NZ ACCOUNTING STANDARDS BOARD

Board Meeting

Wednesday 1 November 2017
External Reporting Board, Level 7, 50 Manners Street, Wellington

LATE PAPERS

Est Time	Item	Topic	Objective		Page
B:PUBLIC SESSION					
11.00 am	**4**	**Revenue and Non-Exchange Expenses**	(AH/ALH)		
	4.1	Cover Memo	Consider	Late paper	2
	4.2	Draft Comment Letter	Consider	Late paper	8
3.30 pm	**8**	**Prepayment Features with Negative Compensation (Amendments to NZ IFRS 9)**	(VSF)		
	8.1	Cover Memo	Consider	Late paper	46
	8.2	Draft *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9)	Approve	Late paper	55
	8.3	Draft Signing Memo	Approve	Late paper	64
	8.4	Application of PBE Policy Approach	Approve	Late paper	68
C: NON-PUBLIC SESSION					
4.00 pm	**10**	**International & Domestic Update**			
	10.4	Update on International Meetings held in September 2017			
	10.4.2	International Standard-setters' Meetings – London 2017	Note	Late paper	70

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	26 October 2017
To:	NZASB Members
From:	Aimy Luu Huynh and Anthony Heffernan
Subject:	**IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses***

Purpose and introduction[1]

1. The purpose of this paper is to:

   (a) have the Board consider chapters 6–7 of the IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP); and

   (b) seek Board comments on the preliminary views (PVs) and specific matter for comment (SMC) in chapters 6–7 of the CP to enable staff to draft the NZASB's comment letter.

2. The focus of the meeting is to receive Board feedback on the non-exchange expenses recognition approaches as proposed in the CP. In preparation for the meeting we encourage the Board to read chapters 6–7 of the CP (agenda item 4.3).

3. Since the last NZASB meeting, the Working Group had their second meeting and discussed its views on the PVs for non-exchange expenses from the CP. These views have been included in the draft comment letter (agenda item 4.2).

4. We have also completed our final planned outreach, we recently presented to the CA ANZ not-for-profit special interest group in Wellington.

Summary of staff recommendations

5. We recommend that the Board:

   (a) CONSIDERS chapters 6–7 of the CP; and

   (b) PROVIDES comments on Preliminary Views 5–9 and Specific Matters for Comment 7 of the CP for the purpose of providing DIRECTION for staff to draft the NZASB's comment letter (agenda item 4.2).

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

6. The draft comment letter (agenda item 4.2) includes an overview of the staff proposed framework for the recognition of non-exchange expenses. The key staff recommendations under this proposed approach are:

   (a) the framework for non-exchange expense recognition should be primarily based on the classification of those transactions with performance obligations or those with no performance obligations, similar to the proposed classification for revenue transactions;

   (b) for non-exchange expense transactions in Category A where there are no performance obligations or stipulations, these should be accounted for using an "Obligating Event Approach", based on the concept of a liability in the IPSASB's *Conceptual Framework*[2]. The liability and corresponding expense will be recognised immediately when the obligating event occurs;.

   (c) for non-exchange expense transactions in Category A where there are stipulations over use (but no performance obligations), these should be accounted for using r an Obligating Event Approach, together with enhanced presentation to disclose any stipulations over use by the resource recipient; and

   (d) for non-exchange expense transactions in Category B where there are performance obligations, these should be accounted for using the Public Sector Performance Obligation Approach (PSPOA) for expenses. This will include non-exchange expense transactions where the resource recipient has an enforceable and specific performance obligation to transfer goods or services either to the resource provider or beneficiaries.

Structure of the memo

7. The remainder of this memo is set out as follows:

   (a) Background;

   (b) Issues with non-exchange expenses;

   (c) Draft comment letter; and

   (d) Next steps.

Background

8. The IPSASB published the CP in August. Comments are due to the NZASB by 22 November 2017 and to the IPSASB by 15 January 2018.

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[2] IPSASB's Conceptual Framework:

A liability is a present obligation of the entity for an outflow or resources that results from a past event.

A present obligation is a legally binding obligation or non-legally binding obligation, which an entity has little or no realistic alternative to avoid.

9. At the NZASB meeting in September the Board agreed:

   (a) the areas of focus for the Board's comment letter are the proposed approaches for the recognition of revenue and non-exchange expense; and

   (b) the other topics covered in the CP may be important to our constituents but due to the short comment period the Board's comment letter will have high-level comments.

10. At the NZASB meeting in October the Board provided feedback on the revenue recognition approaches proposed in the CP. The Board agreed:

    (a) the proposed framework for recognition of revenue transactions in the public sector and not-for-profit sector should be classified as those with performance obligations or those without performance obligations rather than exchange or non-exchange distinction;

    (b) revenue transactions in Category C[3] should be accounted for using the Public Sector Performance Obligation Approach (PSPOA), which is based on IFRS 15 *Revenue from Contracts with Customers* adapted for the public sector;

    (c) revenue transactions in Category A[4] should be accounted for under a residual standard (or a residual section of the standard, if there is only one standard on revenue), which could be an updated IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers);*

    (d) there is a wide spectrum of revenue transactions in Category B[5]. The scope of Category B transactions that could be accounted for using the PSPOA will depend on how the IPSASB define key factors such as enforceability and performance obligation;

    (e) revenue transactions in Category B where there are enforceable performance obligations to transfer goods or services to other parties (including transactions involving transfers to beneficiaries and for subsidised goods or services) should be accounted for using the PSPOA; and

    (f) revenue transactions in Category B where there are stipulations over use (but do not necessarily involve the transfer of goods or services to the resource provider or beneficiary) or only time requirements could be accounted for under an updated IPSAS 23 approach using either the presentation option or the other comprehensive revenue and expense with recycling option.

11. The Board agreed an overview of the Board's proposed framework for revenue recognition in the public sector (as noted above) should precede the responses to the preliminary views and specific matters for comment. The overview will set the scene for the IPSASB on the Board's thinking and rationale for the responses to the preliminary views and specific matters for

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[3] Revenue transactions within the scope of IFRS 15.

[4] Revenue transactions with no performance obligations or stipulations over use.

[5] Revenue transactions with performance obligations or stipulations but do not have all the characteristics of a transaction within the scope of IFRS 15.

comment. The responses to each preliminary view and specific matter for comment should be linked back to the overview where appropriate.

Issues with non-exchange expenses

12. The CP notes the gap in the current IPSASB literature on the accounting for non-exchange expenses is one of the key drivers for this IPSASB project. The CP provides that this gap may lead to ambiguity and inconsistency of accounting policies for this highly significant area of expenditure in the public sector.

13. To assist the Board in providing comments on the proposed recognition approaches for non-exchange expenses, we thought it would be useful to further explore the non-exchange expenditure issues arising in practice. Based on constituent outreach activities we have summarised the key issues below.

Issues with non-exchange expenses	**Details**
1. When does a liability arise?	The key question is when does a liability arise? When an obligation is based on a future event, is there a liability on day 1 or when the future event arises? One of the requirement for a liability is an outflow of resources to an external party. If the funder will never pay out the resource to an external party this will not be a liability. The facts and circumstances of each arrangement will determine when there is a present obligation and when an obligating event occurs. Liabilities are often recognised when there is a constructive obligation such as when the funder approves the grant or government announcement of policies. Most of the issues below relate to when does a liability and corresponding expense arise.
2. Multi-year grants	Some funders want the ability to defer the recognition of the non-exchange expense to over the period in which the grant is consumed by the resource recipient.
3. When does an asset arise?	It is questionable if the resource provider should recognise an asset when it recognise a liability for a non-exchange expense transaction. If the recipient fails to meet the conditions, should there be a right to receive a non-financial asset from the recipient when it is a non-exchange transaction? The resource provider does not expect to receive anything of equal value in a non-exchange transaction so why should they recognise an asset. An asset requires control of the resource by the entity, which is difficult to demonstrate when funding

Issues with non-exchange expenses	**Details**
	is transferred from a resource provider to a resource recipient. If there is an asset recognised, what does it represent? A prepaid expense or a receivable?
4. Timing of payment	Payments can be made in advance, in instalments, at the end of an agreement or a mixture. Most of the issues arise when payments are made in advance for multi-year grants. Some funders don't want to recognise the full expense upfront. This links to issue 2 above.
5. Milestone based arrangements	These are arrangements where the payments are linked to milestones. The recognition of an expense depends on whether the milestones are considered to be substantive (expense recognition is deferred) or administrative (expense recognised upfront). This is also linked to whether the funder has control over the resource. If they do, the funder is more likely to defer the recognition of an expense. If they don't, the funder will recognise the full expense and corresponding liability upfront.
6. Revalidation	This is similar to milestone based arrangements, some arrangements require revalidation by the recipient. For example, a study grant where 50% is paid up front upon signing the agreement, the remaining 50% is paid when the recipient has completed their study and provides evidence of this to the funder. If the recipient does not provide evidence that they have completed their studies and the funder can withhold the remaining 50%, the funder can defer recognising the remaining 50% until the recipient is satisfied with the evidence provided. In arrangements where revalidation does not affect future funding i.e. the revalidation is more of an administrative matter, the full expense is recognised up front.
7. Funding arrangements not aligned with the accounting period	It could be aligned to the resource provider's accounting period rather than the resource recipient. Public sector entities' financial year is usually 1 July to 30 June and recipients will have a range of balance dates.
8. Funding committed in advance	Often the funder provides a commitment to the funding in advance of the period it relates to. In the public sector, budgets for the following period are often approved before year end. One view is if the

Issues with non-exchange expenses	Details
	funding can be linked to a legislative commitment then an expense and liability would be recognised.
9. Distinction between loans and grants	For example, suspensory loans, on the face it may look like a loan but the substance is actually a grant and is accounted for as such in practice.
10. Donating or vesting property, plant and equipment	This is like a capital grant in reverse. The funder constructs or acquire the capital asset and then donate to the recipient. When should the liability and expense be recognised? At the start, during construction, at the end or over the life of the asset?
11. Lack of documentation	This is more an operational matter rather an accounting issue. The lack of documentation makes it difficult to assess when does a liability arise. In the NZ public sector the more arm's length the transaction, the better the documentation to create accountability.

Draft comment letter

14. A draft comment letter is provided as agenda item 4.2. The draft comment letter includes some high level points, the Working Group's feedback and staff's preliminary response that are intended to prompt discussion and assist the Board in developing a response for preliminary views (PVs) 5–9 and specific matter for comment (SMC) 7 of the CP.

15. In agenda item 4.2 we have also indicated by an asterisk * the PVs and SMC that relate to the key areas of focus the Board had agreed to provide detailed comments on.

16. We are seeking Board direction on staff's preliminary response to the proposed approaches for non-exchange expenses recognition in the CP, and any further points that the Board wants to be included in its comment letter.

Next steps

17. The Working Group's third meeting will discuss the draft comment letter. Following the Working Group's feedback staff will update the draft comment letter for the Board's initial review at the December meeting.

Attachments

Agenda item 4.2: NZASB draft comment letter on IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

Agenda item 4.3: IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

NZ ACCOUNTING STANDARDS BOARD

XX January 2018

Mr John Stanford
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
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CANADA
Submitted to: www.ifac.org

Dear John

Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

Thank you for the opportunity to comment on Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP). The CP has been exposed in New Zealand and some New Zealand constituents may have made comments directly to you.

[The main points on the CP to be emphasised here once detailed responses have been finalised.]

Our recommendations and responses to the Preliminary Views and Specific Matters for Comment are set out in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Aimy Luu Huynh (aimy.luuhuynh@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook

Chair – New Zealand Accounting Standards Board

Notes for the Board – draft comment letter

- This draft comment letter considers responses to the Preliminary Views (PVs) 5–9 and Specific Matter for Comment (SMC) 7 of the IPSASB's CP, which primarily address the proposed non-exchange expense recognition approaches.
- PVs 1–4 and SMCs 1–6 of the IPSASB's CP, which primarily address the proposed revenue recognition approaches, were discussed by the Board at the October NZASB meeting.
- The PVs and SMCs marked by an asterisk * relate to key areas the Board previously agreed to provide detailed comment on. For the other PVs and SMCs the Board agreed for staff to develop high level comments only.
- The draft comment letter includes the Working Group's feedback, feedback received from outreach activities, and draft preliminary staff responses to the PVs and SMC in bullet point format. The information provided in the draft comment letter is to support the Board in providing direction on the drafting of the NZASB's comment letter.
- We are seeking Board feedback on the proposed framework for the recognition of non-exchange expenses, the preliminary staff responses to the PVs and SMC, and the questions raised for the Board under the Working Group's feedback for PV 7.
- The Board's feedback received from the October and November NZASB meetings will be used to further develop the draft comment letter, which will be bought back as a complete draft for Board consideration at the December NZASB meeting.

Structure of draft comment letter

- The remainder of the draft comment letter is set out as follows:
  - (a) Overview of the CP proposed framework for the recognition of non-exchange expenses;
  - (b) General comments on the CP proposed framework for the recognition of non-exchange expenses;
  - (c) Overview of the staff proposed framework for the recognition of non-exchange expenses; and.
  - (d) Draft responses to Preliminary Views and Specific Matter for Comment.
- The appendix to this draft comment letter provides the following additional information to support the Board's consideration of the draft comment letter.
  - (a) Appendix A — Current accounting of grant expenditure in New Zealand.
  - (b) Appendix B — Applying the CP approaches to non-exchange expense examples.

  It is not intended that these appendices will be included in the final comment letter, but have been provided for Board information only.

Overview of the CP proposed framework for the recognition of non-exchange expenses

- The scope of the CP excludes the following public sector expense transactions:

  (a) Social benefits[1] – the IPSASB currently has an active project addressing the accounting for these expenses; and

  (b) Exchange expenses[2] – the IPSASB considers there is currently adequate guidance on the accounting for these transactions in the IPSASB's *Conceptual Framework* and other standards (such as IPSAS 13 *Leases* and IPSAS 39 *Employee Benefits*).

- For the purpose of considering non-exchange expense recognition approaches, the CP has categorised non-exchange expenses (excluding social benefits) into three categories.

  (a) Collective services.

  (b) Universally accessible services.

  (c) Grants, contributions and other transfers.

- The CP considers two approaches for the recognition of non-exchange expenses:

  <u>Approach 1 – The Extended Obligating Event Approach (EOEA)</u>

  This approach uses the concept of an obligating event in the IPSASB's *Conceptual Framework* to determine when a resource provider has a liability, and then applies a reverse IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* approach to assess when an expense should be recognised.

  Under this approach:

  (a) if the expense agreement contains a condition[3], the resource provider will recognise the expense when the resource recipient fulfils the condition; and

  (b) if the expense agreement contains a restriction[4] over use, the resource provider will recognise an expense immediately when the liability is recognised.

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[1] As defined by the draft Social Benefits ED (included in the IPSASB September 2017 papers):
Social benefits are provided to:
(a) Specific individuals and/or households who meet eligibility criteria; and
(b) Mitigate the effect of social risks; and
(c) Address the needs of society as a whole; but
(d) Are not universally accessible services.
The types of non-exchange expenses included in social benefits are principally: state pensions, unemployment benefits and income support.

[2] As defined by IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*:
Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

[3] A condition is a stipulation requiring the resource recipient to use resources in a particular way, or return the resources to the resource provider.

[4] A restriction is a stipulation requiring the resource recipient to use resources received in a particular way, with no return requirements.

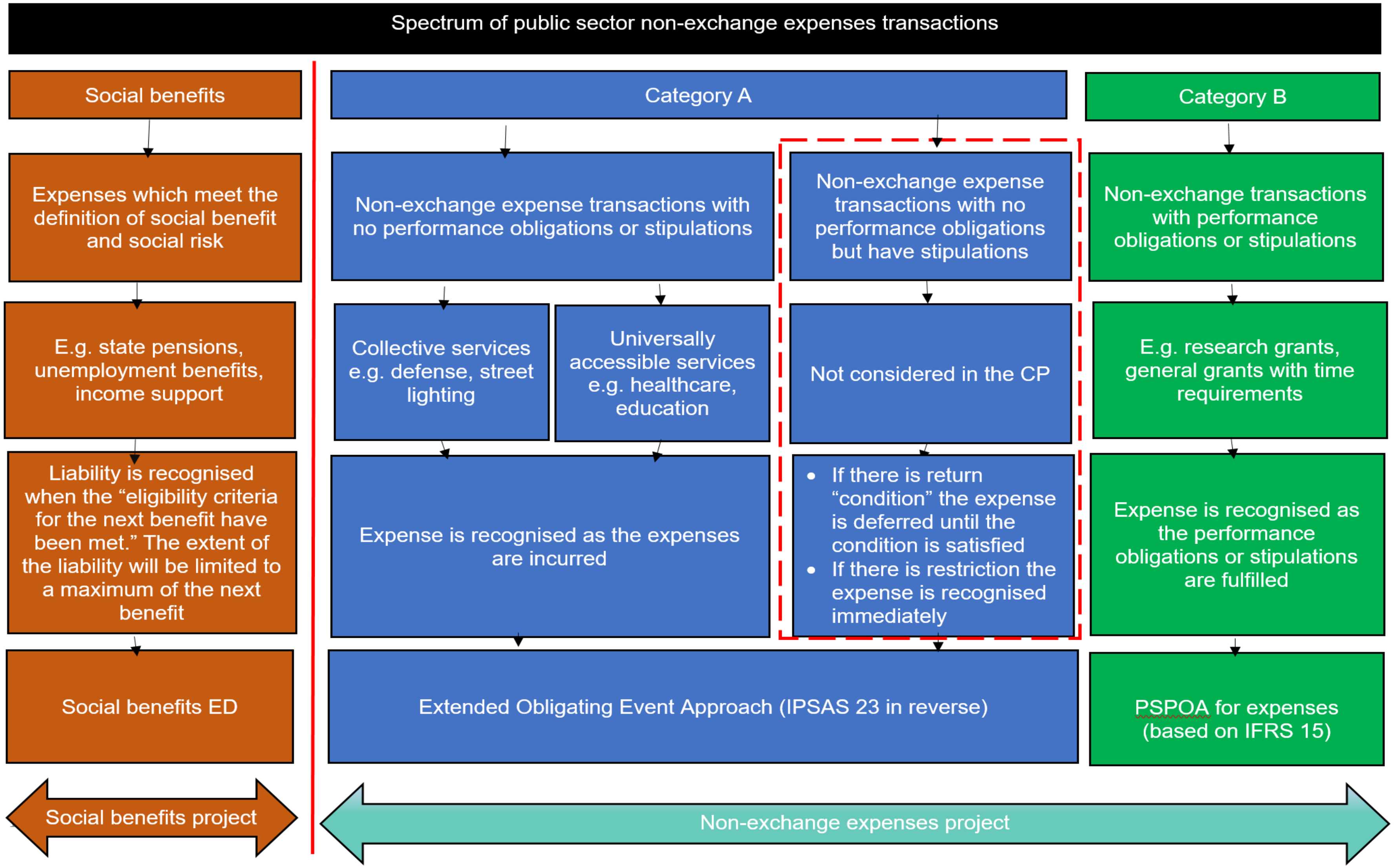
Approach 2 – Public Sector Performance Obligation Approach (PSPOA)

This approach is the counterpart to the proposed PSPOA for revenue transactions, applying the IFRS 15 five-step revenue recognition model reconfigured for non-exchange expenses.

Under this approach the resource providers recognise expenses when the resource recipient satisfies agreed performance obligations.

- We have summarised our understanding of the proposed non-exchange expense recognition approaches in the CP in diagram 1 below.

Diagram 1



Spectrum of public sector non-exchange expenses transactions
Social benefits
Expenses which meet the definition of social benefit and social risk
E.g. state pensions, unemployment benefits, income support
Liability is recognised when the "eligibility criteria for the next benefit have been met." The extent of the liability will be limited to a maximum of the next benefit
Social benefits ED
Category A
Non-exchange expense transactions with no performance obligations or stipulations
Collective services e.g. defense, street lighting
Universally accessible services e.g. healthcare, education
Expense is recognised as the expenses are incurred
Non-exchange expense transactions with no performance obligations but have stipulations
Not considered in the CP
If there is return "condition" the expense is deferred until the condition is satisfied
If there is restriction the expense is recognised immediately
Extended Obligating Event Approach (IPSAS 23 in reverse)
Category B
Non-exchange transactions with performance obligations or stipulations
E.g. research grants, general grants with time requirements
Expense is recognised as the performance obligations or stipulations are fulfilled
PSPOA for expenses (based on IFRS 15)
Social benefits project
Non-exchange expenses project

General comments on the CP proposed framework for the recognition of non-exchange expenses

- The broad comments on the CP proposed framework for the recognition of non-exchange expenses are provided below to explain why we feel improvements to the proposed framework are required. Recommended improvements are reflected in the overview of the staff proposed framework.

Staff comments

- The CP appears to be trying to categorise non-exchange expenses based on two forms of characteristics at the same time: (1) the nature of the benefits received by beneficiaries (i.e. reference to social benefits, collective services, and universally accessible services); and (2) the nature of stipulations (i.e. whether there are restrictions, conditions or performance obligations). We consider this approach to categorising non-exchange expenses for the purpose of considering different recognition approaches is unnecessarily complicated and potentially confusing.

- All three categories of non-exchange expenses used in the CP (universally accessible services; collective services; and grants, contributions and other transfers) could have different degrees of stipulations or performance obligations[5], including transactions involving the transfer goods or services to the resource provider or resource beneficiary. Staff consider the framework for non-exchange expense recognition, should be primarily based on the classification of those transactions with performance obligations or those with no performance obligations. Rather than whether the transaction is exchange or non-exchange; the nature of the benefits received by beneficiaries; or the nature of stipulations.

- Generally, the Treasury group expenses into the following categories.

  - Obligations through exchange contracts.

  - Obligations from deeds of agreement.

  - Obligations from public policy or legislation.

  The key questions under each category are when does an obligating event arise and when to recognise the corresponding expense (immediately or over time). Each policy above is analysed to identify whether there is a cost to the Crown. It is less about whether an expense is exchange/non-exchange but to look at what the Crown is getting when deciding when the obligation arises. Also need to look at whose action affects the obligation.

- The proposed framework mainly focuses on discussing the accounting for universally accessible services and collective services, and it is not clear how the CP proposes to account for other non-exchange expense transactions with no performance obligations but with a broad range of other stipulations like time requirements or other restrictions/conditions over use. PV 7 provides that the IPSASB is of the view that a PSPOA for non-exchange expenses should be applied when grants, contributions and other transfers contain either performance

5 An agreement with the resource recipient to deliver specific and enforceable goods or services either for the direct benefit of the resource provider or for the benefit of beneficiaries.

obligations <u>or</u> stipulations. There is limited discussion on why the IPSASB consider a PSPOA for expenses is appropriate for this wide range of non-exchange expense transactions. Under the proposed framework a PSPOA for expenses would apply to both non-exchange expenses incurred in exchange for the delivery of goods and services and non-exchange expenses incurred in which the resource recipient retains the benefits (e.g. grant to fund salary costs).

- Under the EOEA for Category A non-exchange expense transactions, the CP proposes to use a "reverse" IPSAS 23 approach to determine whether expenses related to a liability are recognised immediately or recognised over time. This approach is based on IPSAS 23 in its current form (in reverse), with expense recognition based on the nature of the stipulations (i.e. whether there are restrictions or conditions). Given the current concerns with IPSAS 23 as highlighted in the CP discussion on the revenue recognition issues, we question why the IPSASB considers a reverse IPSAS 23 with no further updates would be an appropriate option for Category A non-exchange expense transactions.

- In chapter 4 of the CP the IPSASB proposes four options to update IPSAS 23 for revenue transactions with time requirements[6], however in chapter 6 the IPSASB does not discuss applying these updates under a reverse IPSAS 23 approach for non-exchange expenses. However, we note the illustrative examples in appendix B of the CP apply the four options to update IPSAS 23 to non-exchange expenses under the EOEA. We are therefore unclear whether the IPSASB is proposing under the EOEA to apply the four options to update IPSAS 23 (in reverse) for non-exchange expense transactions with time requirements.

Working Group comments

- The dividing line between social benefits and Category A transactions seems quite artificial. The only difference between social benefits and Category A transaction is the form of the resources. For social benefits, the resource is in the form of money, for Category A transactions the resource is in the form of a good/service. For Category A transactions money can be given in the form of vouchers, subsidies and reimbursements. So, there is very little difference between social benefits and Category A transactions.

- In practice, a grant provider generally recognises a liability when there is a constructive obligation. This could be when the recipient has been advised in writing that the grant has been approved.

- For multi-period grants which have conditions in the form of reporting on the use of funding from the recipient to the grantor. There is a need to establish if the reporting is for administrative purposes only or something more substantive that results in the conditions being considered enforceable. If the reporting is substantive and the grant is for a long period

[6] Paragraph 4.9 of CP, options to address time requirements:
Option (b) – require enhanced display/disclosure;
Option (c) – Classify time requirements as a condition;
Option (d) – Classify transfers with time requirements as "other obligations"; and/or
Option (e) – Recognise a transfer with time requirements in net assets/equity and recycle through statement of financial performance [The Board has referred to this approach as the other comprehensive income (OCI) or other comprehensive revenue and expense (OCRE) approach]

such as 30 years, the question is when to recognise the liability. Periodically over the 30 years or when the final report is received?

If the conditions are outside the control of the funder then there are grounds to recognise the liability on day 1.

- The key issues the standard on non-exchange expenses needs to address are:
  - When does a liability arise? When the obligation is based on a future event, is there a liability on day 1 or when the future event arises?
  - Can the resource provider ever have an asset because these are non-exchange transactions? If the recipient fails to meet the conditions, does a right exist to receive a non-financial asset from the recipient for non-performance, when it is a non-exchange transaction? The resource provider does not expect to receive anything of equal value in a non-exchange transaction.
- In NZ, when the government is developing policies such as social investments, they are aware these are complex issues and they want this to be a success so they want to provide a commitment. The government is investing in relationships rather than setting performance requirements. The measures are around the service delivery. There are measures and scoring to assess the future commitments. The three things to consider are:

  1. commitment of the funding;
  2. provision of services; and
  3. payment.

  The CP has the desire to show the provision of services using the EOEA but not all commitments are measurable, they are adjustable. The CP is trying to fit three events into two, the commitment and provision of services into one event. The resources and liability are real but the commitment funding is a level above this and has not been considered in the CP.
- Non-exchange expenses have the same issues as revenue. The accounting leaves information that does not provide a meaningful story. The IPSASB could look at the same options proposed for revenue such as presentation, classify time requirements as a condition, other resources and other comprehensive income (OCI).
- Whether the funder includes the return condition in an arrangement will depend if they have the resource. If they already have the cash, they are unlikely to include the return condition because they want to give out the cash as soon as they receive it. If the funder does not have the cash or dependent of future cash being received, they would want to include the return condition so they can defer recognising the expense until they receive the funds.
- The impact of the IPSAS 23 return obligation principle on grant agreements was discussed. When IPSAS 23 return condition was introduced this often resulted in changes in the grant documentation, but there were no changes in the grant management. Even with the return condition, funders often did not seek repayment for unfulfilled conditions.

- The EOEA is difficult to apply because once the money goes out the door and it is a non-exchange transaction, it is difficult to say there is an asset. The CP has made an overly gross simplification there is an asset. If there is an asset, what do does the funder control?

- The PSPOA is easier to apply, the funder is paying the recipient their entitlement for delivery of the performance obligation. If funder pay the funds in advance, it is like a prepaid expense (an asset). If the funds are not paid in advance but the arrangement is for a multiple period, this is looking like an executory contract in the for-profit sector. If the funder pays in advance of the performance, this gives rise to an asset, a right to receive the performance from the recipient (a prepaid expense). If the recipient satisfies agreed performance obligations before receipt of the funding, this gives rise to a liability because the funder has an obligation to pay the recipient for the performance obligations.

- In NZ, we don't tend to pay a lot of funds in advance so the asset would be quite small whereas we have a lot of commitments so the committed liability would be quite big.

Overview of the staff proposed framework for the recognition of non-exchange expenses

- Consistent with the Board direction one the proposed revenue recognition framework, we suggest the comment letter should include a broad overview of the Board's proposed framework for non-exchange expense recognition, this overview will precede the responses to the PVs and SMCs.

- The staff proposed framework is for Category A and Category B non-exchange expense transactions only. These are the transactions in the scope of the CP and therefore exclude those expense transactions within the scope of the social benefits ED and exchange transactions.

- Diagram 2 shows the spectrum of non-exchange expenses in the public sector. In the forthcoming social benefits exposure draft (ED), the ED is proposing an Obligating Event Approach for the recognition of the liability and corresponding expense. Under this approach the liability and corresponding expense is recognised when the "eligibility criteria for the next benefit have been met" (i.e. the obligating event). The extent of the liability will be limited to a maximum of the next benefit. There is not much conceptual difference between the transactions in the social benefits ED and those in Category A, particularly in relation to universally accessible services and collective services. The only difference is the location of the guidance. The IPSASB wanted the guidance on social benefits in a separate standard. Also, to keep the social benefits project within a manageable size, the IPSASB has a narrow scope of social benefits. Because there is no conceptual difference in these transactions, we are proposing the same recognition approach as social benefits (the Obligating Event Approach) for Category A non-exchange expense transactions, see discussion further below.

- Staff propose the following framework, as summarised in diagram 2, for non-exchange expense recognition.

  (a) The framework for non-exchange expense recognition, should be primarily based on the classification of those transactions with performance obligations or those with no performance obligations. Rather than whether the transaction is exchange or non-exchange; the nature of the benefits (i.e. universal accessible or collective services); or the nature of stipulations (i.e. restrictions or conditions). This consistent with one of the IPSASB's proposed approaches for revenue recognition, the PSPOA.

(b) All Category A transactions, these are non-exchange expense transactions that do not have performance obligations (defined as an obligation for the resource recipient to transfer goods or services), these will be accounted for under the Obligating Event Approach. Under the Obligating Event Approach all expenses are recognised immediately when the obligating event occurs (i.e. when a liability is recognised). This means that in all circumstances when there are no performance obligations, including:

(i) transactions with no stipulations; or

(ii) transactions with restrictions, conditions or other enforcement mechanisms.

The expense is recognised immediately. Only when there are performance obligations can the definition of an asset be satisfied, and therefore expenditure deferred until those performance obligations are satisfied.

Like the EOEA proposed by the CP, this approach is based on the concept of a liability in the IPSASB's *Conceptual Framework*[7]. However, this approach does not allow for the deferral of expenses when there is a return condition.

For transactions with no performance obligations but there are restrictions, conditions or other enforcement mechanisms we are proposing the same approach but with enhanced presentation to disclose to any stipulations on the part of the resource recipient. The enhanced presentation option is similar to the display/disclosure option proposed under the revenue recognition options under an updated IPSAS 23 for revenue.

(c) All Category B transactions, these are non-exchange expense transactions with performance obligations, will be accounted for using the PSPOA for expenses. This will include non-exchange expense transactions where the resource recipient has an enforceable and specific performance obligation to transfer goods or services either to the resource provider or beneficiaries.

- In thinking about the overview for the comment letter staff have developed a diagram of what this framework could look like under the performance obligation or non-performance obligation distinction, this is diagram 2 below.

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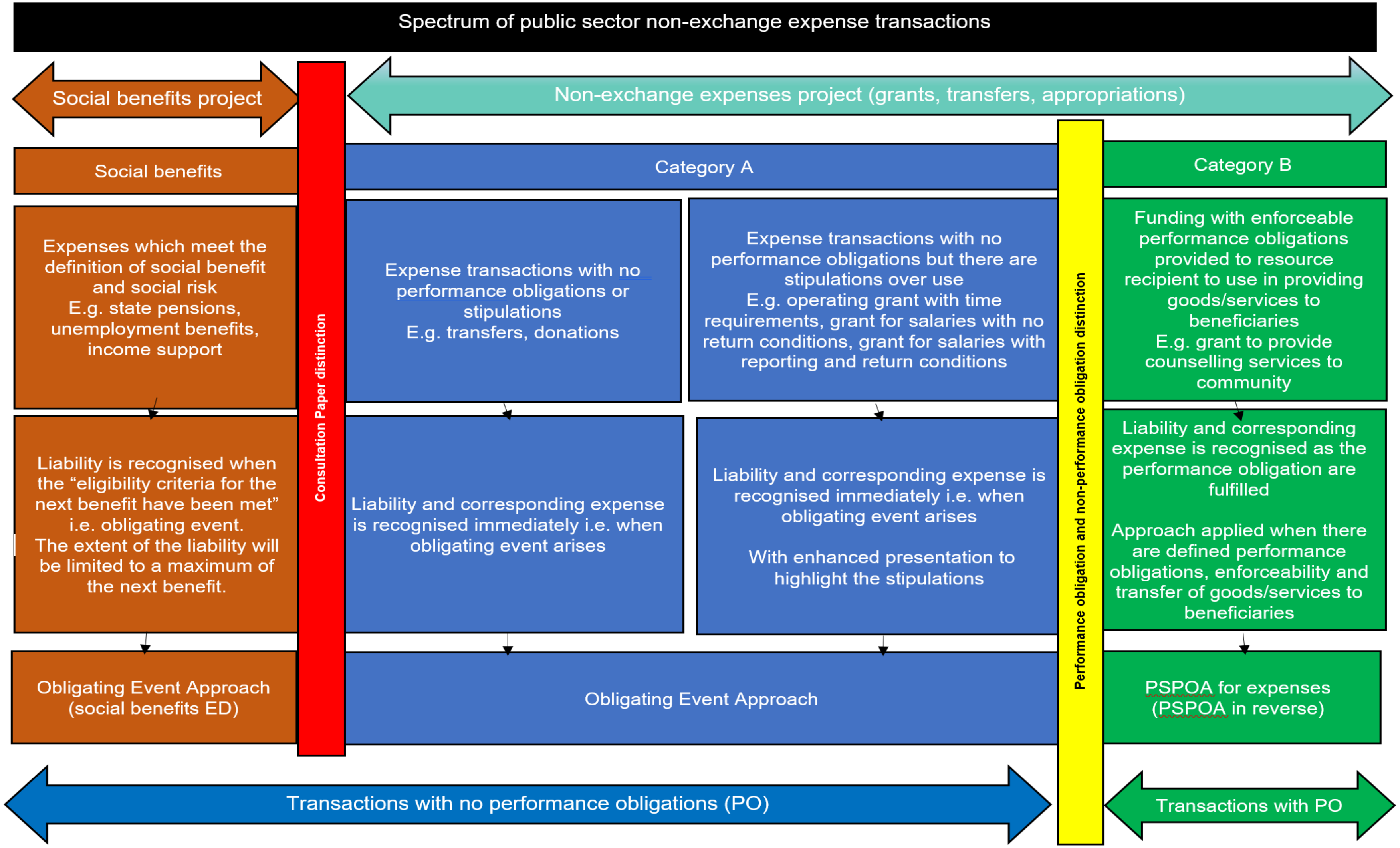
7 IPSASB's Conceptual Framework:
A liability is a present obligation of the entity for an outflow of resources that results from a past event.

A present obligation is a legally binding obligation or non-legally binding obligation, which an entity has little or no realistic alternative to avoid.

Diagram 2



Spectrum of public sector non-exchange expense transactions
Social benefits project
Non-exchange expenses project (grants, transfers, appropriations)
Consultation Paper distinction
Performance obligation and non-performance obligation distinction
Social benefits
Category A
Category B
Expenses which meet the definition of social benefit and social risk E.g. state pensions, unemployment benefits, income support
Expense transactions with no performance obligations or stipulations E.g. transfers, donations
Expense transactions with no performance obligations but there are stipulations over use E.g. operating grant with time requirements, grant for salaries with no return conditions, grant for salaries with reporting and return conditions
Funding with enforceable performance obligations provided to resource recipient to use in providing goods/services to beneficiaries E.g. grant to provide counselling services to community
Liability is recognised when the "eligibility criteria for the next benefit have been met" i.e. obligating event. The extent of the liability will be limited to a maximum of the next benefit.
Liability and corresponding expense is recognised immediately i.e. when obligating event arises
Liability and corresponding expense is recognised immediately i.e. when obligating event arises
With enhanced presentation to highlight the stipulations
Liability and corresponding expense is recognised as the performance obligation are fulfilled
Approach applied when there are defined performance obligations, enforceability and transfer of goods/services to beneficiaries
Obligating Event Approach (social benefits ED)
Obligating Event Approach
PSPOA for expenses (PSPOA in reverse)
Transactions with no performance obligations (PO)
Transactions with PO

Further comments on the staff proposed framework

- FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* has guidance below on recognition of a liability. This guidance is similar with staff's proposed Obligating Event Approach.

  34.59 An entity shall recognise a liability and, usually, a corresponding expense, when it has made a commitment that it will provide resources to another party, if, and only if:

  (a) the definition and recognition criteria for a liability have been satisfied;

  (b) the obligation (which may be a constructive obligation) is such that the entity cannot realistically withdraw from it; and

  (c) the entitlement of the other party to the resources does not depend on the satisfaction of performance-related conditions.

  34.60 Commitments that are performance-related will be recognised when those performance-related conditions are met.

- The timing of liability recognition depends on determining when the resource provider has a present obligation. If a resource provider has the discretion to avoid incurring expenditure, a liability will not be recognised. If the resource provider does not have the discretion to avoid expenditure, a liability is recognised when the resource provider has little or no realistic alternative to avoid the outflow of resources.

- Under the PSPOA for Category B transactions we are envisaging a simplified approach could be developed, based on recognising non-exchange expenses when performance obligations are satisfied by the resource recipient, rather than developing a full PSPOA based on reversing the IFRS 15 five-step model to reflect the resource provider context. This approach will require clear definitions of enforceability and specific performance obligations, with an emphasis on the resource recipient having an obligation to transfer goods or services either to the resource provider or agreed beneficiaries.

- Recognition of an asset is more likely to arise under the PSPOA for expenses. For example, an asset would be recognised if the resources are paid in advance of the recipient fulfilling the performance obligations. The asset represents a prepaid expense because the funder has the right to receive the goods/services to be provided by the recipient.

- An asset is unlikely to arise under the Obligating Event Approach. This conclusion is formed based on the IPSASB's *Conceptual Framework* definition of an asset[8] and the view that when there are no performance obligations the resource provider does not have a resource that it presently controls. There could be stipulations such as conditions over use or time requirements but these are not performance obligations. Even if there are refund conditions, an asset would only be recognised if there are clear repayment provisions for non-compliance

[8] IPSASB's Conceptual Framework:
An asset is a resource presently controlled by the entity as a result of a past event.

with stipulations, a history of seeking refunds for non-compliance, and only when it is considered probable that the resource recipient will not satisfy the agreed stipulations.

The key premise for this approach is that when a liability is recognised a corresponding asset cannot be recognised when there are no performance obligations.

Draft responses to Preliminary Views and Specific Matter for Comment

Preliminary View 5 (following paragraph 6.37)*

The IPSASB is of the view that non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non-exchange transactions should therefore be accounted for under The Extended Obligating Event Approach.

Do you agree with the IPSASB's Preliminary View 5? If not, please give your reasons.

Staff notes for Preliminary View 5

- The IPSASB has taken the view that under the EOEA if an agreement contains a condition the resource provider will not recognise an expense immediately, but will instead recognise an asset until the condition has been fulfilled by the resource recipient. The CP takes a narrow view of a condition, being the requirement to use the funding in a particular way with return obligations if the requirement is not satisfied. The return obligation is used as the basis for the recognition of an asset under the EOEA.

- The CP does not provide sufficient analysis of whether the definition of an asset is satisfied under the EOEA, when there are no performance obligations to transfers goods or services, but instead there are stipulations to use funding in a particular way. An asset can only be recognised in these circumstances if there are clear repayment provisions for non-compliance, a history of seeking refunds, and it is considered probable that the resource recipient will not satisfy the agreed stipulations. It is therefore difficult to recognise an asset to reflect unfulfilled stipulations, on initial recognition of the liability. An asset may be recognised at a later date, when there is evidence of non-compliance and it is probable that the funding will be returned.

- In practice, it is hard to enforce a refund condition once the resources are paid. The recipient may not be in the position to repay the resources because the funding has been spent.

- One approach applied in practice in NZ (refer to appendix A) is to broaden the IPSAS 23 concept of a condition (applied in the context of non-exchange expenses) to allow an asset to be recognised when the resource provider has other mechanisms available to enforce the resource recipient to use funding in a particular way. Under this approach a non-exchange expense transaction with no performance obligation, will be recognised when enforceable stipulations are satisfied by the resource recipient.

- Others expressed views that there is a high threshold for an asset to be recognised, which will be difficult to satisfy for non-exchange expense transactions with no performance obligations. To recognise an asset the resource provider is required to have a resource that they presently controls, which will only exist when there are enforceable and specific performance obligations to transfer goods or services.

- In an early draft of the CP, the advantages and disadvantages of the EOEA were provided[9]. A summary of the advantages and disadvantages is provided below.

  Advantages

  - Uses an approach that is more mature than a PSPOA and has already been applied successfully to public sector transactions.
  - May lead to consistent accounting between resource providers and resource recipients.
  - Can be applied to transactions that do not have performance obligations.

  Disadvantages

  - Uses a model developed for revenue rather than expenses.
  - Requires an exchange/non-exchange determination.
  - Requires judgement to determine if a stipulation is a condition or a restriction which may lead to information asymmetry between resource providers and recipients.
  - May have implementation issues e.g., time requirements, multi-year grants, depending on whether and how these issues are resolved.

- The Charity Commission and the Office of the Scottish Charity Regulator has issued *Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland* (SORP). The SORP provides useful guidance on constructive obligations and grant commitments, an extract of this is provided below. The SORP is similar to one view of the current accounting in NZ (appendix B). If the conditions are within the control of the resource provider then they have the discretion to avoid expenditure and therefore a liability is not recognised. Whereas if the condition is not within the control of the resource provider then they don't have the discretion to avoid the expenditure and therefore a liability is recognised if the payment of the grant is probable. The SORP's view of a condition is wider than a return condition.

  Principles for recognising liabilities from constructive obligations

  7.12. Charities frequently provide services or make grants to their beneficiaries on a non-contractual basis. Although a charity's commitments to provide services or grants are not always legally binding under contract, a liability can still arise if the charity has no realistic alternative to settling an obligation resulting from a commitment it has made. However, not all commitments to provide future services or funding will result in a charity recognising a constructive obligation as a liability or provision.

  7.13. A charity may make general statements or policy statements about their future intentions, for example the aim of relieving famine in a particular location or improving the quality of care provided to a particular group of people. Such statements can be communicated in

[9] IPSASB March 2017 meeting, agenda item 4.3 Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

a variety of ways, including mission statements, setting out future plans within a trustee's annual report or simply making a general policy statement. Statements such as these do not create a constructive obligation as discretion is retained by the charity as to their implementation.

7.14. Evidence of a constructive obligation exists where:

- the commitment made by the charity is specific, for example a promise is made to provide particular goods, services or grant funding;
- this commitment is communicated directly to particular beneficiaries or grant recipients; and
- there is an established pattern of practice that indicates to the recipients of services or funding that the charity will meet its commitment.

7.15. It follows that a charity's decision to provide funding does not create a constructive obligation that must be recognised as a liability unless that decision has been communicated to those affected before the reporting date. The commitment must be communicated in a sufficiently specific manner so as to create a valid expectation on the recipient's part that the charity will discharge its responsibilities.

7.16. The formal written offer of a grant indicates to the recipient that it is probable that settlement will take place. In such circumstances, the charity cannot realistically withdraw from its commitment and so it is unlikely to have a realistic alternative but to meet the obligation. However, the recognition of any resulting liability would be dependent on any conditions attaching to the commitment.

Conditions that limit the recognition of a funding commitment

7.17. Funding commitments can be made which give the funder the discretion to avoid future expenditure based on their assessment of whether the conditions attached to the commitment will be met by the recipient.

7.18. The award of a grant is a non-exchange transaction. A charity awards a grant to further its own charitable purposes but without creating a contractual relationship with the recipient. The award of a grant is recognised as a liability only when the criteria for a constructive obligation are met, payment is probable, it can be measured reliably, and there are no conditions attaching to its payment that limit its recognition.

7.19. Where a grant commitment is payable over a period of more than one year, a liability must be recognised for the full amount of the constructive obligation unless conditions apply to payments falling due after the reporting date. Where payments for later years are subject to performance-related conditions, the donor charity may be able to legitimately withdraw from its commitment if a particular condition attaching to the grant is not met.

7.20. Where a condition remains within the control of the donor charity, then the donor charity retains the discretion to avoid the expenditure and therefore a liability must not be recognised. For example, where a commitment is made to provide grant funding over a number of years, future payments may be subject to a review by the donor charity which gives it discretion to terminate the funding agreement. Provided the review condition has been communicated to the recipient as part of the funding agreement and the review has substance, then a constructive liability is unlikely to arise for payments relating to periods subsequent to the review date.

7.21. Alternatively, when there is no condition attaching to the grant that enables the donor charity to realistically avoid the commitment, a liability for the full funding obligation must be recognised.

7.22. Not all terms attaching to a funding commitment create a condition that gives a donor charity discretion to withdraw from its funding obligation. For example, a term in a grant offer that seeks to relieve the donor charity from a future obligation in the event of a lack of funds at a future settlement date would not normally prevent the recognition of a liability if payment is probable. The liability would only be derecognised (reversed) if a future event requires the funding offer to be rescinded. The reversal of the balance sheet provision must be recognised in the statement of financial activities and deducted from the heading to which the expenditure was originally charged.

7.23. Grant commitments may contain conditions that are outside the control of the donor charity. For example, a charity may promise a grant payment on the condition that the recipient finds matching funding. When a condition falls outside the control of the donor charity, a liability arises and expenditure must be recognised if the payment of the grant is probable.

7.24. Certain grants may contain specific conditions that closely specify a level of output or service to be performed by the recipient of the grant. These are termed performance-related grants. [guidance on this is provided under PV 7 below]

Working Group's feedback

- Broadly agreed with PV 5 — applying the EOEA for non-exchange transactions with no performance obligations.
- Some members disagreed with the analysis provided for EOEA. In particular these members did not agree with the conclusion in paragraph 6.20 and 6.21, i.e. that an asset could exist for funding provided in a non-exchange transaction (other than perhaps a small amount, based on the probability of the resource recipient failing to meet the conditions of the grant and returning the funding).
- The Working Group agreed there are no performance obligations imposed on the resource recipient for universally accessible services and collective services, because the resource recipient is the beneficiary in these types of transactions, rather than another public benefit entity that provides goods/services to beneficiaries.
- Non-exchange expense transactions related to delivery of universally accessible services and collective services could have either performance obligations or stipulations, so they could be accounted for under the EOEA or PSPOA dependent on the terms of the agreement.

Staff's preliminary response

- As noted in our overview the framework for non-exchange expense recognition, should be based on the classification of those transactions with performance obligations or those with no performance obligations. Rather than whether the transaction is exchange or non-exchange; the nature of the benefits (i.e. universal accessible or collective services); or the nature of stipulations (i.e. restrictions or conditions).

- We agree universally accessible services and collective services impose no performance obligations on the resource recipient because the resource recipient is the beneficiary in these types of transactions, rather than another public sector entity that provides goods/services to beneficiaries.

- For non-exchange expense transactions with no performance obligations or stipulations, we recommend these transactions be recognised using an Obligating Event Approach. Under this approach, a liability and corresponding expense is recognised immediately when an obligating event arises.

- For non-exchange expense transactions with no performance obligations but with stipulations over use, we also recommend these expense transactions be recognised using an Obligating Event Approach. This approach is supported by enhanced presentation to disclose the intention established by the resource provider that the resource recipient use the funding over multiple accounting periods or to use the funding in a specific way.

- The timing of the recognition of a liability depends on determining when the resource provider has a present obligation. If a resource provider has the discretion to avoid incurring expenditure, a liability will not be recognised. If the resource provider does not have the discretion to avoid expenditure, a liability is recognised because the resource provider has little or no realistic alternative to avoid an outflow of resources.

- We don't agree there is an asset if there are return conditions. In practice, it is hard to enforce a refund condition once the resources are paid. The recipient may not be in the position to repay the resources because it has already been spent. An asset can only be recognised for non-exchange expense transactions with no performance obligations, if there are clear repayment provisions for non-compliance, a history of seeking refunds and it is considered probable that the resource recipient will not satisfy the agreed stipulations. It is therefore difficult to recognise an asset to reflect unfulfilled stipulations, on initial recognition of the liability. An asset may be recognised at a later date, when there is evidence of non-compliance and it is probable that the funding will be returned.

- Partially agree with PV 5 subject to the points above and from the overview.

Preliminary View 6 (following paragraph 6.39)*

The IPSASB is of the view that, because there is no obligating event related to non-exchange transactions for universally accessible services and collective services, resources applied for these types of non-exchange transactions should be expensed as services are delivered.

Do you agree with the IPSASB's Preliminary View 6? If not, please give your reasons.

Notes for Preliminary View 6

- Same points as for PV 5 because the two PVs are similar.

Working Group's feedback

- The Working Group agreed with the accounting outcomes proposed by PV 6, but did not agree with the rationale provided in the CP for recognising the expense as services are delivered for universally accessible services and collective services. The rationale provided by the CP is that these transactions do not give rise to obligating events and therefore both the liability and corresponding expense are not recognised prior to the delivery of those services to beneficiaries.

- The rationale in practice for recognising the expenses as incurred for universally accessible services and collective services is because public sector financial statements do not provide useful information when large liabilities are recognised on the balance sheet for future commitments related to these transactions. This point was discussed in context to the previous NZASB's deliberations on the accounting for NZ superannuation under the IPSASB's Consultation Paper for Social Benefits – if staying alive is a eligibility criterion but the government can't control this, then when applying the definition of a liability it is difficult to argue there is no obligation for the full liability when the recipient reaches the age of 65 for the rest of their life. However, this would result in the recognition of a large liability and no offsetting revenue thus creating a mismatch. The same argument can be applied to universal services such as the free education from the age of 5 to 19. When a child is born, there is a commitment. If you start down this track then where would you stop, all commitments would be recognised on the balance sheet. It is questionable whether this recognition approach would provide useful information. On the basis that the accounting outcomes under PV 6 would provide more useful information in the financial statements, some Working Group members supported the recognition of expenses related for universally accessible services and collective services as the expenses are incurred.

- Paragraph 6.38 of the CP notes that these services can be varied by the government. For example, in education the government can adjust the cost but the students still have to be taught. It seems like the CP is using the measurement argument to avoid recognition of the full liability and corresponding expense. There is some merit in financial reporting providing some information on commitments of collective goods and services. This can be in the form of long-term fiscal sustainability reporting. This goes back to the point above about the three matters to consider: commitment, provision of goods/services and payment.

Staff's preliminary response

- As noted in our overview, our proposed framework for non-exchange expense recognition should be classified as those with performance obligation or those without performance obligation rather than exchange or non-exchange. For non-exchange expense transactions with no performance obligations or stipulations, these are recognised using the Obligating Event Approach, as described under PV 5.

- We disagree with the rationale provided for PV 6 that there is no an obligating event related to non-exchange transactions for universally accessible services and collective services. The actual rationale for recognising the expense as the expenses are incurred for universally accessible services and collective services is because the financial statements do not provide useful information if there is a large liability on the balance sheet. These services do have an obligating event and there is a present obligation. Whilst governments can vary the level of services provided, it is hard to argue that they can avoid settling the obligation.

- In general, we agree that it is appropriate for grants, transfers and other contributions for the delivery of universally accessible services and collective services to beneficiaries to be expensed as services are delivered, because transactions of this nature often have no performance obligations. However, as noted in the CP universally accessible services and collective services may involve non-exchange and exchange expense transactions with stipulations or performance obligations including transactions with suppliers or employees to supply goods or services. We therefore encourage the IPSASB to classify non-exchange expense recognition based on the nature of the agreement (i.e. whether there are stipulations or performance obligations), rather than based on whether the non-exchange transaction is for universally accessible services or collective services. The classification of non-exchange expenses based on the benefits received by beneficiaries introduces an unnecessary scope consideration when applying the different approaches.

- Partially agree with PV 6 subject to the points above, comments under PV 5 and from the overview.

Preliminary View 7 (following paragraph 6.42)*

The IPSASB is of the view that where grants, contributions and other transfers contain either performance obligations or stipulations they should be accounted for using the PSPOA which is the counterpart to the IPSASB's preferred approach for revenue.

Do you agree with the IPSASB's Preliminary View 7? If not, please give your reasons.

Notes for Preliminary View 7

- Paragraph 6.12(c) of the CP notes grants and contributions will include other transfers that may be related to specific and irregular events (such as disaster relief), but the CP has not indicated which approach would be applied for non-exchange expense transactions of this nature. There is unlikely to be any performance obligation but there could be stipulations being that the grants/transfers be used to assist individuals and households. If there are stipulations, the CP is proposing the PSPOA. This approach may not be appropriate because disaster relief grants are often general with no specific performance obligations.

- In an early draft of the CP, the advantages and disadvantages of the PSPOA for expenses were provided[10]. A summary of the advantages and disadvantages is provided below.

  Advantages

  - Exchange/non-exchange distinction is not required.
  - May lead to consistency of accounting approach between resource providers and resource recipients because performance obligations will be identified in binding agreements.
  - May lead to recognition of revenue and expenses coinciding.
  - May lead to improvements in public sector financial management because funding arrangements will identify specific deliverables.

  Disadvantages

  - Uses a model developed for revenue.
  - Requires the identification of performance obligations.
  - Based on an IFRS Standard developed for for-profit entities.
  - Can be difficult to determine stand-alone prices in the public sector – therefore may not be appropriate for all transactions with performance obligations.
  - Relies on robust information flow between the resource provider and the resource recipient otherwise it may lead to inconsistent accounting by the resource provider and the resource recipient.
  - May lead to an inconsistent approach to that being developed for social benefits.

- The CP notes the analysis of the PSPOA in chapter 4 has not been repeated and considered from a non-exchange expense context. It would be helpful for the CP to consider the pros and cons of a PSPOA for non-exchange expenses, without this analysis it is difficult for respondents to assess whether this approach would work.

- The CP provides that the IPSASB is of the view "*that it is important for the approach in a non-exchange expenses standard to mirror the approach adopted for equivalent revenue transactions*". The proposed PSPOA for non-exchange expenses is different that the proposed PSPOA for revenue because of the following reasons.

[10] IPSASB March 2017 meeting, agenda item 4 3 Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

- The proposed PSPOA for revenue transactions applies when there is an enforceable agreement. There appears to be no discussion in the CP on "enforceability" in a non-exchange expense context.
- The IPSASB did not think revenue transactions with just a time requirement will meet the "distinct services" criterion and therefore formed the view that a PSPOA would not be appropriate for these revenue transactions. Whereas for non-exchange expenses, the IPSASB's PV suggests the PSPOA can be applied if the transaction has a stipulation of any nature (which includes time requirements). This seems to indicate a general grant with only time requirements could apply the PSPOA for non-exchange expenses
- The IPSASB has not defined what is a "performance obligation" for non-exchange expenses, so it is difficult to assess the type of non-exchange expense transactions that would apply the PSPOA.

- The proposed PSPOA for non-exchange expenses is similar to one view of the current accounting in NZ in appendix A, where the concept of a condition is expanded to include "performance obligation" to use resources received in a particular way, but do not necessarily involve the transfer of goods or services to a third party. The expense is recognised as the performance obligations are fulfilled.
- Rather than use the full IFRS 15 model in reverse for expenses to develop a PSPOA, we suggest the IPSASB should use the performance obligation concept as the base for the recognition of non-exchange expenses with performance obligations. This approach will require the following to be considered.
  - Clear definition of a performance obligation such as specificity of the goods and services to be delivered. Does the definition require the transfer of goods or services to the resource provider or beneficiary?
  - Is a time requirement considered a performance obligation?
  - Clear definition of enforceable, what enforcement mechanisms in addition to a return obligation would allow for a PSPOA to be applied?
  - When would an asset be recognised and what does it represent i.e. prepayment, resources in advance, something else?
- The SORP has some useful guidance on performance-related grants, an extract of this is provided below. The SORP notes a performance-related grant has to relate to a specific service or output. A general grant or a general grant with time requirements is not a performance-related grant.

  7.25. The key characteristic of a performance-related grant is that the amount of the grant payable to the recipient is determined by the extent of their performance in meeting the conditions set out in the grant agreement.

  7.26. The payment of a performance-related grant is conditional on the grant recipient delivering a specified level of service or units of output. For example, the payment might be conditional on the number of meals provided or the usage or opening hours of a facility. In such cases the grant-maker will often have negotiated the nature of services to be provided. The liability and expenditure arising from performance-related grants must be recognised to the extent that the recipient of the grant has provided the specified service or goods.

7.27. A grant that is restricted to a particular purpose does not create a performance related condition, as the payment of the grant is not conditional on the achievement of a specified level of service or outputs by the recipient. Similarly, a grant that funds a project over a number of years is not recognised as a performance-related grant simply because the funding obligation is to be met over an extended period of time.

Working Group's feedback

- Agreed the PSPOA should be applied to non-exchange expenses with performance obligations.
- The IPSASB needs to define what is a performance obligation and consider how far to stretch this. If a performance obligation is just a return condition then this would be the EOEA. Many things other than return condition can drive performance. There are other mechanisms to incentivise the recipients.
- The IPSASB needs to define what is enforceability. If enforceability is monitoring in the form of reports from the recipient to the resource provider, whether there is an asset will depend on how the reports are used. If the reports are just filed as an administrative tool then it hard to justify an asset. If the reports are actively reviewed and there are remedies for non-performance, this indicates a strong monitoring mechanism and strengthens the argument for an asset.
- An example of a funder was discussed. The funder of grants is a public sector entity. One of the conditions of the grant is recipients provide an accountability report which state what the grant has been spent on. Currently the funder has a large number of accountability reports outstanding but the funder does not recognise a debtor. They don't recognise a debtor unless they have done everything they can to obtain the accountability reports from the recipients. The funder only recognises a debtor if they are certain of recovery of funds from the recipient because any write off of debtors has to go through cabinet.
- There are some concerns with creating extra accounting compliance on the funders and recipients. Often the recipients in the not-for-profit sector are fairly small.
- The CP has not fully considered the accounting for non-exchange expense transactions with no performance obligations but with stipulations such as time requirements or conditions over use. There is still a need for a residual standard for these transactions. The CP has not considered the four options under Approach 1 Exchange/Non-Exchange – Updated IPSAS 23 for revenue. These options are:
  - enhanced display/disclosure;
  - classify time requirements as a condition;
  - classify transfers with time requirements as "other resources"; and
  - net assets/equity and recycle through the statement of financial performance.

- For revenue recognition approaches, the NZASB has ruled out the two liability options. For non-exchange expenses, should the IPSASB consider the presentation and OCI options? It is questionable whether the OCI option should be applied to expenses because it feels different from revenue (for a start the recognition of expenses through OCI would result in a negative equity reserve). The NZASB should rethink about the OCI option for revenue
- Even if the funding has time requirements, this can't mandate people to spend the money within the specified time. There are two competing approaches in public policy.
    - Performance based obligation – specify the performance for accountability measures, this is Category B transactions.
    - Rights based approach – funding is provided to those who are the best position to provide the goods/services rather than setting performance expectation.

  In NZ we are trying to push for a performance based approach.

- For defence and street lighting, these arrangements can be set up to have performance obligations. Equally can have non-performance obligation contracts for research grants.

Staff's preliminary response

- As noted in our overview, our proposed framework for non-exchange expense recognition, should be classified as those transactions with performance obligations or those with no performance obligations. Rather than whether the transaction is exchange or non-exchange; the nature of the benefits (i.e. universal accessible or collective services); or the nature of stipulations (i.e. restrictions versus conditions).
- We agree non-exchange expense transactions with performance obligations should be accounted using a PSPOA for expenses. We consider that a performance obligation is defined as an enforceable agreement with the resource recipient to deliver specific goods or services either for the direct benefit of the resource provider or agreed beneficiaries. Under this approach expenses are recognised as the performance obligations are fulfilled.
- We disagree the PSPOA for expenses should be applied to non-exchange expense transactions with stipulations. Stipulations is not the same as performance obligations. In chapter 4 of the CP, the IPSASB did not think revenue transactions with just a time requirement will meet the "distinct services" criterion and therefore formed the view that a PSPOA would not be appropriate for these revenue transactions. We agree with the IPSASB's rationale for revenue, therefore expense transactions with just time requirements are not performance obligations and should not be accounted for under the PSPOA. The PSPOA equally does not apply to:
    - grants with consumption-based stipulations that are not enforceable;
    - grants with consumption-based stipulations that are enforceable; and
    - grants where there is no transfer of goods/services to beneficiaries.
- Under the PSPOA for expenses we envisage a simplified approach could be developed, based on recognising expenses when performance obligations are satisfied by the resource provider,

rather than developing a full PSPOA based on reversing the IFRS 15 five-step model to reflect the resource provider context. This approach will require the following to be considered.

- Clear definition of a performance obligation such as specificity of the goods and services to be delivered. Does the definition require the transfer of goods or services to the resource provider or beneficiary?
- Clear definition of enforceable, what enforcement mechanisms in addition to a return obligation would allow for a PSPOA to be applied?
- When would an asset be recognised and what does it represent i.e. prepayment, resources in advance, something else?

- The CP does not appear to have fully considered the accounting for non-exchange expense transactions with no performance obligations but have stipulations such as time requirements or conditions over use. There is still a need for a residual standard for these transactions.
- Under our proposed framework, for other non-exchange expense transactions with no performance obligations but with stipulations over use, these are recognised using the Obligating Event Approach. Under this approach, a liability and corresponding expense are recognised immediately when an obligating event arises. This approach is supported by enhanced presentation to highlight the stipulation.
- Partially agree with PV 7 subject to our comments above and in the overview.

Questions for the Board

PV 7 provides the IPSASB view that the PSPOA should be applied for all non-exchange expense transactions with either performance obligations <u>or stipulations over use</u>. We agree the PSPOA should be applied to non-exchange expense transactions with performance obligations, but do not agree this approach should be stretched to include stipulations.

Based on constituent outreach activities, we have noted three options to account for non-exchange expense transactions with stipulations (but no performance obligations).

(a) The Obligating Event Approach — under this approach non-exchange expense transactions will be expensed immediately when a liability is recognised, with enhanced presentation to disclose stipulations. This approach is in staff's proposed framework for non-exchange expense recognition.

(b) The EOEA — under this approach non-exchange expense transactions with restrictions over use will be expensed immediately, and those with conditions (return obligations or other enforcement mechanisms) will be expensed when the recipient satisfies the conditions. This approach is proposed by the CP for Category A non-exchange expense transactions.

(c) The OCRE (OCI) approach — under this approach non-exchange expense transactions with stipulations will be initially recognised through OCRE and recycled to the statement of financial performance as the stipulations are fulfilled. This approach is the reverse of the option being considered by the Board for revenue recognition approaches.

1. Does the Board support the Obligating Event Approach with enhanced presentation for non-exchange expense transactions with stipulations (but no performance obligations), or should we develop any of the other two options for inclusion in the comment letter?
2. If the Board do not support an OCRE approach for question 1, does the Board want to reconsider the OCRE option for the recognition of revenue with stipulations (but no performance obligations)?

Preliminary View 8 (following paragraph 7.18)

The Board considers that at initial recognition, non-contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.

Do you agree with the IPSASB's Preliminary View 8? If not, please give your reasons.

Notes for Preliminary View 8

- PV 8 is consistent with the New Zealand government's accounting policy prior to the adoption of the PBE standards, see below.
- Face value is more understandable to users and the balance sheet asset is appropriately measured.
- A summary of the current and past accounting of non-contractual receivables for New Zealand from an IPSASB paper[11] is provided below.
  - Prior to 2014/15 the Government of New Zealand developed accounting policies for sovereign receivables based on IFRSs. More recently the accounting policies for sovereign receivables have been based on the requirements in IPSAS 23.
  - In 2008, under IFRSs, the New Zealand Government developed the following accounting policy for sovereign receivables:

    "Receivables from taxes, levies and fines (and any penalties associated with these activities) as well as social benefit receivables which do not arise out of a contract are collectively referred to as sovereign receivables.

    Sovereign receivables are initially assessed at nominal amount or face value; that is, the receivable reflects the amount of tax owed, levy, fine charged, or social benefit debt payable. These receivables are subsequently adjusted for penalties and interest as they are charged, and tested for impairment. Interest and penalties charged on tax receivables are presented as tax revenue in the statement of financial performance."
  - For certain receivables, such as fines, it was expected a percentage would not be collected based on past history because entities/citizens would be unable or unwilling to pay the amount owed, or estimated to be owed. Under the accounting policy this

[11] IPSASB June 2017 meeting, agenda item 11.8 Issues paper Statutory Receivables

was recognized as a day one impairment expense (which also required an appropriation).

- In 2009 the New Zealand Treasury also issued guidance on the treatment of tax receivables which outlined the following approach to tax receivables:

  (a) Tax receivables should be recognized at the amount of the tax owed, the guidance stated that the amount of tax owed was equal to fair value, and expressed the view that this was consistent with NZ IAS 39 and IPSAS 23. The tax obligation was regarded as being analogous to the transaction price and no concessionary terms or conditions exist in most cases to suggest that fair value would be less than face value.

  (b) Subsequent re-estimation of the tax owed (or estimated to be owed) is necessary because of the gap between the tax event and the tax filing date. Changes to assessments or expectations regarding the outcome of taxes in dispute is an adjustment to tax revenue.

  (c) Tax receivables should be subsequently adjusted for any penalties and interest as charged, and should be assessed annually for impairment in accordance with NZ IAS 36 *Impairment of Assets*.

  (d) Tax receivables are short term, so there is no need for discounting.

- Following the adoption of PBE Standards based on IPSASs in 2014/15 there have been debates about how the requirements in IPSAS 23 for initial measurement at fair value should be applied to statutory receivables and revenue. The differing views are as follows:

  (a) One view was that initial fair value of statutory receivables is the best estimate of the inflows arising to the government, represented by the discounted cash flows expected to be received. Under this fair value approach, statutory receivables and revenue are initially recognized at the discounted value, with no day one impairment expense for amounts expected to be uncollectible. Proponents of this view argued that in one unusual case, where only 3% of the fine is actually collected, that it would be misleading to show 100% as revenue and 97% as an impairment expense on initial recognition. It was acknowledged that this extreme scenario is not common in New Zealand.

  (b) The alternative view was that, for the majority of fines and taxes, initial recognition of fines at face value provides useful information, is more transparent and better meets the objective of accountability. Under this alternative view the amount expected to be uncollectible would be shown as an impairment. Proponents of this view (the face value approach), argued that sovereign power is exercised through the use of constitutionally and legally sanctioned authority. If it is assumed that tax payers and fines-payers are willing to abide by constitutionally and legally sanctioned processes, then it can be argued that they are willing to pay the amount levied. On that basis when applying the definition of fair value (“the amount at which an asset could be exchanged, or liability settled, between knowledgeable, willing parties in an arm’s length transaction”), the initial fair-value of receivables arising from the exercise of sovereign power should be the amount owed, or estimated to be owed because both parties are knowledgeable and willing to transact at that initial amount.

- o The debate in New Zealand has focused on whether fair value is the same as face value, or whether it is face value less amounts that are regarded as being uncollectable from day 1. The latter approach was taken on transition to the new PBE Standards (based on IPSASs) in the 2014/15 financial statements of the New Zealand Government, because it was considered that recording sovereign revenue at its face value would not comply with IPSAS 23. However, there continue to be concerns about whether the requirements in IPSAS 23 are appropriate for demonstrating accountability for the initial sovereign revenue and the collection of that revenue.

Staff's preliminary response

- Agree with PV 8.
- This measurement promotes transparency and accountability. Face value reflects what is levied under statue for users.
- Face value is easier for users to understand compared to fair value.

Preliminary View 9 (following paragraph 7.34)

The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

Do you agree with the IPSASB's Preliminary View 9? If not, please give your reasons.

Notes for Preliminary View 9

- Practically, the fair value approach is the easiest to apply out of the three approaches. These receivables are often made up of a large number of debtors with small amounts. Preparers can apply an actuarial model to calculate the estimated cash flows. For example, large tax portfolios can apply an actuarial model to calculate updated estimate cash flows, using a history of tax estimates by tax type, history of collecting a particular tax type in prior periods, and then overlaid with assumption about the current economic conditions.
- For these large portfolios, it is difficult to apply the amortised cost approach (would need to track separate discount rates based on dates of debt origination), and it would probably be unworkable to apply the IFRS 9 expected credit loss impairment model without a practical expedient to use life-time credit losses for all statutory debtors.
- The cost approach also seems problematic in determining when there is an indication of impairment, plus how would you determine a debtor impaired/impairment reversed within a large portfolio. Rather than identify indications of when the portfolio might be impaired, it may be more pragmatic to just re-value the portfolio annually on a discounted cash flow basis (fair value approach).

- The fair value approach has the most appeal as the most workable because it appears the easiest of the three approaches to apply in practice. However, we would strongly support the IPSASB determining the presentation and disclosure for statutory receivables starting from scratch, and not automatically adopting all the disclosures from IFRS 9 by analogy. Many of the IFRS 9 disclosures have been designed with commercial contractual arrangements in mind with a focus on counter-party credit risk. Many of the disclosures therefore won't be applicable to statutory receivables.

- In the NZ context, the government's tax receivable portfolio is not overly sensitive to discount rates, but that may not be the case in other jurisdictions. The IPSASB will need to consider how the volatility in a discounted cash flow is best presented in the statement of financial performance. Also, the IPSASB would need to consider where the fair value gain or loss is displayed in the statement of financial performance and what it is called. It may be better to display the movement in the same line each year, regardless of whether it moved from a loss or gain in different years.

Staff's preliminary response

- Agree with PV 9.

- The fair value approach has the most appeal as the most workable because it appears the easiest of the three approaches to apply in practice. However, we would strongly support the IPSASB determining the presentation and disclosure for statutory receivables starting from scratch, and not automatically adopting all the disclosures from IFRS 9 by analogy. Many of the IFRS 9 disclosures have been designed with commercial contractual arrangements in mind with a focus on counter-party credit risk. Many of the disclosures therefore won't be applicable to statutory receivables.

- In the NZ context, the government's tax receivable portfolio is not overly sensitive to discount rates, but that may not be the case in other jurisdictions. The IPSASB will need to consider how the volatility in a discounted cash flow is best presented in the statement of financial performance. Also, the IPSASB would need to consider where the fair value gain or loss is displayed in the statement of financial performance and what it is called. It may be better to display the movement in the same line each year, regardless of whether it moved from a loss or gain in different years.

Specific Matter for Comment 7 (following paragraph 7.46)

For subsequent measurement of non-contractual payables do you support:

(a) Cost of Fulfillment Approach:

(b) Amortized Cost Approach;

(c) Hybrid Approach; or

(d) IPSAS 19 requirements?

Please explain your reasons.

Notes for Specific Matter for Comment 7

- The current New Zealand Government accounting policy for taxes payable is nominal value. This is a reasonable approximation of the fair value. This measurement is most aligned with the cost of fulfilment approach.
- Cost of fulfilment would be consistent with PV 9 (subsequent measurement at fair value) for non-contractual receivables. There needs to be a compelling reason to have a different measurement basis between non-contractual payables and non-contractual receivables.

Staff's preliminary response

We support the cost of fulfilment approach. This is consistent with the fair value approach for non-contractual receivables. There needs to be a compelling reason to have a different measurement basis between non-contractual payables and non-contractual receivables.

APPENDIX A Current accounting of grant expenditure in New Zealand

1. The gap in the PBE Standards on non-exchange expenses has resulted in preparers using other sources for authoritative guidance. These sources include the PBE *Conceptual Framework*, PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* and PBE IPSAS 23 *Revenue from Non-Exchange Transactions.*

2. In absence of a specific guidance on non-exchange expenses, preparers have used the sources above to develop guidance for grant expenditure.

3. The Office of the Auditor-General (OAG) has drafted *How Should Public Entities Account for Grant Expenditure?* (draft guidance). This draft guidance was used for a technical discussion forum and has not been officially issued by the OAG. Whilst the draft guidance is not an official document it is useful to see one view of the accounting for grant expenditure. An extract of the draft guidance is provided below. Treasury has issued a circular to their agencies with similar views on the accounting for grant expenditure.

Grant expenditure where the grant has no conditions

4. If a grant is provided without conditions, or the conditions are of a non-substantive or administrative nature, the resource provider is unlikely to retain control over the grant once the resource provider has an obligation to transfer resources.

5. Stipulations need to be substantive rather than administrative to be considered conditions. Examples of non-substantive or administrative stipulations are:

   (a) grant payments that are made upon the receipt of an invoice; or

   (b) grant payments that are made upon the receipt of a progress report when such reports are not subject to review and possible action.

6. If in substance the grant stipulations are of a non-substantive or administrative nature the grant should be accounted for as if there were no conditions (see paragraph 7).

7. Such grants should be recognised by the resource provider as an expense on approval and communication to the recipient (the obligating event), even if it is a multi-year grant, unless it contains a substantive termination clause. This is irrespective of whether the grants are paid in arrears (reimbursement basis) or in advance.

8. The accounting for grant expenditure where the grant has no conditions will be:

   DR. Expense
   CR. Liability
   (obligation to pay upon the approval of grant and communication to the recipient)

   DR. Liability
   CR. Bank
   (payment of grant)

Grant expenditure where the grant has conditions

9. If a grant is provided with conditions the expenditure should be recognised by the resource provider when the relevant conditions are satisfied.

10. To account for grant expenditure on a "with conditions" basis, the resource provider must be able to reasonably refuse to pay (more) funding or enforce repayment of funding already provided to the recipient.

11. The accounting for grant expenditure where the grant has conditions will be as follows:

    Grants paid in advance

    DR. Asset
    CR. Bank
    (payment of grant)

    DR. Expense
    CR. Asset
    (conditions are satisfied)

    Grants paid in arrears

    DR. Expense
    CR. Liability
    (conditions are satisfied)

    DR. Liability
    CR. Bank
    (payment of grant)

12. Conditions may be satisfied on a continuous basis irrespective of the actual milestone schedule. The substance of the arrangement should be considered, including the likely cash flows if the expenditure or project ceased at balance date.

13. For example, a grant paid in arrears with a condition restricting the funding to eligible marketing costs might be recognised as an expense as the marketing expenditure is incurred, rather than on the next milestone, if all eligible expenditure incurred is likely to be funded (whether or not the full project is completed). However, this accounting approach will require the resource provider to have the relevant expenditure information from the recipient. If this information is not available, then the accounting would need to be based around milestones/reporting dates - when relevant information will be available from the recipient.

14. As another example, a grant paid in arrears to reimburse the costs of a project might only be paid if the project is completed (i.e. if a project is ceased part way through, no grant would be paid). In this case, it may be appropriate to only recognise an expense when the project completion milestone is reached (or possibly interim milestones in the funding agreement).

15. Using the completion milestone as the expense recognition point may unreasonably defer expenditure recognition (particularly, for example, for long projects with completion just after balance date). Often the resource provider will have raised a valid expectation with the recipient that it will provide funding and the ability to not pay the funding will be limited and could be subject to legal challenge. In these circumstances, one may conclude that the final grant payment process may not represent a condition in substance and an earlier expenditure recognition point may be appropriate. There are examples of such arrangements where the full liability and expense is recognised upfront. This is on the basis it is considered probable that the milestones will be met in future based on experience and the grant vetting process supports this argument.

Deferring the recognition of a grant expenditure that is paid in advance

16. A resource provider can defer recognising grant expenditure for a grant that has been paid in advance until the conditions are met and instead recognise an asset, such as a prepayment or debtor. The key hurdle to recognising an asset is to meet the asset recognition criteria. However, in many cases, the resource provider will not control the resources once the grant has been paid out and therefore recognising an asset will not be appropriate.

17. Due to the nature of government funding (particularly to the NGO sector), deferral of expense recognition beyond the point of payment is unlikely, unless there are very clear repayment provisions for non-completion/delivery and a history of seeking refunds for non-completion.

18. In addition, the collectability of the “debts” needs to be considered. In practice, it may be difficult to recover any funds, as the recipient may have spent them and not be in a position to repay the resource provider.

19. In some cases it may be appropriate to disclose a contingent asset where the recognition criteria have not been met, for example if unused funds must be returned to the resource provider and an inflow of funds from across the portfolio of grants paid is assessed as probable.

APPENDIX B Applying the CP approaches to non-exchange expenses examples

Example 1: General grant

1. Fact pattern

   (a) A public benefit entity (PBE) pays $100,000 on balance date to a charity.

   (b) The funds must be used over three years for the charity's charitable purpose.

   (c) There are return conditions. Any unspent funds at the end of the three years must be returned to the PBE.

   (d) This is a non-exchange expense transaction.

2. A summary of the current accounting and proposed approaches is set out it table 1 below.

Table 1 Example 1

Initial recognition	Recognise expense over more than one period	Comments
Current accounting: View 1		
DR Expense $100K CR Bank $100K	☒ No	The debit entry is an expense. The debit entry is not an asset because the grant does not meet the asset recognition criteria. The PBE no longer has control over the resource once the payment has been made. Even though there are return conditions, the argument is that it is hard to recover resources once it has been paid. The expense is recognised when the grant is paid (i.e. the expense is recognised up front).
Current accounting: View 2		
DR Asset $100K CR Bank $100K	☑ Yes DR Expense $XX CR Asset $XX	The debit entry is an asset if it meets the asset recognition criteria. The expense is recognised over the three years. To recognise an asset the arrangement needs clear repayment provisions for non-completion/delivery and a history of seeking refunds for non-completion. In practice, it may be difficult to recover any funds as the recipient may have spent this and may not be in the position to repay the resource provider. If the asset recognition criteria is not met, the resource provider could disclose a contingent asset about the possibility of the recipient returning the funds if it is not used within the three years.

Approach 1: The Extended Obligating Event Approach		
DR Expense $100K CR Bank $100K	☑ Yes DR Expense $XX CR Asset $XX	The debit entry is an asset because there are return conditions. An asset is recognised until the conditions have been fulfilled by the resource recipient. Once the conditions have been fulfilled, the resource provider will recognise an expense and decrease the corresponding asset. An asset is initially recognised because in the event of the resource recipient breaching the condition, the resource provider has an enforceable right to require the resource recipient to return the resources. Therefore, the resource provider controls those resources until the condition is fulfilled.
Approach 2: The Public Sector Performance Obligation Approach (PSPOA) for Expenses		
DR Expense $100K CR Bank $100K	☒ No	There are no enforceable promises to deliver distinct services to the PBE or to beneficiaries to which consideration can be allocated. Therefore, the expense is recognised when it is paid. This arrangement does not contain performance obligations as described in the PSPOA approach. See the five-step model below.

The PSPOA for Expenses	
Step 1 – Identify the binding arrangement	Both parties have entered into a binding agreement where the PBE agrees to transfer $100,000 for the charity's charitable purpose to be used over a three-year period (stipulation). However, the arrangement contains no promises to deliver distinct services to the PBE or to beneficiaries.
Step 2 – Identify the performance obligations	The arrangement contains no promises to deliver services that are distinct enough to consider linking the satisfaction of performance obligations and the consideration. The PBE could not enforce the charity to deliver services to them, or to beneficiaries. Also, some of the funds used by the charity may not result in the direct transfer of services to beneficiaries. This arrangement does not contain performance obligations as described in the PSPOA five-step model.
Step 3 – Determine the consideration	The total consideration is $100,000.
Step 4 – Allocate the consideration	There are no performance obligations to allocate the consideration against.
Step 5 – Recognise expense	The total expense of $100,000 would be recognised by the PBE when paid (on signing) because there are no promises to deliver services to the PBE or to beneficiaries in the arrangement. DR Expense $100K CR Bank $100K

Example 2: Specific grant

3. Fact pattern

   (a) A public benefit entity (PBE) pays $100,000 on balance date to a charity.

   (b) The funds must be used to provide 3,000 hours of counselling services to the community over three years.

   (c) The charity is required to report to the PBE on a monthly basis the progress of the counselling services provided. Progress is measured by the number of counselling hours provided in a month.

   (d) There are no return conditions.

   (e) This is a non-exchange expense transaction.

4. A summary of the current accounting and proposed approaches is set out it table 2 below.

Table 2 Example 2

Initial recognition	Recognise expense over more than one period	Comments
Current accounting		
DR Expense $100K CR Bank $100K	☒ No	The debit entry is an expense. The debit entry is not an asset because the grant does not meet the definition of an asset. The PBE no longer has control over the resource once the payment has been made. The expense is recognised when the grant is paid (i.e. the expense is recognised up front).
Approach 1: The Extended Obligating Event Approach		
DR Asset $100K CR Bank $100K	☒ No	No changes to the recognition of expense from the current accounting. The agreement has a restriction rather than a condition. In the event of a breach of a restriction the PBE has no enforceable right to recover the resource.
Approach 2: The PSPOA for Expenses		
DR Asset $100K CR Bank $100K	☑ Yes DR Expense $XX CR Asset $XX	There are enforceable performance obligations imposed on the charity to provide counselling services to the community, the expense is recognised as the counselling services are provided. See the five-step model below.

The PSPOA for Expenses	
Step 1 – Identify the binding arrangement	The funding agreement establishes a binding arrangement where both parties have enforceable rights – the PBE has the ability to enforce the charity to provide the counselling services and refund the resources if this is not delivered and the charity has the ability to enforce the funding under the arrangement.
Step 2 – Identify the performance obligations	In the agreement, the charity has promised to perform a task (the counselling services) for the PBE. The counselling services are a distinct service and the promises in respect of the counselling services are explicitly stated in the agreement. Each hour of counselling services provided is a performance obligation.
Step 3 – Determine the consideration	The total agreed consideration of $100,000 is promised for the provision of 3,000 hours of counselling services to the community.
Step 4 – Allocate the consideration	Consideration of $100,000 is allocated to each performance obligation as it is fulfilled – that is approx. $33 per hour of counselling service provided.
Step 5 – Recognise expense	The PBE would recognise the expense as the charity satisfies the performance obligation by providing the counselling services (reducing the asset that was initially recognised). The hours of counselling services provided would be an appropriate measure of progress to determine how much expense should be recognised as the performance obligation is satisfied. The satisfaction of the performance obligation can be evidenced by the charity's monthly report to the PBE. DR Asset $100K CR Bank $100K (an asset is recognised because the charity has yet to fulfil any performance obligation) DR Expense $XX CR Asset $XX (expense is recognised as the counselling services are provided)

XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	26 October 2017
To:	NZASB Members
From:	Vanessa Sealy-Fisher
Subject:	***Prepayment Features with Negative Compensation***

Action required[1]

1. The Board is asked to:

   (a) APPROVE for issue *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9);

   (b) APPROVE the Certificate Signing Memorandum; and

   (c) CONSIDER the application of the *Policy Approach to the Development of PBE Standards* to *Prepayment Features with Negative Compensation*.

Background

2. The (IASB) issued Exposure Draft ED/2017/3 *Prepayment Features with Negative Compensation* (Proposed amendments to IFRS 9) (IASB ED/2017/3) in April 2017. Comments were due to the IASB by 24 May 2017.

3. The NZASB issued IASB ED/2017/3 for comment in New Zealand around the same time. Because of the short comment period (30 days), the NZASB requested that comments be submitted directly to the IASB.

4. The IASB received 60 comment letters from its world-wide constituents. It did not receive comments from any New Zealand constituents, including the NZASB.

5. The IASB issued *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) in October 2017. The amending standard is effective for annual reporting periods beginning on or after 1 January 2019, with earlier application permitted.

Reason for issuing the amending standard

6. The IFRS Interpretations Committee (the Committee) received a request seeking clarification regarding the classification of particular prepayable financial assets when applying IFRS 9 *Financial Instruments*. Clarification was sought on whether a debt instrument could have

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

contractual cash flows that are solely payments of principal and interest on the principal amount outstanding if its contractual terms permit the borrower to prepay the instrument at a variable amount that could be more or less than unpaid amounts of principal and interest. As a result of such a contractual prepayment feature, the lender could be forced to accept a prepayment amount that is substantially less than unpaid amounts of principal and interest, which would, in effect, include an amount that reflects a payment **to** the borrower by the lender (instead of compensation **from** the borrower to the lender) even though the borrower chose to terminate the contract early. This is referred to as 'negative compensation'.

7. The Committee noted that such contractual cash flows would not be solely payments of principal and interest and therefore the financial assets would be measured at fair value through profit or loss. However, Interpretations Committee members suggested that the Board consider whether using amortised cost measurement could provide useful information about particular financial assets with such prepayment features, and if so, whether the requirements in IFRS 9 should be changed in this respect.

8. The Committee had also received a request regarding the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. The question was whether, applying IFRS 9, an entity recognises any adjustment to the amortised cost of the financial liability arising from such a modification or exchange in profit or loss at the date of the modification or exchange.

9. The Committee asked the IASB to consider both these issues.

Key issues

Prepayment features with negative compensation

10. The amending standard provides a narrow exception to IFRS 9 for financial assets that contain prepayment features with negative compensation. Depending on an entity's business model, some such instruments may now be measured at amortised cost or fair value through other comprehensive income (FVOCI) rather than at fair value through profit or loss.

11. IASB ED/2017/3 proposed that financial assets with prepayment features with negative compensation would be eligible to be measured at amortised cost or FVOCI subject to the assessment of the business model under which they are held if the following two conditions are met:

    (a) the prepayment amount is inconsistent with paragraph B4.1.11(b)[2] of IFRS 9 only because the party that chooses to terminate the contract early (or otherwise causes the early termination to occur) may *receive* reasonable additional compensation for doing so); and

    (b) when the entity initially recognises the financial asset, the fair value of the prepayment feature is insignificant.

[2] Paragraph B4.1.11 is reproduced in Appendix 1 to this memo.

12. Nearly all respondents agreed with the first eligibility condition. However, respondents expressed mixed views on the second eligibility condition.

13. Most respondents who disagreed with the second eligibility condition were of the view that the treatment of prepayment features with negative compensation should be aligned with the treatment of prepayment features with positive compensation. There were also concerns on the difficulty of assessing whether the fair value of the prepayment feature is insignificant when the entity initially recognised the financial asset.

14. After consideration of the feedback received, the IASB decided to proceed with the amendments to IFRS 9, but to delete the second eligibility condition in IASB ED/2017/3.

Modification or exchange of a financial liability that does not result in derecognition

15. The IASB Basis for Conclusions which accompanies *Prepayment Features with Negative Compensation* clarifies the accounting requirements for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability.

16. The Committee issued a tentative agenda decision on this issue in March 2017. The tentative agenda decision expressed the view that the principles and requirements in IFRS 9 (in particular paragraph B5.4.6) provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition.

17. Based on the comments received (13) on that tentative agenda decision, the Committee did not finalise the agenda decision and instead referred the matter to the IASB.

18. Respondents disagreed with the following aspects of the tentative agenda decision.

    (a) The conclusion in the tentative agenda decision that the requirements in paragraph B5.4.6 of IFRS 9 apply to *all revisions* of estimated payments or receipts, including changes in cash flows arising from a modification or exchange of a financial liability that does not result in the derecognition of a financial liability. Respondents were of the view that an exchange or modification is different from a revision of estimated payments or receipts that occurs according to the original (unmodified) contractual terms of the financial instrument, and therefore, those two cases should be analysed separately and possibly result in different accounting.

    (b) Applying paragraph B5.4.6 to a modification of the interest rate charged does not represent the substance of the transactions. In the respondents' view, such a change in interest rate reflects a change in the economic characteristics of the liability *in future periods* and would be more faithfully represented by the recognition of an increased or decreased interest expense over the remaining life of the borrowing, rather than by the recognition of an immediate gain or loss. Some respondents thought that paragraph B5.4.5 of IFRS 9 applies in this case, rather than paragraph B5.4.6.

19. The requirements in paragraph B5.4.6 of IFRS 9 have been discussed at several IASB meetings and IASB staff were of the view that respondents have not provided any new information

beyond that considered by the Committee and the Board in their deliberations. The IASB decided that standard-setting is not required in this situation but it would consider other ways to highlight the relevant accounting required by IFRS 9.

20. This has been done in the IASB Basis for Conclusions which accompanies *Prepayment Features with Negative Compensation*. The Basis for Conclusions states that standard-setting is not required because the requirements in IFRS 9 provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition. In addition, those requirements are consistent with the requirements for adjusting the gross carrying amount of a financial asset when a modification does not result in the derecognition of the financial asset.

RDR concessions

21. The amending standard requires disclosures by an entity that adopts IFRS 9 before it adopts these amendments (see paragraph 7.2.34). These disclosures were not included in IASB ED/2017/3 because the ED proposed an effective date for the amendments of annual periods beginning on or after 1 January 2018, which is the same as the effective date for IFRS 9.

22. The IASB Basis for Conclusions notes that these disclosures are similar to those in paragraphs 42I–42J of IFRS 7 *Financial Instruments: Disclosures*.

23. No RDR concessions are proposed at this time because there are currently no concessions for the equivalent disclosures in NZ IFRS 7.

24. For the Board's information, Appendix 2 to this memo provides a comparison of the disclosures in paragraph 7.2.34 of IFRS 9 with the disclosures in NZ IFRS 7 and the concessions, both current and proposed under the new RDR framework.

Consistency with Australian accounting standards

25. The Australian Accounting Standards Board expects to issue the equivalent amendments to AASB 9 *Financial Instruments* at its meeting in December.

Due process

26. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of IASB ED/2017/3 and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB's meeting on 19 July 2017.[3]

27. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in our view, meets the requirements of section 22 of the Financial Reporting Act 2013.

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[3] A summary of the IASB's July 2017 meeting is available at: http://www.ifrs.org/news-and-events/updates/iasb-updates/july-2017/#4

28. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the standard is likely to require the disclosure of personal information. In our view, the standard does not include requirements that would result in the disclosure of personal information, and therefore no consultation with the Privacy Commissioner is required.

Draft amending standard and signing memo

29. Attached as agenda item 8.2 is a copy of *Prepayment Features with Negative Compensation*. A paragraph has been added to limit application to Tier 1 and Tier 2 for-profit entities only.

30. Attached as agenda item 8.3 is a draft Certificate Signing Memorandum from the Chair of the NZASB to the Chair of the XRB Board.

Application of the PBE Policy Approach

31. Agenda item 8.4 sets out the application of the *Policy Approach to Developing the Suite of PBE Standards* to *Prepayment Features with Negative Compensation*. Agenda item 8.4 recommends that the Board agrees not to incorporate *Prepayment Features with Negative Compensation* into PBE IFRS 9 but to wait for the International Public Sector Accounting Standards Board (IPSASB) to consider whether to incorporate the amendments into the equivalent International Public Sector Accounting Standard.

Recommendations

32. We recommend that the Board:

    (a) APPROVES for issue *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9) (agenda item 8.2);

    (b) APPROVES the Certificate Signing Memorandum from the Chair of the NZASB to the Chair of the XRB Board requesting approval to issue the amending standard (agenda item 8.3); and

    (c) CONSIDERS the application of the *Policy Approach Developing the Suite of PBE Standards* to *Prepayment Features with Negative Compensation* and AGREES to wait for the IPSASB to consider the incorporation of these amendments into IPSASs (agenda item 8.4).

Attachments

Agenda item 8.2:	Draft *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9)
Agenda item 8.3:	Draft Certificate Signing Memorandum
Agenda item 8.4:	Application of PBE Policy Approach to *Prepayment Features with Negative Compensation*
Agenda item 8.5:	*Policy Approach to Developing the Suite of PBE Standards* (in supporting papers)

Appendix 1

Paragraph B4.1.11 of NZ IFRS 9

Contractual terms that change the timing or amount of contractual cash flows

B4.1.10 …

B4.1.11 The following are examples of contractual terms that result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding:

(a) …

(b) a contractual term that permits the issuer (ie the debtor) to prepay a debt instrument or permits the holder (ie the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the early termination of the contract; and

(c) …

Appendix 2

Comparison of the disclosures in new paragraph 7.2.34 of IFRS 9 with the similar disclosures in NZ IFRS 7, and the current and proposed RDR concessions in respect of those disclosures. The comment in red font is a response from an Australian constituent to the proposal in the RDR ED.

New paragraph 7.2.34 of IFRS 9	Current RDR in NZ IFRS 7	Proposed RDR in NZ IFRS 7	Comments in RDR EDs
7.2.34 In the reporting period that includes the date of initial application of these amendments, the entity shall disclose the following information as at that date of initial application for each class of financial assets and financial liabilities that were affected by these amendments: (a) the previous measurement category and carrying amount determined immediately before applying these amendments;	**Initial application of IFRS 9** 42I In the reporting period that includes the date of initial application of AASB 9/NZ IFRS 9, the entity shall disclose the following information for each class of financial assets and financial liabilities as at the date of initial application: (a) the original measurement category and carrying amount determined in accordance with AASB 139/NZ IAS 39 or in accordance with a previous version of AASB 9/NZ IFRS 9 (if the entity's chosen approach to applying AASB 9/NZ IFRS 9 involves more than one date of initial application for different requirements);	**Initial application of IFRS 9** 42I In the reporting period that includes the date of initial application of AASB 9/NZ IFRS 9, the entity shall disclose the following information for each class of financial assets and financial liabilities as at the date of initial application: (a) the original measurement category and carrying amount determined in accordance with AASB 139/NZ IAS 39 or in accordance with a previous version of AASB 9/NZ IFRS 9 (if the entity's chosen approach to applying AASB 9/NZ IFRS 9 involves more than one date of initial application for different requirements);	Paragraph 42I(a) is a Key Disclosure Area (current liquidity and solvency, and the nature of the transaction or event that makes it significant or material to the entity) – the benefits of providing the disclosure exceed the costs. Therefore, paragraph 42I(a) is kept for Tier 2 entities.
(b) the new measurement category and carrying amount determined after applying these amendments;	(b) the new measurement category and carrying amount determined in accordance with AASB 9/NZ IFRS 9;	(b) the new measurement category and carrying amount determined in accordance with AASB 9/NZ IFRS 9;	Paragraph 42I(b) is a Key Disclosure Area (current liquidity and solvency,) – the benefits of providing the disclosure exceed the costs. Therefore, paragraph 42I(b) is kept for Tier 2 entities.

New paragraph 7.2.34 of IFRS 9	Current RDR in NZ IFRS 7	Proposed RDR in NZ IFRS 7	Comments in RDR EDs
(c) the carrying amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated; and	(c) the amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated, distinguishing between those that AASB 9/NZ IFRS 9 requires an entity to reclassify and those that an entity elects to reclassify at the date of initial application. In accordance with paragraph 7.2.2 of AASB 9/NZ IFRS 9, depending on the entity's chosen approach to applying AASB 9/NZ IFRS 9, the transition can involve more than one date of initial application. Therefore this paragraph may result in disclosure on more than one date of initial application. An entity shall present these quantitative disclosures in a table unless another format is more appropriate.	(c) the amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated, distinguishing between those that AASB 9/NZ IFRS 9 requires an entity to reclassify and those that an entity elects to reclassify at the date of initial application. In accordance with paragraph 7.2.2 of AASB 9/NZ IFRS 9, depending on the entity's chosen approach to applying AASB 9/NZ IFRS 9, the transition can involve more than one date of initial application. Therefore this paragraph may result in disclosure on more than one date of initial application. An entity shall present these quantitative disclosures in a table unless another format is more appropriate.	Paragraph 42I(c) is not a Key Disclosure Area – the costs of providing the disclosure exceed the benefits. Therefore, paragraph 42I(c) is reduced for Tier 2 entities. Respondent AR7 to the RDR EDs is of the view that this disclosure would be required where there is a material impact to meet the requirements of AASB 108, in which case there is no reduced burden.

New paragraph 7.2.34 of IFRS 9	Current RDR in NZ IFRS 7	Proposed RDR in NZ IFRS 7	Comments in RDR EDs
(d) the reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through profit or loss.	42J In the reporting period that includes the date of initial application of AASB 9/NZ IFRS 9, an entity shall disclose qualitative information to enable users to understand: (a) how it applied the classification requirements in AASB 9/NZ IFRS 9 to those financial assets whose classification has changed as a result of applying AASB 9/NZ IFRS 9. (b) the reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through profit or loss at the date of initial application. In accordance with paragraph 7.2.2 of AASB 9/NZ IFRS 9, depending on the entity's chosen approach to applying AASB 9/NZ IFRS 9, the transition can involve more than one date of initial application. Therefore this paragraph may result in disclosure on more than one date of initial application.	42J In the reporting period that includes the date of initial application of AASB 9/NZ IFRS 9, an entity shall disclose qualitative information to enable users to understand: (a) how it applied the classification requirements in AASB 9/NZ IFRS 9 to those financial assets whose classification has changed as a result of applying AASB 9/NZ IFRS 9. (b) the reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through profit or loss at the date of initial application. In accordance with paragraph 7.2.2 of AASB 9/NZ IFRS 9, depending on the entity's chosen approach to applying AASB 9/NZ IFRS 9, the transition can involve more than one date of initial application. Therefore this paragraph may result in disclosure on more than one date of initial application.	Paragraph 42J is not a Key Disclosure Area – the costs of providing the disclosure exceed the benefits. Therefore, paragraph 42J is reduced for Tier 2 entities.

Prepayment Features with Negative Compensation (Amendments to NZ IFRS 9)

This Standard was issued on 9 November 2017 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 7 December 2017.

For-profit reporting entities that are subject to this Standard are required to apply it in accordance with the effective date, which is set out in Part C.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard is based on amendments issued by the International Accounting Standards Board (IASB) to clarify how to classify particular prepayable financial assets in accordance with IFRS 9 *Financial Instruments*.

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CONTENTS

Part A

Introduction

This Standard sets out amendments to NZ IFRS 9 *Financial Instruments* to clarify how to classify a debt instrument if its contractual terms permit the borrower to prepay the instrument at a variable amount that could be more or less than unpaid amounts of principal and interest.

As a result of such a contractual prepayment feature, the lender could be forced to accept a prepayment amount that is substantially less than unpaid amounts of principal and interest, which would, in effect, include an amount that reflects a payment **to** the borrower by the lender (instead of compensation **from** the borrower to the lender) even though the borrower chose to terminate the contract early. This is referred to as 'negative compensation'.

Tier 2 entities are required to comply with all the requirements in this Standard.

Part B – *Prepayment Features with Negative Compensation*

Scope

This Standard applies to Tier 1 and Tier 2 for-profit entities.

Amendments to NZ IFRS 9 *Financial Instruments*

Paragraph 7.1.7 is added. A new heading and paragraphs 7.2.29–7.2.34 are added.

Chapter 7 Effective date and transition

7.1 Effective date

…

7.1.7 *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9), issued in November 2017, added paragraphs 7.2.29–7.2.34 and B4.1.12A and amended paragraphs B4.1.11(b) and B4.1.12(b). An entity shall apply these amendments for annual periods beginning on or after 1 January 2019. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

7.2 Transition

…

Transition for *Prepayment Features with Negative Compensation*

7.2.29 An entity shall apply *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9) retrospectively in accordance with NZ IAS 8, except as specified in paragraphs 7.2.30–7.2.34.

7.2.30 An entity that first applies these amendments at the same time it first applies this Standard shall apply paragraphs 7.2.1–7.2.28 instead of paragraphs 7.2.31–7.2.34.

7.2.31 An entity that first applies these amendments after it first applies this Standard shall apply paragraphs 7.2.32–7.2.34. The entity shall also apply the other transition requirements in this Standard necessary for applying these amendments. For that purpose, references to the date of initial application shall be read as referring to the beginning of the reporting period in which an entity first applies these amendments (date of initial application of these amendments).

7.2.32 With regard to designating a financial asset or financial liability as measured at fair value through profit or loss, an entity:

(a) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if that designation was previously made in accordance with the condition in paragraph 4.1.5 but that condition is no longer satisfied as a result of the application of these amendments;

(b) may designate a financial asset as measured at fair value through profit or loss if that designation would not have previously satisfied the condition in paragraph 4.1.5 but that condition is now satisfied as a result of the application of these amendments;

(c) shall revoke its previous designation of a financial liability as measured at fair value through profit or loss if that designation was previously made in accordance with the condition in paragraph 4.2.2(a) but that condition is no longer satisfied as a result of the application of these amendments; and

(d) may designate a financial liability as measured at fair value through profit or loss if that designation would not have previously satisfied the condition in paragraph 4.2.2(a) but that condition is now satisfied as a result of the application of these amendments.

Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application of these amendments. That classification shall be applied retrospectively.

7.2.33 An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight and the restated financial statements reflect all the requirements in this Standard. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

7.2.34 In the reporting period that includes the date of initial application of these amendments, the entity shall disclose the following information as at that date of initial application for each class of financial assets and financial liabilities that were affected by these amendments:

(a) the previous measurement category and carrying amount determined immediately before applying these amendments;

(b) the new measurement category and carrying amount determined after applying these amendments;

(c) the carrying amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated; and

(d) the reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through profit or loss.

In Appendix B, paragraphs B4.1.11(b) and B4.1.12(b) are amended. Paragraph B4.1.12A is added. Paragraph B4.1.10 has not been amended but has been included for ease of reference. New text is underlined and deleted text is struck through.

Classification (Chapter 4)

Classification of financial assets (Section 4.1)

…

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

…

Contractual terms that change the timing or amount of contractual cash flows

B4.1.10 If a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, if the asset can be prepaid before maturity or its term can be extended), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows. The entity may also need to assess the nature of any contingent event (ie the trigger) that would change the timing or amount of the contractual cash flows. While the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk. (See also paragraph B4.1.18.)

B4.1.11 The following are examples of contractual terms that result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding:

(a) a variable interest rate that consists of consideration for the time value of money, the credit risk associated with the principal amount outstanding during a particular period of time (the consideration for credit risk may be determined at initial recognition only, and so may be fixed) and other basic lending risks and costs, as well as a profit margin;

(b) a contractual term that permits the issuer (ie the debtor) to prepay a debt instrument or permits the holder (ie the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable ~~additional~~ compensation for the early termination of the contract; and

(c) a contractual term that permits the issuer or the holder to extend the contractual term of a debt instrument (ie an extension option) and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the extension of the contract.

B4.1.12 Despite paragraph B4.1.10, a financial asset that would otherwise meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b) but does not do so only as a result of a contractual term that permits (or requires) the issuer to prepay a debt instrument or permits (or requires) the holder to put a debt instrument back to the issuer before maturity is eligible to be measured at amortised cost or fair value through other comprehensive income (subject to meeting the condition in paragraph 4.1.2(a) or the condition in paragraph 4.1.2A(a)) if:

(a) the entity acquires or originates the financial asset at a premium or discount to the contractual par amount;

(b) the prepayment amount substantially represents the contractual par amount and accrued (but unpaid) contractual interest, which may include reasonable ~~additional~~ compensation for the early termination of the contract; and

(c) when the entity initially recognises the financial asset, the fair value of the prepayment feature is insignificant.

B4.1.12A For the purpose of applying paragraphs B4.1.11(b) and B4.1.12(b), irrespective of the event or circumstance that causes the early termination of the contract, a party may pay **or** receive reasonable compensation for that early termination. For example, a party may pay or receive reasonable compensation when it chooses to terminate the contract early (or otherwise causes the early termination to occur).

Part C – Effective Date

This Standard is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted.

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	1 November 2017
To:	Graeme Mitchell, External Reporting Board
From:	Kimberley Crook, Chair NZASB
Subject:	***Prepayment Features with Negative Compensation***

Introduction[1]

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9).

2. The International Accounting Standards Board (IASB) issued *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) in response to a submission received by the IFRS Interpretations Committee (the Committee). The submission sought clarification regarding the classification of particular prepayable financial assets when applying IFRS 9 *Financial Instruments*.

3. Specifically, the submission asked whether a debt instrument could have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding if its contractual terms permit the borrower to prepay the instrument at a variable amount that could be more or less than unpaid amounts of principal and interest. As a result of such a contractual prepayment feature, the lender could be forced to accept a prepayment amount that is substantially less than unpaid amounts of principal and interest, which would, in effect, include an amount that reflects a payment **to** the borrower by the lender (instead of compensation **from** the borrower to the lender) even though the borrower chose to terminate the contract early. This is referred to as 'negative compensation'.

4. The Committee noted that such contractual cash flows would not be solely payments of principal and interest and therefore the financial assets would be measured at fair value through profit or loss. However, Interpretations Committee members suggested that the Board consider whether using amortised cost measurement could provide useful information about particular financial assets with such prepayment features, and if so, whether the requirements in IFRS 9 should be changed in this respect.

5. In response to the Committee's recommendation and similar concerns raised by banks and their representative bodies in response the Committee's discussions, the IASB decided to propose a narrow exception to IFRS 9 for particular financial assets that would otherwise have

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contractual cash flows that are solely payments of principal and interest but do not meet that condition only as a result of a prepayment feature.

Due process

6. The IASB issued Exposure Draft ED/2017/3 *Prepayment Features with Negative Compensation* (Proposed amendments to IFRS 9) (ED/2017/3) in April 2017. ED/2017/3 had a comment period of 30 days in order that the proposed amendments could be finalised before the effective date of IFRS 9, which is annual periods beginning on or after 1 January 2018.

7. The NZASB issued ED/2017/31 for comment in New Zealand around the same time. Because of the short comment period (30 days), the NZASB requested that comments be submitted directly to the IASB by 24 May 2017.

8. The IASB received 60 comment letters from its world-wide constituents. It did not receive comments from any New Zealand constituents, including the NZASB. The NZASB did not receive any comment letters.

9. Most respondents supported the IASB's efforts to address the concern raised about the classification of particular financial assets with prepayment features that may result in negative compensation. However, they had mixed views on the second eligibility condition proposed by the IASB.[2] The IASB removed this condition so that an entity would not be required to assess the fair value of the prepayment feature at initial recognition of the financial asset.

10. Many respondents also expressed concern that the Basis for Conclusions on ED/2017/3 seemed to interpret or provide additional guidance on the existing requirements in IFRS 9, in particular on the meaning of 'reasonable compensation for the early termination of the contract'. The IASB retained the explanation of 'reasonable compensation for the early termination of the contract' in the Basis for Conclusions because it supports the first eligibility condition to ensure that the scope of the amendments is not extended beyond intended population of financial assets. However, the wording has been amended so that the explanation is not absolute in its conclusions.

11. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2017/3 and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB's meeting on 19 July 2017.[3]

12. The IASB issued the Amendments to IFRS 9 in October 2017. The amendments are effective for annual reporting periods beginning on or after 1 January 2019, with earlier application permitted.

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2 The IASB had initially proposed two conditions. The first was that the prepayment feature is inconsistent with paragraph B4.1.11(b) of IFRS 9 only because the party that chooses to terminate the contract early (or otherwise cause the early termination to occur) may *receive* reasonable additional compensation for doing so. The second was that when an entity initially recognises the financial asset, the fair value of the prepayment features is insignificant.

3 A summary of the IASB's July 2017 meeting is available at: http://www.ifrs.org/news-and-events/updates/iasb-updates/july-2017/#4

13. The NZASB has approved *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9). The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in the NZASB's view, meets the requirements of section 22 of the Financial Reporting Act 2013.

14. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the standard is likely to require the disclosure of personal information. In the NZASB's view the standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Consistency with XRB Financial Reporting Strategy

15. *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9) is identical to *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) except for a scope paragraph limiting its application to Tier 1 and Tier 2 for-profit entities.

16. The amending standard introduces new disclosures that are similar to some disclosures in NZ IFRS 7 *Financial Instruments: Disclosures* that are required when an entity first adopts NZ IFRS 9. As there are no RDR concessions for the equivalent disclosures in NZ IFRS 7, there are no RDR concessions in the amending standard.

17. The Australian Accounting Standards Board (AASB) is expected to adopt the amending standard in December 2017.

18. The issue of *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9) is consistent with all three elements of the Financial Reporting Strategy: it adopts the international interpretation, retains a harmonised position with Australia and is consistent with the Accounting Standards Framework.

Other matters

19. There are no other matters relating to the issue of *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9) that the NZASB considers to be pertinent or that should be drawn to your attention.

Recommendation

20. The NZASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachment

Prepayment Features with Negative Compensation (Amendments to NZ IFRS 9)

Kimberley Crook
Chair NZASB

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	26 October 2017
To:	NZASB Members
From:	Vanessa Sealy-Fisher
Subject:	**PBE Policy Approach: *Prepayment Features with Negative Compensation***

Recommendation[1]

1. We recommend that the Board AGREES:

   (a) not to incorporate *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) into PBE IFRS 9 *Financial Instruments* at this time; and

   (b) to wait until we develop a replacement for PBE IFRS 9 based on an equivalent International Public Sector Accounting Standard (IPSAS), which is currently under development.

Background

2. The Board regularly considers whether new or amending IFRS Standards should be incorporated into PBE Standards. These decisions are guided by the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach), a copy of which is included in the supporting papers (see agenda item 8.5).

3. The Board is being asked to approve *Prepayment Features with Negative Compensation* (Amendments to NZ IFRS 9) at this meeting (see agenda items 8.1 to 8.3). The Board now needs to consider whether this amending standard should be incorporated into PBE Standards, and if so, when.

Application of the PBE Policy Approach

4. The PBE Policy Approach contains a number of triggers for considering whether to change PBE Standards. In this case the IASB has issued an amendment to an IFRS Standard (IFRS 9 *Financial Instruments*) that the IPSASB is using as the basis of a proposed IPSAS. IPSASB ED 62 *Financial Instruments* is based on IFRS 9, but also includes public sector specific requirements and illustrative examples for matters such as concessionary loans. The IPSASB included the proposals in IASB ED/2017/3 *Prepayment Features with Negative Compensation* (Proposed

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amendments to IFRS 9) in ED 62, but has yet to receive feedback on those proposals and make a final decision.[2] Our draft feedback on the IPSASB's proposals is discussed in agenda item 5.

5. For the purpose of applying the PBE Policy Approach we have treated the IASB's amending standard as an amendment to an IFRS Standard that the IPSASB has used as the basis for an IPSAS. We have therefore applied section 4.2.1 (paragraphs 26–30) of the PBE Policy Approach.

6. In considering the application of the development principle and section 4.2.1 of the PBE Policy Approach to *Prepayment Features with Negative Compensation* we have noted the following points from the August meeting.

   (a) The Board noted that financial instruments with prepayment features that could result in negative compensation are not common among the main four banks in New Zealand. However, these instruments are found in Australia.

   (b) At this stage there is no indication that such instruments would be material for the Crown.

   (c) The Board AGREED that there is no urgency for incorporating *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) into PBE IFRS 9 *Financial Instruments*.

7. We also consider that it would be better to wait for the new IPSAS based on IFRS 9 to be finalised.

Next steps

8. If the Board agrees with the staff recommendation, we propose that the Board considers the incorporation of these amendments into the PBE Standards once the IPSASB has issued a standard based on ED 62.

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[2] See ED 62 paragraphs 49S and AG64.

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	26 October 2017
To:	NZASB Members
From:	David Bassett
Subject:	***Overview of International Standard-Setters' Conferences – London (Sep 2017)***

Introduction[1]

1. The purpose of this paper is to provide the Board with an overview of the international standard-setters' conferences held in London, England from 24th September to 28th September 2017.

2. Kimberley Crook (NZASB Chair) and David Bassett (XRB Deputy Director Accounting Standards) attended the following international standard-setters' conferences/meetings during this period:

   - Asian-Oceanian Standard-Setters Group (AOSSG);
   - World Standard-Setters (WSS);
   - International Forum of Accounting Standard-Setters (IFASS); and
   - Accounting Standards Advisory Forum (ASAF).

3. Charles Hett (NZASB member) attended day one of the WSS conference as an observer.

Asian-Oceanian Standard-Setters Group (AOSSG) 24th September 2017

4. The AOSSG is a group of accounting standard setters in the Asian-Oceanian region. The group has been formed to discuss issues and share experiences on the adoption of IFRS Standards and to contribute to the development of a high-quality set of global accounting standards. The AOSSG meets at least once a year (the annual conference) and holds interim meetings at other times when there are a reasonable number of AOSSG members present. The September meeting held in London was an interim meeting. The 2017 AOSSG annual conference will be held in China in November.

5. The topics covered during the 2017 AOSSG interim meeting included:

   - **Wider Corporate Reporting** – Gary Kabureck (IASB member) presented an education session updating AOSSG members on "what role the IASB should play in wider

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corporate reporting" and on the progress of the IASB's *Wider Corporate Reporting* project.

Gary noted that the IFRS Foundation's strategy towards wider corporate reporting is that the IASB should play an active role, but not be at the forefront of leading developments in areas outside the traditional boundaries of financial reporting. Gary advised AOSSG members that the IASB staff are currently exploring revising the IASB's *Management Commentary Practice Statement*. However, the IASB has yet to consider whether or not to take on any such project. Gary sought feedback from AOSSG members as to whether they felt such a project would be beneficial.

AOSSG members generally felt that the IASB had a role to play in wider corporate reporting, but expressed mixed views regarding what that role should be. AOSSG members were generally supportive of the IASB commencing a project to revise its *Management Commentary Practice Statement*.

- **Principles of Disclosure** – The Presentation and Disclosure Working Group, led by Korea, presented views received from AOSSG members on the IASB's Discussion Paper DP 2017/1 *Disclosure Initiative—Principles of Disclosure*.

  The Working Group leader acknowledged that they had received a copy of the NZASB comment letter.

- **Revised Working Group Plan and Strategy** – Each of the new AOSSG Working Group Leaders provided an update of the Working Group membership and their plans to lead their working groups going forward, including any sub-working groups established, and the delegated leaders of those sub-working groups.

  New Zealand is a member of the Presentation and Disclosure Working Group and the Business Groups and Assets Working Group.

- **2017 Annual AOSSG Meeting Preparation Update** – China updated the AOSSG members on the meeting preparations for the 2017 AOSSG annual conference.

World Standard-Setters (WSS) 25th – 26th September 2017

6. The WSS conference is an annual conference hosted by the IASB for the world's financial reporting standard setters.

7. The conference provides a forum for international standard-setters to:
   - share IFRS Standards' convergence, adoption, implementation and application experiences;
   - be consulted on the IASB's agenda;
   - be updated on developments in IFRS Standards; and
   - provide feedback to the IASB and its staff on active IASB agenda projects.

8. The topics covered during the 2017 WSS conference included:

- **IASB Technical Programme Update –** Mary Tokar (IASB member) provided an update on the IASB's activities and current work programme. Mary advised that the IASB expects to issue consultation documents for the following projects in 2018:
  - *Financial Instruments with Characteristics of Equity*;
  - *Goodwill and Impairment*;
  - *Rate-regulated Activities*;
  - *Business Combinations under Common Control*;
  - *Primary Financial Statements;* and
  - *Dynamic Risk Management*.

- **Working with National Standard-setters** – Sue Lloyd (IASB Vice-chair) provided an update on how the IASB is maintaining effective relationships with national standard-setters (NSS), supporting NSS with the implementation of IFRS and collaborating with NSS on technical work.

  Sue further provided an overview of the implementation activities that the IASB has undertaken regarding IFRS 17 *Insurance Contracts*. These activities included the development of implementation materials available on the IASB's website, the establishment of the IFRS 17 Transition Resource Group (which makes all its papers and discussions publicly available) and education activities with NSS.

- **Rate-regulated activities** – WSS participants received a short update on the IASB's *Rate-regulated Activities* project. Participants were then split into break-out groups to discuss a case study that looked at applying a possible accounting model for defined rate regulation to different fact patterns. The model uses a "rate-adjustment mechanism" that would create a temporary difference when the regulated rate in one period includes amounts relating to required activities carried out by the entity in a different period.

  Mixed views were expressed on whether the "right" that a rate-regulated entity has to charge more to its customers, and an "obligation" to charge less, are an asset and liability respectively. Many participants were not convinced that these items would meet the definition of an asset and liability in the revised conceptual framework but could see how profit and loss could be better reflected by recognising such items as income or expense in the period the "right" or "obligation" arises. The IASB acknowledged more work is needed in this area to be clear why such arrangements are different from executory contracts and other similar arrangements.

- **Financial Instruments with Characteristics of Equity (FICE)** – IASB staff provided an update on the preliminary approach to be proposed in the FICE Discussion Paper. Under the preliminary approach, financial instruments would be classified as a liability if there is either an obligation to transfer economic resources: (i) at particular points in time other than at liquidation; or (ii) for a specified amount independent of the economic resources of the entity (irrespective of 'form') (so not dependent on the entity's 'residual').

  Equity claims would be claims that are not liabilities (i.e., they do not require the transfer of resources at a time other than liquidation), and that depend on the residual amount, e.g., ordinary shares.

  WSS participants were split into break-out groups and asked to apply the proposed approach against some practical examples.

  WSS participants generally applied the preliminary approach consistently arriving at consistent outcomes for each of the examples. Some participants requested that the IASB clarify that an obligation to transfer economic resources would not include an entity's own shares. Some participants also expressed concerns about focusing on what happens at liquidation to determine the classification of debt or equity when the general assumption is for an entity to be a going concern.

International Forum of Accounting Standard-Setters (IFASS) 26th – 27th September 2017

9. IFASS is an informal network of national and regional accounting standard-setters from around the world, plus other organisations that have a close involvement in financial reporting issues. It is a forum at which interested stakeholders can discuss matters of common interest.

10. The IFASS conference is held twice a year. The September 2017 conference held in London was the second IFASS conference held in 2017.

11. The topics covered during the September 2017 IFASS conference included:

- **Business Combinations under Common Control** – Within table groups IFASS participants discussed two entity combination examples and considered (i) how the economic substances of business combinations and business combinations under common control should be evaluated; and (ii) how to identify the acquirer in a combination under common control. The chair of each table group reported back to the wider IFASS group.

  IFASS participants expressed mixed views as to how business combinations under common control should be accounted for. Although some felt that the economic substance of the transaction would affect the accounting treatment, others felt that all business combinations under common control should be accounted for using the pooling of interests' approach.

- **Wider Corporate Reporting** – Within table groups IFASS participants discussed: (i) their experiences with non-financial reporting, including whether as a national standard-setter they have a mandate for standard setting in the wider corporate reporting arena; and (ii) what role the IASB and standard setters should play in wider corporate reporting. The chair of each table group reported back to the wider IFASS group.

  One key point highlighted by some participants is the need to distinguish between two types of wider corporate reporting, being:

  - non-financial information that is useful for investors and other resource providers, in particular, information relating to the drivers of long-term value creation; and
  - other types of non-financial information that is useful for broader public policy reasons.

  IFASS participants reported varied experience levels with non-financial reporting. Some jurisdictions felt that the implementation of IFRS was currently more of a pressing issue than developing non-financial reporting requirements. Many jurisdictions noted they did not have mandate to develop standards in this area, while other jurisdictions noted that they have a mandate to develop non-financial reporting standards and have issued standards in this space (e.g. New Zealand).

  IFASS participants generally supported the IASB playing a role in wider corporate reporting, but no clear consensus of what that role should be was reached.

- **Interpretation Issues** – India presented two interpretation papers to IFASS participants. The first paper sought feedback from IFASS participants as to whether independent directors were considered key management personnel (KMP). IFASS participants felt that IAS 24 *Related Party Disclosures* was clear that such directors were KMP.

  The second paper discussed an "alternative minimum tax" scheme adopted in India and sought feedback from IFASS participants as to whether an alternative minimum tax credits were within the scope of IAS 12 *Income Taxes*. Some IFASS participants felt that the alternative minimum tax credits were in the scope of IAS 12 as the alternative minimum tax was an income tax, and therefore the recognition of any credits would be subject to the recognition requirements of IAS 12 i.e., does an entity expects to make future taxable profits against which it will be able to utilise the tax credits.

- **Not-For-Profit-Reporting (optional session)** – The IFASS Not-for-profit (NFP) Working Group provided an update on the group's activity. As part of the update, the group secretariat presented the International Not-for-profit Online Platform[2] that had been compiled. The platform brings together various NFP

[2] http://www.cipfa.org/policy-and-guidance/standards/international-not-for-profit-platform

financial reporting standards and guidance from different jurisdictions into one place.

New Zealand is a member of the NFP Working Group. The International Not-for-profit Online Platform contains references to the NFP accounting requirements in New Zealand.

Genny Kiff (Wellcome Trust CFO) provided a presentation on the Good Financial Grant Practice (GFGP) initiative. The GFGP initiative seeks to develop a new and integrated system for the financial governance of grant funds awarded to grantees which will standardise, simplify and strengthen the governance of grant funding.

- **Public Sector Reporting (optional session)** – Ian Carruthers (IPSASB Chair) and John Stanford (IPSASB Technical Director) provided an update on the current projects of the International Public Sector Accounting Standards Board (IPSASB).

Accounting Standards Advisory Forum (ASAF) 28th September 2017

12. The ASAF is an advisory forum to the IASB, through which ASAF members can contribute towards the achievement of the IASB's goal of developing globally accepted high-quality accounting standards.

13. The ASAF is comprised of 12 members and a non-voting Chair (being the IASB Chair or Vice-chair). The 12 members represent different geographical regions.

14. The ASAF conferences are generally held four times a year, normally in London. The September 2017 ASAF conference was the 3rd ASAF conference held in 2017.

15. The topics covered during the September 2017 ASAF conference included:

- **Alternative Performance Measures** – Kimberley Crook (NZASB Chair) presented the XRB's research report on Alternative Performance Measures.

  ASAF members and IASB members welcomed the presentation. Several ASAF members noted that the research findings in New Zealand were consistent with findings in their jurisdictions.

- **Improving the Statement of Cashflows** – The UK Financial Reporting Council (FRC) presented a session on feedback received on its Discussion Paper *Improving the Statement of Cash Flows*. IASB staff outlined how the FRC's work might influence the IASB's *Primary Financial Statements* project.

  ASAF members were generally supportive of the IASB staff exploring targeted changes to the statement of cash flows.

- **Definition of a Business** – The IASB staff sought to obtain the views of ASAF members on the differences between the IASB's tentative decisions made at its April and June 2017 meetings and the *Accounting Standards Update Clarifying the*

Definition of a Business (the FASB Amendments) issued by the FASB in January 2017. The IASB's tentative decisions included making the proposed screening test[3] optional.

ASAF members agreed that any differences in wording between the IASB and FASB were suitable if they ultimately resulted in the same application. ASAF members expressed concerns with the tentative decision to make the screening test optional. Some ASAF members felt that making the screening test a rebuttable presumption would be more appropriate.

- **Goodwill and Impairment** – The EFRAG representative presented the proposals in the Discussion Paper *Goodwill Impairment Test: Can it be improved*? The proposals included an alternative goodwill impairment test that seeks to address concerns regarding the timeliness of the recognition of any impairment of goodwill. Specifically, the proposed impairment test seeks to address the potential shielding of impairment of recognised goodwill (from an acquisition) by internally generated goodwill, that is not recognised within a cash generating unit (CGU) generated post-acquisition.

  ASAF members generally felt that the proposals were overly complex, and would not be welcomed by preparers. ASAF members also noted that the proposals would not address concerns that the timely recognition of any impairment of recognised goodwill could potentially be shielded by unrecognised pre-acquisition internally generated intangibles in a CGU.

  The IASB staff presented a proposed pre-acquisition headroom (PH) approach as an alternative goodwill impairment test. The approach seeks to also address concerns regarding the timeliness of the recognition of any impairment of goodwill. However, the PH approach seeks to address the potential shielding of impairment of recognised goodwill by internally generated unrecognition goodwill in a CGU generated pre-acquisition.

  Overall, ASAF members were not supportive of the approach. Although not as complex as the EFRAG approach, members felt that it would be difficult to operationalise (e.g., where an entity might have numerous CGUs with ongoing business combinations and new goodwill being recognised).

[3] The IASB's Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* includes a proposal to consider a set of activities and assets acquired not to be a business if the fair value of the gross assets acquired is concentrated in a single asset or group of similar assets. This proposal is often called a 'screening test'.