeted review.
- 4.5 More specifically, these emerging concerns have highlighted a need for the XRB to consider whether more flexibility is needed in the XRB’s current strategic approach to developing PBE Standards based on IPSAS. To assist constituents in providing feedback on this matter, this Discussion Paper:
- provides background information on the XRB’s decision to use IPSAS as the base for developing PBE Standards when the ASF was first issued;
 - explains how the XRB’s strategy of using IPSAS has been implemented through the development of its [Policy Approach to Developing the Suite of PBE Standards](#) (“PBE Policy Approach”);
 - discusses recent IPSAS developments that raise questions about whether the XRB’s current approach should be modified to provide more flexibility in how IPSAS is used to develop PBE Standards; and
 - outlines two possible approaches the XRB could take in the future: the current approach and a more flexible approach.

4.6 The scope of this matter does not include the alignment of IPSAS with the Tier 3 or Tier 4 PBE Simple Format Reporting Requirements. The Tier 3 and Tier 4 PBE standards are highly simplified, resulting in little direct alignment with IPSAS. The XRB intends to carry out a separate standards-level review of Tier 3 and Tier 4 PBE standards shortly after the completion of this targeted review of the ASF.

4B. The XRB's current strategy for the development of PBE Standards

Background information on the decision to use IPSAS as a base for developing PBE Standards

4.7 An explicit part of the ASF's multi-standards approach is the XRB's decision to adopt a set of accounting standards for PBEs other than one based on IFRS Standards. This was in response to growing concerns among New Zealand constituents about the appropriateness of using IFRS Standards as the base for developing accounting standards for PBEs.

4.8 The XRB concluded that IPSAS provides a better basis than IFRS Standards for PBE reporting in Tier 1 and Tier 2, because IPSAS are developed specifically for public sector entities whose primary objective is to deliver services to the public, rather than to make profits and generate a return on equity to investors.

4.9 However, the XRB also recognised that it would be premature to adopt "pure" IPSAS (in the same way that NZ IFRS for Tier 1 for-profit entities reflects "pure" IFRS Standards).¹ This is primarily because:

- (a) IPSAS are developed for public sector entities and the requirements are not always appropriate for NFPs or do not necessarily fit with the New Zealand regulatory environment — New Zealand specific modifications would be required;
- (b) IPSAS does not currently represent a complete set of standards — other sources for standards would be required, included selected NZ IFRS and domestic standards; and
- (c) it was recognised that the ability to assert compliance with international standards was of less importance to public sector and NFP PBEs.

4.10 Therefore, the ASF concludes that a modified version of IPSAS should be used to develop PBE Standards, as explained further in the following section.

4.11 Another key reason for basing PBE Standards for Tiers 1 and 2 on IPSAS (with modifications) — rather than developing a unique set of domestically-based New Zealand standards for PBEs — was the cost-benefit presumption that New Zealand (given its size) should adopt international standards whenever feasible.²

The XRB's PBE Policy Approach to Developing the Suite of PBE Standards

4.12 When PBE Standards were first issued in May 2013, it was expected that the standards would be enhanced and developed over time. In September 2013, the XRB published its PBE Policy Approach to assist the NZASB in making consistent decisions when developing and enhancing PBE Standards.

¹ Paragraph 60 of the ASF

² Proposed Application of Accounting and Assurance Standards under the Proposed New Statutory Framework for Financial Reporting — Discussion Document, ASRB, September 2009

4.13 The PBE Policy Approach sets out the “development principle”, to be applied when considering making a change to the PBE Standards suite. Triggers for considering such changes include the IPSASB issuing a new or amended IPSAS, the IASB issuing a new or amended IFRS Standard, and domestic developments within New Zealand. The development principle is set out below.

Figure 3: The development principle in the PBE Policy Approach

The development principle requires the NZASB to consider the following factors when considering changes to the PBE Standards suite:

- (a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and NFP PBEs, including public sector PBE groups NFP PBE groups, than would be the case if the development was not made; and
- (b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:
 - (i) *relevance to the PBE sector as a whole*: for example, where the potential development arises from the issue of a new or amended IFRS Standard, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;
 - (ii) *relevance to the NFP or public sector sub-sectors*: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;
 - (iii) *coherence*: the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);
 - (iv) *the impact on mixed groups*; and
- (c) In the case of a potential development arising from the issue of a new or amended IFRS Standard, the IPSASB’s likely response to the change (e.g. whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).

4.14 The PBE Policy Approach also includes some rebuttable presumptions, which include the following.

- (a) The NZASB will adopt a new or amended IPSAS.
- (b) The NZASB will not include an IFRS Standard that the IASB has issued on a new topic in the suite of PBE Standards unless the IPSASB addresses the issue.
- (c) If a new or amended IFRS Standard is issued on a topic for which there is an existing PBE Standard based on an IPSAS, the NZASB will consider the factors in the development principle in determining whether to make a similar change to the PBE Standards ahead of the IPSASB. Particular emphasis in this case needs to be placed on the IPSASB’s likely response to the change and whether the IPSASB will address the change in an acceptable time frame.

- 4.15 The current strategy (as provided for in the PBE Policy Approach) provides some flexibility for the NZASB to develop PBE Standards ahead of the IPSASB, but this is somewhat limited (e.g. to topics that the IPSASB is not expected to address in the foreseeable future or not within an acceptable timeframe). For example, the NZASB recently developed and issued a new PBE Standard on insurance for NFP PBEs³ (based on the new for-profit standard IFRS 17 *Insurance Contracts*), as it was considered that PBE insurers in New Zealand would benefit from such a standard, and the IPSASB does not intend to develop an IPSAS on insurance in the foreseeable future.
- 4.16 A key consideration addressed by the PBE Policy Approach is the approach to take when the IASB issue a new or amending standard. This is particularly important for mixed groups, where the benefit of aligning the PBE Standards with NZ IFRS to the extent possible is to reduce the differences between the financial statements of PBEs and for-profit entities for transactions with similar characteristics.
- 4.17 The PBE Policy Approach acknowledges these mixed group concerns, but also notes that careful consideration is required before making any changes to PBE Standards. The PBE Policy Approach generally results in waiting for the IPSASB to address any changes introduced by the IASB, to avoid the risk of getting ahead of the IPSASB.
- 4.18 The Policy also provides that when the IPSASB issues a new or amending IPSAS, it may be appropriate to amend the IPSAS when developing the corresponding PBE Standard to address NZ-specific factors. However, the PBE Policy Approach sets a relatively high hurdle for modifying IPSAS, and does not expect that substantial amendments to an IPSAS will be required.
- 4.19 Overall, therefore, the effect of the PBE Policy Approach is to maintain relatively close alignment between PBE Standards and IPSAS. While there is some flexibility in the PBE Policy Approach to develop a PBE Standard a head of the IPSASB and to modify an IPSAS when developing an equivalent PBE Standard, the PBE Policy Approach currently sets a high hurdle for doing so.

4C. Maintaining close alignment with IPSAS: Recent developments

- 4.20 This section outlines recent developments since the ASF was introduced, and the impact of these developments on PBE Standards and PBEs.

The issuing of several new IFRS Standards, with IPSAS projects “lagging” behind

- 4.21 When the ASF was first introduced in 2012, IPSAS were mostly aligned with IFRS Standards.
- 4.22 Since 2014 the IASB has issued a number of new standards, including IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers*, IFRS 16 *Leases* and IFRS 17 *Insurance Contracts*. These standards represent the IASB’s latest thinking on the topics covered by the respective standards. Equivalent NZ IFRS were issued shortly after these IFRS Standards were issued. We note NZ IFRS 9, 15 and 16 have already become effective for for-profit entities.
- 4.23 When a new IFRS Standard is issued, application of the PBE Policy Approach usually results in the NZASB waiting for the IPSASB to consider the IFRS Standard and to issue a new or amending IPSAS addressing this topic, before making changes to PBE Standards, as explained earlier.

³ PBE IFRS 17 *Insurance Contracts* was issued in July 2019 and is applicable to Tier 1 and Tier 2 NFP PBEs

- 4.24 The IPSASB has initiated “alignment projects” on IFRS 9, 15, 16 (the IPSASB project relating to IFRS 9 has been completed). The term “alignment” refers to the formal processes the IPSASB follows to assess the applicability of IFRS requirements when developing pronouncements for the public sector.
- 4.25 We have observed that these IPSASB alignment projects have been taking an increasing amount of time to complete, especially when the IPSASB proposes to incorporate some of the requirements in the related IFRS Standard, but at the same time also introduces significant additions to or departures from the IFRS Standard to address public sector specific issues. This is the case for the IPSASB’s current projects on revenue and leases.
- 4.26 Table 9 below provides some examples of the current time lag between the IASB issuing a new standard and IPSASB completing a project on the same topic.⁴

Table 9: Examples of the time lag between IFRS standards and IPSASB projects

IFRS Standard/IPSASB Project	IFRS issue date	IFRS effective date	IPSAS expected issue date	IPSAS expected effective date
IFRS 9 <i>Financial Instruments</i> / IPSAS 41 <i>Financial Instruments</i>	July 2014	Jan 2018	Aug 2018 (already issued)	Jan 2022
IFRS 13 <i>Fair Value Measurement</i> / <i>Measurement</i>	May 2011	Jan 2013	June 2021	Jan 2023
IFRS 15 <i>Revenue from Contracts with Customers/Revenue</i>	May 2014	Jan 2018	June 2021	Jan 2023
IFRS 16 <i>Leases/Leases</i>	Jan 2016	Jan 2019	June 2021	Jan 2023

- 4.27 This time lag causes the following issues in New Zealand.
- The first issue relates to quality and understandability of financial reporting for PBEs. While users of the financial statements of for-profit entities in New Zealand can benefit from the new thinking represented by the new NZ IFRS, the equivalent PBE Standard will continue to contain “old” and potentially significantly different requirements until the IPSASB finalises its project.
 - The second issue is that for (potentially) several years, a similar transaction would be treated differently under PBE Standards as compared to NZ IFRS solely as a consequence of the standard-setting process (rather than because of differences between the sectors, such as different user information needs). This could cause issues for reporting entities that are “mixed groups” (e.g. a PBE with a for-profit subsidiary).
- 4.28 An example of the above is the IPSASB’s project on leases, which is not expected to be finalised for another two years from now. In the meantime, New Zealand PBEs will continue to apply the current lease accounting requirements in PBE Standards, which are based on the old IFRS requirements for leases – rather than applying the new requirements in IFRS 16, which (in our view) lead to higher quality financial reporting. In addition, as NZ IFRS 16 became effective for for-profit entities for periods beginning on or after 1 January 2019, a “mixed group” will likely need to prepare consolidation adjustments when reporting on the group’s leases.

⁴ Expected dates for completion of IPSASB projects based on the March 2019 [IPSASB Work Plan](#)

- 4.29 Similarly, the IPSASB's project on financial instruments took significant time to complete. However, in this case the NZASB decided to issue an interim PBE Standard (PBE IFRS 9), pending the development of the new IPSAS. This was to remedy the significant "mixed group" issues that would otherwise arise when NZ IFRS 9 became effective. This would have affected the New Zealand Government in particular. In addition, PBE IFRS 9 allowed PBEs to benefit from the improvements in financial reporting introduced by IFRS 9, without having to wait for the IPSASB to finalise its project.⁵ However, as explained earlier, the development of a PBE Standard ahead of the IPSASB is an exception to the usual approach of waiting for the IPSASB.
- 4.30 The above developments raise the following question: In cases where adopting the requirements of a new IFRS Standard into PBE Standards would benefit New Zealand PBEs and mixed groups, but the IPSASB's project on the same topic is expected to take a significant period of time to complete, would constituents prefer the XRB to have more flexibility to develop a PBE Standard ahead of the IPSASB? Or, would constituents prefer to accept the time lag between new IFRS Standards and new IPSAS, and maintain close alignment between PBE Standards and IPSAS?

The IPSASB's work programme and the impact on the development of PBE Standards in New Zealand

- 4.31 The close alignment between IPSAS and IFRS when the ASF was first introduced meant that the IPSASB could leverage off the work of the IASB. However, the IPSASB's work programme has recently entered a new phase, which is more focused on major projects to develop new or revised standards to address public sector-specific issues (such as "non-exchange" revenue and expenses, concessionary leases and measurement bases specific to the public sector). While work on these public sector specific issues is welcomed, the process of developing an IPSAS on such topics, without an IFRS Standard to use as a base, is a much more challenging task, which the IPSASB is undertaking with limited resources.
- 4.32 Furthermore, the IPSASB's strategy aims to address the needs of a wide range of current and future constituents – many of which are in the process of adopting (or have yet to adopt) accrual accounting, as many jurisdictions currently use cash accounting rather than accrual accounting. The current state of public sector accounting globally is reflected in IPSASB's strategic objective for 2019-2023, which involves increasing the adoption of accrual-based IPSAS.⁶

⁵ The IPSASB has since finalised this project, issuing IPSAS 41 *Financial Instruments* in August 2018

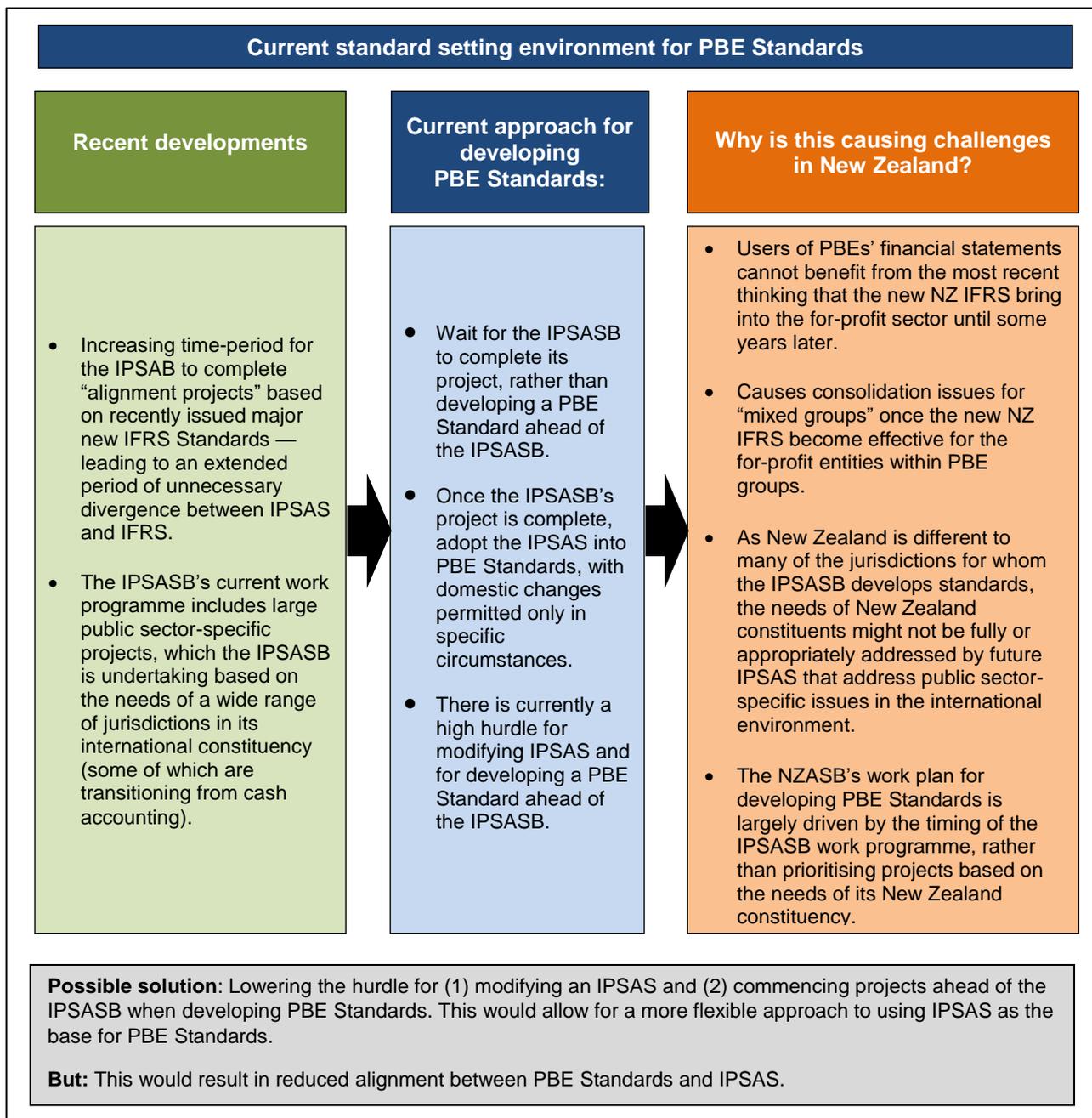
⁶ According to the [IPSASB's Strategy and Workplan 2019-2023](#), the IPSASB's overarching objective for 2019-2023 is "Strengthening Public Finance Management (PFM) globally through increased adoption of accrual-based IPSAS". This is to be delivered through "developing and maintaining IPSAS and other high-quality financial reporting guidance for the public sector" and "raising awareness of IPSAS and the benefits of accrual adoption".

- 4.33 New Zealand is different to many of the other jurisdictions that form the IPSASB’s constituency, for the following reasons.
- (a) New Zealand PBEs – particularly in the public sector – have a long-history of preparing general purpose financial reports (GPFR) on an accrual basis;
 - (b) “Mixed groups”, consisting of a PBE parent and for-profit subsidiaries, are common in New Zealand;
 - (c) New Zealand constituents consider it important that transactions of the same substance across the PBE and for-profit sector be accounted for on a similar basis (i.e. the removal or avoidance of unnecessary differences between the two sectors is considered important); and
 - (d) In New Zealand, PBE Standards apply not just to public sector PBEs but also to NFP PBEs.
- 4.34 Therefore, the needs of New Zealand constituents and the issues they consider important might not be fully or appropriately addressed by the IPSASB’s future standards that address public-sector specific issues in the international environment.
- 4.35 This is an issue because, while the current PBE Policy Approach allows the NZASB some flexibility to modify an IPSAS to reflect New Zealand-specific matters when developing a PBE Standard based on that IPSAS, there is currently a relatively high hurdle for doing so.
- 4.36 Another consequence of the current PBE Policy Approach is that the timing of when PBE-specific issues of importance to New Zealand are addressed is largely dependent upon the IPSASB’s work programme and the time taken to complete its projects in an international environment.
- 4.37 For example, we have been aware of challenges experienced by New Zealand PBEs regarding the determination of whether revenue arises from exchange or non-exchange transactions, and whether “restrictions” or “conditions” apply when considering revenue recognition. Furthermore, there is currently no guidance in PBE Standards on the recognition and measurement of non-exchange expenses, which has resulted in some diversity in practice. These implementation challenges have not been addressed by the NZASB because the IPSASB has active projects on revenue and non-exchange expenses, and the application of the PBE Policy Approach has resulted in waiting for the IPSASB to finalise these projects before introducing any changes in New Zealand. We note the IPSASB’s projects on revenue and non-exchange expenses are still ongoing at the time of writing.
- 4.38 The above developments raise the following questions about the XRB’s strategy for developing PBE Standards, moving forward.
- (a) Whether the policy for developing PBE Standards should prioritise local considerations to ensure that PBE Standards are “fit for purpose” for the New Zealand environment – which could be achieved by the NZASB having more flexibility than it currently does to develop a PBE Standard ahead of the IPSASB and/or to modify an IPSAS when developing a PBE Standard; or
 - (b) Whether maintaining close alignment between PBE Standards and IPSAS is more important?

Summary: The challenges of maintaining close alignment with IPSAS

4.39 The following diagram summarises the challenges arising from the current approach of maintaining close alignment with IPSAS when developing PBE Standards.

Figure 4: Challenges arising in the current standard setting environment for PBE Standards



4.40 Given the current challenges of maintaining close alignment with IPSAS, this suggests that moving to a more flexible approach to how IPSAS is used to develop PBE Standards would be beneficial. However, some may argue that close alignment with IPSAS is important, and that too many differences between an IPSAS and a corresponding PBE Standard may make it difficult for the New Zealand public sector entities to explain the standards they are applying to international bodies. In the future, if more Governments across the world adopt IPSAS, it may become increasingly important for the financial statements of the New Zealand Government and other large public sector entities to clearly explain the basis for preparing their financial statements in contrast to “pure” IPSAS adoption. However, current information suggests that there is still a significant amount of change required globally before adoption of “pure” IPSAS is sufficiently wide-spread for this to be a major concern.⁷

4D. Options for how IPSAS is used when developing PBE Standards

4.41 Given the concerns discussed in the previous section regarding the current way in which IPSAS is used when developing PBE Standards, this section discusses possible approaches to using IPSAS that the XRB could take when developing future PBE Standards, and the advantages and disadvantages of each approach. The approaches are:

- (a) **Option 1:** Continuing with the **current policy of maintaining relatively close alignment with IPSAS** (i.e. the “status quo”); or
- (b) **Option 2:** A **more flexible approach** to using IPSAS as the base for developing PBE Standards.

4.42 We are seeking constituents’ views on their preferred option.

Option 1: Continuing the current approach of maintaining close alignment with IPSAS (status quo)

4.43 The current approach to using IPSAS in the development of PBE Standards is set in the NZASB’s PBE Policy Approach, which is discussed in [section 4B](#).

4.44 In brief, this approach would involve continuing to maintain close alignment between PBE Standards and IPSAS where possible, with limited divergence in specified circumstances (for example, to add guidance for NFP PBEs, to remove options not relevant to New Zealand, and to ensure the scope of a standard is consistent with New Zealand legislation).

4.45 Although this approach would not resolve the challenges discussed earlier (see [section 4C](#) above), it would maintain relatively close alignment between IPSAS and PBE Standards. Hence, this option would be preferable if close alignment with IPSAS is regarded as being more important.

Option 2: A more flexible approach in using IPSAS as the base for developing PBE Standards

4.46 Under a more flexible approach, the standard-setting process for the future development of the existing suite of PBE Standards would be focused on local considerations, rather than maintaining close alignment with IPSAS. The use of IPSAS would be positioned as a means to an end (i.e. developing standards for PBEs in New Zealand), not as an objective in itself.

⁷ Please refer to Appendix D in the full Discussion Paper for more information on the current and expected future adoption of IPSAS around the world.

4.47 More specifically, applying a more flexible approach in the future could include the following:

- (a) When a new or amended IPSAS is issued, the **NZASB would consider whether or not to incorporate that IPSAS into PBE Standards and what modifications might be needed** when doing so, based on an assessment that would focus on local considerations (e.g. would the change to PBE Standards improve the quality of financial reporting in New Zealand and would the benefits outweigh the costs for New Zealand PBEs), rather than focusing on maintaining close alignment with IPSAS.

Hence, instead of the current PBE Policy approach – which includes a rebuttable presumption that the IPSAS will be adopted in New Zealand, places a high hurdle on rebutting that presumption, and limits the extent of New Zealand modifications to that IPSAS – the NZASB would consider whether or not to adopt the IPSAS (and, if adopted, the extent of modifications required) based on whether doing so would be in the best interests of New Zealand PBEs and users of their financial statements.

- (b) When a new or amended IFRS Standard is issued on a topic that is also relevant to the PBE sector, the **NZASB would consider whether to develop an equivalent new or amended PBE Standard based on the new IFRS Standard** (based on the costs and benefits of doing so), rather than waiting for the IPSASB to complete an alignment project.

For example, if the delay in developing an equivalent new or amended PBE Standard would cause significant problems in New Zealand (e.g. for mixed groups), then it may be more beneficial to develop a new or amended PBE standard instead of waiting for the IPSASB. Conversely, if the delay would not cause significant problems, then it may be more cost-effective to wait for the IPSASB to address the topic.

4.48 This more flexible approach would help resolve the challenges discussed earlier, but a likely consequence is that, in the future, there would be less alignment between PBE Standards and IPSAS than exists today. Hence, this option may be preferable if resolving these challenges are more important than maintaining IPSAS alignment. This option would be preferable if the future development of PBE Standards should be more focused on local considerations rather than international considerations.

Question for respondents

SMC 1: Importance of close alignment between PBE Standards and IPSAS

3. Moving forward, should the XRB's policy for developing PBE Standards prioritise local considerations to ensure that PBE Standards are "fit for purpose" for the New Zealand environment? Or, is maintaining close alignment with IPSAS more important?
Please provide reasons for your response.
4. If you think close alignment between PBE Standards and IPSAS is important, for whom is this important and why?
5. If you think prioritising local considerations is more important, should the PBE Policy Approach be amended to provide more flexibility in how IPSAS is used as the base for PBE Standards, as suggested under [Option 2 above](#)?
6. Do you have any other comments on the way IPSAS are used as the base for PBE Standards?